20. European System of Contract Laws – a Map for Combining the Advantages of Centralised and Decentralised Rule-making

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I. INTRODUCTION

The EC Commission's Communication on European Contract Law puts the question of how much harmonisation or uniform codification of contract law is needed in the European Union on the political agenda. It proposes four options, three of which are rather evident: first there is the possibility to legislate or not on the European level. The second is the other side of the medal; leaving integration to the market (Option I)[1] and leaving the drafting of European contract law restatements to groups of scholars (Option II)[2] is equivalent to not legislating – even if sponsorship is given. Markets and groups of scholars will step in anyway; and even improving existing EC legislation (Option III) – although really an option – is only the other side of the medal of introducing a new instrument at the EU level. This latter is the last option – Option IV.[3] The Communication is very short on this. It proposes to draft a European Contract Law Code which either substitutes national contract laws or leaves them intact and provides simply a further option. Such an optional European Code – from which states could opt out, according to the Commission's view – is one possibility. This certainly does not exhaust the potential of an optional Code; there are many more variants. This paper concerns Option IV, but also implicitly considers Option III as a model.

The paper takes an overwhelmingly majoritarian view in economics as its starting point: in economic theory, it is virtually undisputed that centralised rule-making has advantages and disadvantages; decentralised rule-making has important advantages and disadvantages as well. Any more centralised tool than

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1 See COM(2001) 398 final, p. 16 *et seq.* (paras. 49–51).

2 See COM(2001) 398 final, p. 17 *et seq.* (paras. 52–56).

3 See COM(2001) 398 final, pp. 18–20 (paras. 57–60; Option III) and p. 20 *et seq.* (paras. 62–69; Option IV).

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an optional European Code would all too easily give up all advantages of decentralised rule-making – mainly the potential of innovation which is certainly paramount in quickly changing times and the potential to serve individual preferences more adequately which is also certainly paramount in a time when democracy and economic theory are based on normative individualism.

The paper therefore investigates the different potential designs of options with respect to a legislative tool on the central level (European Code). It also provides first elements of evaluation of the different parts of this map. Full evaluation is a task for the future which constitutes a whole research programme and requires broad, careful and ongoing discussion. And the map of an optional European Code and the two-level system introduced by it will have a name: we call it the mixed *European System of Contract Laws*, in the plural. By this, we do not only mean that several jurisdictions interplay; we also mean that this is a system, not a transitional solution only. The system should be designed (and core elements are presented here) for keeping flexibility intact in a long-term perspective and to procure standardisation tools (through unification). The ultimate scope is to have the framework for a high quality contract law. In this, transaction costs and the ease of cross-border transactions is only one parameter. High quality contract law is more important.

II. EUROPEAN SYSTEM OF CONTRACT LAWS: BASIC IDEA AND THEORETICAL FOUNDATIONS

1. The Aim: A Two-Level System of Contract Laws

Legal rules can be interpreted as instruments for solving conflicts and facilitating cooperation between individuals in human societies.[4] From an economic point of view, a market economy with an appropriate institutional framework is particularly capable for inducing wealth and economic growth, because market competition leads to the efficient allocation of resources and economic and technical progress. This is also the economic credo of the EC Treaty. Since

[4] For the characterisation of legal rules as 'general purpose tools' that are adapted to the 'solution of recurring problem situations', see F.A. Hayek, *Law, Legislation, and Liberty, Vol. 2: The Mirage of Social Justice* (London, Routledge & Kegan Paul, 1976), 21. For a good introduction into New Institutional Economics and Law and Economics as the relevant theoretical foundations for the economic analysis of legal rules see, e.g., E.G. Furubotn and R. Richter, *Institutions and Economic Theory* (Ann Arbor, University of Michigan Press, 1998); R.D. Cooter and T. Ulen, *Law and Economics* (2nd edn., Reading, Addison-Wesley, 1997); H.-B. Schäfer and C. Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts* (3rd edn., Berlin, Springer, 2000). In economics the ultimate normative orientation are the preferences of the individuals of the society. See from the perspective of constitutional economics, G. Brennan and J.M. Buchanan, *The Reason of Rules* (Cambridge, Cambridge University Press, 1985).

private property and freedom of contract are the core institutions for market economies, an appropriate *contract law* is one of the most important preconditions for the effectiveness of market economies.

Within contract law it is necessary to differentiate between mandatory law and facilitative law. *Mandatory law* limits the freedom of contract of the individuals and therefore has to be seen as *regulations*. There is no doubt from an economic point of view that markets need an institutional framework in the form of mandatory rules in order to ensure the efficient working of markets.[5] But there is much discussion to what extent mandatory rules are necessary and helpful for solving problems of market failure or for attaining additional aims (beyond economic efficiency). That is the difficult problem of 'regulation' versus 'deregulation'. *Facilitative law* encompasses two different groups of functions, which both help to save transaction costs: (1) One group encompasses the functions of the legal order that help the parties to *enforce contracts* ('pacta sunt servanda'; including the services of the court system).[6] (2) The second group consists of supplying *legal standard solutions* ('default rules') for typical transaction or cooperation problems. If the legal order is capable of offering good legal standard solutions for many different typical problems, the parties can save bargaining (and therefore transaction) costs by using those standard solutions instead of writing thick contracts.[7] Therefore a flourishing market economy presupposes the existence of a high-quality contract law, which consists both of appropriate mandatory rules and of transaction cost-saving facilitative law.

If we ask for the appropriate perspective of the evolution of contract law within the EU, we have to consider two important aspects:

(1) In each of the fifteen Member States of the EU a well-established contract law already exists. Therefore we have no situation in which we can design a contract law from scratch. The users of these national contract laws are familiar with it, that is – speaking economically – much specific human capital has already been invested. And it can be presumed that the differences between the national contract laws can at least partly be explained by different problems and preferences. Therefore, different groups of individuals might need different regulations and different standard solutions (default rules).
(2) Furthermore, it is crucial to accept the insight that we cannot assume that we already know the best legal rules for solving problems of transaction and cooperation. On the contrary, we should start systematically from the assumption that the best contract law – and this refers both to mandatory

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5 See W. Eucken, *Grundsätze der Wirtschaftspolitik* (Tübingen, Mohr, 1952).

6 E.g. see for the problem of optimal remedies in the case of breach of contract, R.D. Cooter and T. Ulen (n. 4), 214 *et seq.*

7 For the saving of transaction costs by offering efficient default rules see Cooter and Ulen (n. 4), 180 *et seq.*

and facilitative law – has not been discovered yet.[8] Therefore innovative improvements of the existing rules are possible and desirable. Additional to that, we have to take into account that the European economy has to thrive in a very dynamic world, in which through technological, economical and social change new problems are emerging, which lead to new possibilities but also problems of transaction and cooperation between individuals (e.g. e-commerce). Another possibility that has to be considered is the change of preferences. Therefore it is necessary that the legal rules of a society (including contract law) have to adapt to these ever-changing circumstances. Both the problem of our limited knowledge of the best legal rules and the necessity to continuously adapt the legal solutions to changing problems implies that a high capacity of adapting and innovating legal rules, both on the level of regulations and the level of legal standard solutions, is an important precondition for the long-term success of a European contract law.[9]

The main thesis of our article is that the aim of ensuring an efficient and adaptable contract law within the EU can best be attained by establishing a consistent two-level system of contract laws in the European Union. In such a *European System of Contract Laws* both national contract laws and a European contract law would be integrated in a systematic way.[10] Since – as we show in the following section – there are considerable advantages and disadvantages

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[8] For a thorough analysis of the fundamental knowledge problem that all policy makers (including legislators) need to cope with, see particularly F.A. v. Hayek, 'The Errors of Constructivism', in: F.A. v. Hayek (ed.), *New Studies in Philosophy, Politics, Economics and the History of Ideas* (London/Henley, Routledge & Kegan Paul), 3.

[9] For a more detailed analysis of the necessity of legal innovations in a dynamic world, see W. Kerber, 'Rechtseinheitlichkeit und Rechtsvielfalt aus ökonomischer Sicht', in: S. Grundmann (ed.), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts – Gesellschaftsrecht, Arbeitsrecht, Schuldvertragsrecht* (Tübingen, Mohr, 2000), 67.

[10] The idea of a European two-level system of contract laws can be seen as a special case of a more general concept, in which the idea of federalism is consequently applied both to the European Union in general and to the European legal order in particular. The general problem of centralisation and decentralisation of the European Union can be analysed and solved from the perspective of the economic theory of competitive federalism (which integrates interjurisdictional competition into the traditional economic theory of federalism). For such a perspective see C. Kirchner, 'The Principle of Subsidiarity in the Treaty on European Union: A Critique from the Perspective of Constitutional Economics', (1998) 6 *Tulane Journal of International and Comparative Law* 291; W. Kerber, 'Interjurisdictional Competition within the European Union', (2000) 23 *Fordham International Law Journal*, 217; W. Kerber, 'Wettbewerbsföderalismus als Integrationskonzept für die Europäische Union', *Perspektiven der Wirtschaftspolitik*, [2002] (forthcoming); see also the so-called 'FOCJ' concept in B.S. Frey and R. Eichenberger, *The New Democratic Federalism for Europe: Functional, Overlapping and Competing Jurisdictions* (Cheltenham, Edward Elgar, 1999).

both for a centralised and a decentralised contract law, we claim that the desirable solution for the contract law in the EU is neither an entirely decentralised nor an entirely centralised (and uniform) contract law. Rather we claim that the optimal solution is one skilfully designed combination of European and national contract law rules, both for mandatory and facilitative law. Therefore the problem of the future contract law in the EU should not be discussed in the dichotomy of a centralised, uniform European law versus decentralised, heterogeneous national contract laws. Rather, the discussion should start on the basis of a *concept of an integrated European two-level system of contract laws* and focus on the question, what kind of mandatory rules and legal standard solutions should be established on the European and national levels and what additional rules (including rules for choice of law) are necessary for rendering such a system of contract laws coherent and workable? An entirely centralised law (in the form of a uniform code) or an entirely decentralised law can be seen as the two extreme solutions within the design possibilities such a two-level concept of law offers for the discussion. But our suggestion is that we should look for the optimal mix of centralisation and decentralisation within such a two-level system of contract laws.

2. Advantages and Disadvantages of Centralised and Decentralised Rule-making

For a better substantiation of our main idea of searching for an appropriate combination of the advantages of centralised and decentralised contract law, we will briefly summarise the main arguments for and against centralised and decentralised rule-making.[11]

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[11] For the discussion about the advantages and disadvantages of uniformity and heterogeneity of legal rules and therefore also about the advantages and disadvantages of centralised and decentralised making of legal rules, see, e.g., P. Behrens, 'Voraussetzungen und Grenzen der Rechtsfortbildung durch Rechtsvereinheitlichung', *RabelsZ* 50, (1986), 19; H. Kötz, 'Rechtsvereinheitlichung – Nutzen, Kosten, Methoden, Ziele', *RabelsZ* 50, 1986, 1; J. Basedow, 'Über Privatrechtsvereinheitlichung und Marktintegration', in: *Festschrift for E.-J. Mestmäcker* (1996), 347; C. Kirchner, 'Europäisches Vertragsrecht', in: H.-L. Weyers (ed.), *Europäisches Vertragsrecht* (Baden-Baden, Nomos, 1997), 118 *et seq.*; F. Parisi and L.E. Ribstein, 'Choice of Law', in: P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, vol. 1 (1998), 236; R. Van den Bergh, 'Subsidiarity as a Demarcation Principle and the Emergence of European Private Law', (1989) 5 *Maastricht Journal of European and Comparative Law* 129; W. Kerber (n. 9), 81 *et seq.*; see for the following arguments also particulary W. Kerber and K. Heine, 'Zur Gestaltung von Mehr – Ebenen – Rechtssystemen aus ökonomischer Sicht', in: C. Ott and H.-B. Schäfer (eds.), VIII. Travemünder Symposium zur ökonomischen Analyse des Rechts, Vereinheitlichung des Zivilrechts in transnationalen Wirtschaftsräumen – Beiträge zur Evolution von Recht und zentraler Rechtsetzung, (Tübingen, Mohr Siebeck, 2002) (forthcoming) and the contribution by R. Van den Bergh, ch. 17 in this volume.

Static and dynamic economies of scale: An important argument for centralised rule-making can be derived from static economies of scale effects, which might arise in the production and application of law. The drafting of laws, the decision processes of the legislators and the implementation of laws can cause considerable costs, which can be interpreted as fixed costs (set-up costs). These costs can be reduced if within one territory such as the EU, only one set of uniform legal rules are established instead of many different ones. Those fixed costs exist both for mandatory and facilitative law. Beyond that, dynamic economies of scale might also be important. If it is true that the quality of a law depends on the number of cases which have been decided within this law, and therefore on the cumulative experience, then from the economic point of view dynamic economies of scale exist. If we have only one set of contract law rules in the EU, more experiences can be accumulated within this law and therefore its quality may be higher in the long run than if different contract laws exist simultaneously.[12]

Transaction costs: The advantage of a centralised set of legal rules is that the information costs about the relevant legal situation for the *users* of the legal rules (firms and consumers) might be considerably lower than in a decentralised system, in which, for example, fifteen different sets of legal rules exist (as within the EU). This is an important argument for centralised rule-making, but it is clear that the argument is only relevant for cross-border transactions, and not for domestic ones. If we take into account also *political transaction costs* in the form of political bargaining processes of agreeing to a set of legal rules,[13] the result of the advantages of centralised and decentralised rule-making are mixed. On one hand, political transaction costs can be reduced by centralised rule-making through saving parallel political processes. On the other hand, it can be suggested that the bargaining costs can be much higher in the case of centralised rule-making, because due to more heterogeneous preferences and interests the consent costs can be much higher than in political processes in national legislations.

Heterogenous preferences and problems: If the preferences, and transaction and cooperation problems are different in the Member States of the EU, then it would be efficient to develop different legal rules for fulfilling these different preferences. This is true both for mandatory and facilitative law. If the preferences

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[12] Dynamic economies of scale can lead to path dependence effects in legal evolution and therefore also to lock-in effects, which might have to be critically assessed. For an analysis of the perhaps problematic effects of those path dependence effects in the corporate law evolution within the EU after the *Centros* decision of the ECJ see K. Heine and W. Kerber, 'European Corporate Laws, Regulatory Competition, and Path Dependence' (2002), 13 *European J. of Law and Economics*, 47.

[13] For the concept of political transaction costs, see Furubotn and Richter (n. 4), 47 *et seq.*

in regard to the extent of consumer protection are different between the Member States of the EU, any uniform regulation has to be an unsatisfactory average solution. In those cases different mandatory rules might be the superior answer (perhaps combined with establishing uniform minimum or maximum standards for solving other problems). This argument is still more important in the case of facilitative law. If the typical transaction and cooperation problems are different in the various countries, then different legal standard solutions (default rules) should also be offered for reducing the transaction costs of the parties. The existence of heterogenous preferences and problems is an important argument in favour of a greater decentralisation of rule-making.

Externalities: The above mentioned problem that an average solution for the whole EU has negative effects on the fulfilment of differentiated preferences can also be interpreted as a problem of external costs, which many individuals have to bear due to legal solutions that do not correspond to their preferences. In that case decentralised decisions would help to reduce these externalities; but decentralised rule-making can also lead to an externality problem. If the decision of one Member State for legal rules (especially mandatory rules) does lead to certain kinds of negative external effects in other Member States, then decentralised rule-making can lead to noninternalised negative external effects, and therefore to an overall inefficient rule-making within the EU. In a centralised system of rule-making such external effects cannot emerge, but the problem might also be solved satisfactorily by establishing EU minimum/maximum standards (as in the case of fundamental freedoms) which restrict the scope of decentralised rule-making for avoiding those external effects.

Barriers of trade and distortions of competition: Different mandatory legal rules (regulations) or perhaps also different legal standard solutions (facilitative law) are often interpreted as (non-tariff) barriers of trade or as distorting competition within the Internal Market. One can argue that within a centralised legal system with uniform legal rules no such problems can arise for the Internal Market, because all market participants throughout the whole EU act under the same set of legal rules ('level playing field' argument). Within a more decentralised system of legal rules it is necessary to distinguish very carefully, which kinds of differences in the legal rules can lead to unreasonable impediments for the Internal Market.[14] If we have a high mobility of goods, services, factors, firms and individuals within the EU and/or extensive choice of law through the parties, then the problem of distortions of competition through different legal rules in the Member States vanishes, because the mobility allows firms and individuals to use those sets of rules which they deem best for solving their problems. But

[14] For a thorough critique of the 'level playing field' argument see ch. 17 by R. Van den Bergh in this volume.

in any case, the problem of potential barriers to trade and distortion of competition may be greater in a decentralised system of law than in a centralised legal system.

Consistency of a legal order: One important characteristic of a good legal order is its consistency or coherence. Within a system of legal rules there should be neither unresolved conflicts between different (subsets of) rules (i.e. that different rules contradict each other), nor large gaps, for which no rules exist at all. Both problems can lead to serious failures for the working of the legal order. It seems clear that in a centralised, uniform legal system it is easier to attain this aim of consistency and to avoid incompatibilities and conflicts between legal rules. Therefore in a more decentralised system of law, in which rules are enacted by different legislators, problems of incompatibility of legal rules or gaps of regulation can be a much greater problem. For tackling this problem of complementarities between legal rules a more decentralised system of law needs rules and procedures for solving these problems.[15]

Knowledge problem: Two different, but closely related arguments in regard to knowledge problems, can be distinguished. As mentioned above, we should not assume that the knowledge about the optimal legal rules for solving transaction and cooperation problems (both for mandatory and facilitative law) already exist. Legal scholars (and perhaps also economists) might know much about good legal rules, but it would be a 'pretension of knowledge' (Hayek) to assume that it is not possible to discover even better ones. Therefore it is important to establish a legal system that has a large capability for improving their legal solutions. We come back to this argument in the next paragraph. The other kind of knowledge problem is that the knowledge of which legal rules are appropriate for solving the transaction and cooperation problems of the citizens might be widely dispersed and cannot be centralised. This is an application of Hayek's famous argument of the impossibility of centralisation of the dispersed knowledge in a society to the making of legal rules.[16] If local knowledge about the specific problems and preferences in certain regions or Member States exists, then a decentralised system of rule-making is much more suitable for using this local knowledge about the suitability of legal rules for solving transaction and cooperation problems. This may be relevant both for mandatory and facilitative law. Please note that this argument differs from the problem of heterogenous preferences and legal problems.

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[15] For an analysis of this problem with regard to corporate law, see Heine and Kerber (n. 12).

[16] See F.A. v. Hayek, 'The Use of Knowledge in Society', 35 *American Economic Review* 519. For a critique of the idea of an omniscient central planner in the economic theory of federalism, see A. Breton, *Competitive Governments: An Economic Theory of Politics and Public Finance* (Cambridge, Cambridge University Press, 1996), 185.

Adaptability and innovativeness: Decentralisation can also be positive for the innovative improvement of legal rules and their adaptability to new problems.[17] In contrast to a centralised legal system, a decentralised system allows for decentralised experimentation and therefore parallel experimentation processes with the possibility of mutual learning (through imitation). Therefore a much greater amount of different legal solutions can be generated and tested by the users of law. So much more experience can be accumulated and it is much easier to select superior legal solutions than in a centralised system. Due to the long and tiresome political decision processes on the central level (with its cumbersome procedures of finding broadly acceptable compromises) we cannot expect that in the case of centralised rule-making a high responsiveness to newly emerging problems is possible in the long run. In a largely decentralised system, however, the probability that some jurisdictions enact new and better legal solutions, which can spread by imitation through other jurisdictions, is much higher. In a similar way, it is also much easier in a decentralised system of law to correct wrong decisions about appropriate legal rules (or to reduce the negative effects of wrong decisions) than in a centralised system. So if we think that the optimal legal solutions are not already found and known or presume that we have to expect also for the future the emergence of many new problems due to dynamic change, then the adaptability and innovativeness of the legal system (dynamic efficiency) is very important, leading to a powerful argument in favour of a more decentralised system of law.

Competition among legal rules: The concept of a decentralised system of law can additionally be combined with the idea of competition among legal rules or regulatory competition. If individuals or firms are mobile between jurisdictions, they are able to migrate to that jurisdiction in which the whole body of public goods, legal rules and taxes are most suitable for solving their problems. Consequently, competition processes between jurisdictions for attracting individuals, firms and investments emerge and additional incentives exist for the jurisdictions to improve their legal rules. This kind of regulatory competition, which can refer both to mandatory law and to facilitative law, can be considerably intensified if individuals and firms are granted the right to choose directly between legal rules (choice of law), e.g. between the different contract laws of the Member States. In the theory of regulatory competition there is much

[17] See for the following argument in more detail, Kerber (n. 9), 69 *et seq.* For the general argument that decentralisation in a federal system can lead to more experimentation and mutual learning, see also W.E. Oates, 'An Essay on Fiscal Federalism', 37 *Journal of Economic Literature* 1132 *et seq.*, who characterises federalism as 'laboratory federalism'.

discussion about the workability of competition processes among legal rules.[18] There are both specific arguments of potential failures (as, e.g., 'race to the bottom' arguments) and arguments why competition can increase the advantages of decentralised systems of law. Whereas a centralised system of law excludes the possibility of competition among legal rules, a decentralised system offers the additional opportunity of using the advantages of competition among legal rules. In that case, however, an appropriate institutional framework has to be established for ensuring the workability of competition among legal rules.[19]

Rent seeking problems: Mandatory legal rules (regulations) can be misused for protecting special interest groups (rent seeking behaviour). In the theory of regulatory competition, one argument in favour of decentralised systems of law and regulatory competition is that the mobility of individuals, firms and factors between different jurisdictions or different sets of rules limits the extent of rent seeking behaviour through regulation. Consequently, a decentralised system of law with regulatory competition would lead to a lower level of rent seeking than a centralised system, in which firms, individuals and factors have no possibility to avoid the effects of the rent seeking activities on the central level.

Status quo-situation in the EU: Within the EU we do not start from scratch in respect of contract law. In all Member States a well-established contract law with both mandatory rules and legal standard solutions exists. This implies that

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[18] For contributions to the theory of regulatory competition see e.g. H. Siebert and M.J. Koop, 'Institutional Competition. A Concept for Europe?', 45 *Aussenwirtschaft* 1990, 439; V. Vanberg and W. Kerber, 'Institutional Competition among Jurisdictions: An Evolutionary Approach' (1994) 5 *Constitutional Political Economy*, 193; J.-M. Sun and J. Pelkmans, 'Regulatory Competition in the Single Market' (1995) 33 *J. of Common Market Studies*, 67; M.E. Streit and W. Mussler, 'Wettbewerb der Systeme und das Binnenmarktprogramm der Europäischen Union', in: L. Gerken (ed.), *Europa zwischen Ordnungswettbewerb und Harmonisierung* (Berlin, Springer, 1995), 75; H.-W. Sinn, 'The Selection Principle and Market Failure in Systems Competition' (1997) 88 *J. of Public Economics*, 247; K. Gatsios and P. Holmes, 'Regulatory Competition', in: P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, vol. 3 (1998), 271; A. Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law', (1999) 48 *ICLQ*, 405; W. Kerber (n. 9), 67; R. Van den Bergh, 'Towards an Institutional Legal Framework for Regulatory Competition in Europe' (2000) *Kyklos*, 435; J.P. Trachtman, 'Regulatory Competition and Regulatory Jurisdiction' (2000) 3 *J. of Int. Economic Law*, 331; K. Heine and W. Kerber (2002) (n. 12). For a recent monograph about the problem of the feasibility of regulatory competition in regard to corporate law, see K. Heine, *Regulierungswettbewerb im Gesellschaftsrecht. Zur Funktionsfähigkeit eines Wettbewerbs der Rechtsordnungen im europäischen Gesellschaftsrecht* (Berlin, Duncker & Humblot, 2002) (forthcoming).

[19] See W. Kerber, 'Zum Problem einer Wettbewerbsordnung für den Systemwettbewerb', 17 *Jahrbuch für Neue Politische Ökonomie* [1998], 199; and R. Van den Bergh (n. 18), 435.

the set-up costs for these national laws and many information costs (including specific human capital) by the present users are already made (sunk costs); also, many positive effects of dynamic economies of scale through accumulating much experience in the national contract laws have already been realised. Therefore many costs of a decentralised system, which would have to be taken into account, if we were in a situation without any contract law, are no more relevant for our present problem of developing a perspective for the future contract law in the EU. So the existing huge investments in national contract laws constitute an important argument in favour of a more decentralised system of contract laws.

3. Cumulating the Advantages and Reducing the Disadvantages – Searching for an Optimal European System of Contract Laws

This analysis of the advantages and disadvantages of centralised and decentralised rule-making has made clear that there are many good arguments both for and against centralised and decentralised rule-making. Consequently, the problem of the further development of contract law in the EU is a very complex one. If we take into account (1) the present situation with its well-established national contract laws and also the many already existing EU rules within contract law, and (2) the considerable disadvantages, which are linked to a purely centralised or decentralised solution, it seems reasonable to search for the solution within our above-mentioned two-level system of contract laws with both national and European contract law rules. So the main idea that we want to suggest in this article is, how can we establish a European system of contract laws in which the particular advantages of centralised and decentralised rule-making can be cumulated and the corresponding disadvantages be avoided as far as possible? This can also be seen as an application of the subsidiarity principle. As an example for this idea, consider the possibility that the EU offers additional legal standard solutions to those of the Member States (facilitative law). This might reduce the transaction costs for cross-border transactions and increase the variety of standard solutions offered to the parties, without reducing the innovativeness of the whole system of contract laws due to the maintenance of the competences of the Member States in offering facilitative law.

What does a European system of contract laws mean? It has to be seen as a consistent two-level system of contract law rules, which encompasses both legal rules on the EU level and legal rules on the level of the Member States. These legal rules can consist of mandatory rules and facilitative law, particularly default rules. An additional group of (meta–)rules will be necessary for determining, to what extent the EU and the Member States have the competence to enact mandatory rules or offer legal standard solutions in contract law and to what extent the parties are allowed to choose between these different legal rules (choice

of law).[20] Additionally, the contract law rules on these two levels have to be interpreted as a system, because the decisive criterion is its workability as a whole, i.e. whether this European system of contract laws is able to offer efficient solutions for transaction and information problems for the citizens of the EU in the long run.

So the perspective of the development of the future contract law in the EU is not the transition from national contract laws to one European contract law, but the transition from national contract laws to one European two-level system of contract laws sustainable in the long run, within which the specific legal contract law rules (mandatory and facilitative law) can evolve and adapt to the current transaction and cooperation problems. This can also be seen as the attempt to apply the concept of federalism to the legal system ('legal federalism'). Consequently, the central question is, how should the rules for such a European system of contract laws be designed so that on the one hand enough consistency and uniformity can be maintained with the positive effects of reducing transaction costs, avoiding problems of conflict of legal rules and removing obstacles from trade, without on the other hand eliminating the advantages of decentralisation with its positive effects of fulfilling heterogenous preferences, using local knowledge and innovativeness and adaptability due to parallel processes of experimentation? Or, what is the optimal mixture between centralisation and decentralisation? As we have indicated in the last section, economics can help to answer these questions by providing a set of arguments and criteria.

In the following sections a mapping of the design options for such a European two-level system of contract laws will be developed. After presenting in the next section III the main design dimensions of such a system, the most important different design options, i.e. combinations of the dimensions, will be presented and analysed in section IV.

III. DESIGN DIMENSIONS IN A EUROPEAN SYSTEM OF CONTRACT LAWS

The main design dimensions for an optional European Code are concerned with two questions: (1) how binding is the contract law rule, and (2) who decides whether the centralised or the decentralised rule should apply and to what extent? A third question sometimes discussed is less important. It is about how detailed the rules are.[21]

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[20] If we include the idea of competition among legal rules (regulatory competition) in this European two-level system of contract laws, those meta-rules can also be interpreted as the institutional framework, which ensures the workability of regulatory competition. Consquently, we can speak of a competitive order ('Wettbewerbsordnung'). See, e.g., W. Kerber (n. 19); Van den Bergh (n. 18), 435.

[21] There can be principles or detailed rules; both are contained in O. Lando and H. Beale (eds.), *Principles of European Contract Law, Part I and II*, (The Hague, Kluwer, 2000); Unidroit, *Principles of International Commercial Contracts* (Rome, Unidroit, 1994) (although the titles do not necessarily indicate this). Another question related to this topic

1. Facilitative Law (mainly Default Rules) and Regulation (mainly Mandatory Law)

There is a long standing tradition to distinguish non-mandatory law (default rules) and mandatory law.[22] The parties can deviate from the former. Traditionally these rules form the vast majority of contract law.

a) The distinction

aa) Default rules are typically justified as a standard contract offered to the parties which helps them to save transaction costs because they do not have to formulate rules for every eventuality ('Reservevertragsordnung'). In this line of ideas, the legislator should investigate and follow what are the typical wishes of the parties (and not judge them). However, the following explanations also apply if default rules are seen as a set of rules by which the legislator wants to maximise overall wealth, but from which he allows the ultimate cost bearers, the parties, to deviate. Default rules are part of facilitative law (but not synonym). Facilitative law is all law which helps parties to use their freedom of entering into agreements and contains two basic sets of rules. One is about enforcing such agreements (containing rules about *pacta sunt servanda* but also rules about court proceedings, for instance their maximum duration, and about remedies like specific performance as opposed to only damages). The other set consists of the – already named – default rules which form the 'standard contract' or 'Reservevertragsordnung'. The latter is by far the more important. For simplicity's sake we will refer only to this second set in our explanations.

bb) Mandatory law is not primarily concerned with enabling party agreement, but with regulating cases where freedom of contract itself produces sub-optimal results. The problem about mandatory law is that, for regulatory purposes, it forbids or prescribes solutions or conditions excluding them or the other ones

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is whether to use directives or regulations (COM(2001) 398 final, 20 (para. 63 seq.)) although directives are normally detailed as well. The need has been felt to modify principled rules into detailed rules: see, for instance, and from quite different perspectives: Ch. v. Bar, 'Die Study group on a European Civil Code', *Festschrift for D. Henrich* (2000), 1; J. Smits, 'The future of European Contract Law: on diversity and the temptation of elegance', in: *Towards a European Jus Commune in Legal Education and Research* (Maastricht, forthcoming).

Both in the case of principles and detailed rules, which are unanimously accepted, potential for innovation and for serving different preferences is important. These are the core advantages of decentralised rule-making. On the other hand, at least in the long run, it should be possible (for the ECJ) to also work principles on Community level into a workable set of rules and thus achieve the advantages of centralised rule-making, i.e. standardisation.

[22] See COM(2001) 398 final, p. 2, 10 seq. (para. 27).

from the possible range of solutions or conditions. The restricted range can serve the range of needs or preferences of the parties possibly less completely.[23] Moreover, the solutions excluded can no longer be tested.

Mandatory law is bound to become an issue in the discussion of a European Code if consumer law is to be included. It is mainly mandatory. Not to include consumer law, on the other hand, would mean that the *acquis communautaire* is questioned,[24] that the historic development of European contract law is neglected (in which consumer contract law was a strong driving force)[25] and it would run counter to more general and fundamental ideas about the role of consumer law within private law and the need of integrating these areas.[26] The *acquis communautaire* is so important, particularly in the area of mandatory law, because it is precisely mandatory contract law which is harmonised very substantially and even in almost all questions,[27] although often only at a minimum level.[28] For a

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[23] See above section II2.

[24] Which the Commission is firmly opposed to: see COM(2001) 398 final, p. 19.

[25] Characteristic is E. Hondius, 'Kaufen ohne Risiko: Der europäische Richtlinienentwurf zum Verbraucherkauf und zur Verbrauchergarantie' [1997], *Zeitschrift für Europäisches Privatrecht (ZEuP)*, 130, 131: 'Insbesondere die Verbraucherschutzrichtlinien haben dazu beigetragen, ein europäisches Privatrecht zu gestalten.' Moreover, in a comparative law perspective, one has to note that all modern codes are integrated codes, namely the Dutch Code, the English Sale and Supply of Goods Act and also the Nordic Codes: E. Hondius, *Consumer Guarantees – Towards a European Sale of Goods Act* (Rome, Unidroit 18, 1996), 7 (for Italy and the Netherlands); in favour of integration: S. Grundmann, 'Generalreferat: Internationalisierung und Reform des deutschen Kaufrechts', in: S. Grundmann, D. Medicus and W. Rolland (eds.), *Europäisches Kaufgewährleistungsrecht – Reform und Internationalisierung des deutschen Schuldrechts* (Cologne, Heymanns, 2000), 281, 282–288; E. Hondius, 'Niederländisches Verbraucherrecht – vom Sonderrecht zum integrierten Zivilrecht', *VuR* [1996], 295, 295; see also the references in n. 26.

[26] See S. Grundmann, 'Consumer Law, Commercial Law, Private Law – How can the Sales Directive and the Sales Convention be so similar?', presentation SECOLA-Conference in Rome, www.secola.org (German version) (2002) *AcP* 202, 40; A. Schwartz, 'Legal implications of imperfect information in consumer markets', (1995) 151 *JITE* 31, esp. 35–46; also, however, for different reasons: E. Hondius, 'Consumer Law and Private Law – the case for integration', in: W. Heusel (ed.), *Neues Europäisches Vertragsrecht und Verbraucherschutz – Regelungskonzepte der Europäischen Union und ihre Auswirkungen auf die nationalen Zivilrechtsordnungen – New European Contract Law and Consumer Protection – the concepts involved in Community regulations and their consequences for domestic civil law – Le nouveau droit des contrats et la protection des consommateurs – concepts de la réglementation communautaire et leurs conséquences pour le droit civil national* (Cologne, Bundesanzeiger, 1999), 19.

[27] See in more detail S. Grundmann, 'The Structure of European Contract Law', (2001) *ERPL* 505, 517–521; and commentaries referred to in n. 42 below.

[28] For this approach and its importance see n. 48 et seqs.

European Code including consumer law, one must ask the question of how to treat rules in a two-level system both for non-mandatory and for mandatory law.

cc) For the design of an optional European Code, the major problem with this distinction is that *default can become mandatory (and vice versa) depending on* the situation. In the following, we mean by mandatory or default, what is mandatory or default in the particular situation. Default rules can become mandatory at least in standard contract terms cases – and this is the vast majority of cases. As far as *unfair contract terms law* applies, the deviation from default rules in standard contract terms must typically remain within narrow limits. In all Member States this is true, at least for consumer contracts, in some also for pure commercial contracts.[29] Thus default rules in standard contract terms cases turn into rules which set a rather narrow corridor of allowed solutions in a mandatory way. Thus many, in some Member States even most contracts in practice, are subject to mandatory law, at least in that only a corridor of solutions is allowed. In these situations, whatever is true in the interplay of centralised mandatory regulation and decentralised mandatory regulation is true also for default rules – although only in an indirect way (via unfair contract terms law) and in an attenuated form (a corridor is left). There is a second situation – also of some importance – in which there is the danger in the future that more law is mandatory law.[30]

b) The additional distinction between mandatory substantive law and mandatory information rules

Mandatory rules typically have restrictive effects on the range of solutions or conditions. Parties can possibly not tailor the contract conditions or solutions to serve best their individual preferences. Parallel experimentation is reduced. There are, however, mandatory rules which do not share this core characteristic

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[29] See for Art. 3 of the Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, (EC) OJ [1993] L 95/29: ECJ 27.6.2000 – case C-240–244/98 *Océano grupo editorial* [2000] ECR I–4941, 4972 *et seq.*; and, for instance, for German Unfair Contract Terms Law, sec. 307 (2) Civil Code and M. Wolf, in: M. Wolf, N. Horn and W. Lindacher, *AGB-Gesetz – Kommentar* (4th edn., Munich, Beck, 1999), § 9 para. 76. Germany is one of those states where this applies also to pure commercial contracts (see sections 1, 9 and 24 of the German Unfair Contract Terms Code, now integrated into the Civil Code as sections 305 (1), 307, 310 (1) and (2)).

[30] This is so if a European Code substitutes national laws and thus renders all cases within the Community purely domestic cases. Then those rules become absolutely mandatory which today are mandatory only in domestic cases, but are not in cross-border cases under art. 3 of the Rome Convention on the law applicable to contracts (see consolidated version (EC) OJ [1998] C 27/34). This refers to all mandatory rules not concerned with labour law, consumer protection and public good protection.

– and potential disadvantage – of (other) mandatory rules. In this respect, mandatory substantive rules and mandatory information rules are fundamentally different.[31] Mandatory information rules only prescribe the disclosure of information, then leave the freedom to tailor the contract substance to the parties (freedom of contract).[32] Their scope is to enhance the conditions for an optimal use of freedom of contract: they are meant to increase the possibility of rational, i.e. also informed choice, by both parties, bringing the contract solution as close as possible to the real preferences of both parties.[33] As restricting this freedom is the core effect of normal mandatory law also influencing the capacity of innovation in a market, mandatory substantive rules and mandatory information rules are fundamentally different in nature and therefore should and will be distinguished.

2. Choice between Different Sets of Rules

a) Union, States or Parties

Union, states and parties are the three potential decision makers. They will decide about preferences and innovation quite differently. This criterion is not concerned with who offers the rules, but with who ultimately decides on the question, which of the rules which are in the market is applied to a particular problem in the particular case. The Union can decide to have only its law applied to a problem. It may leave an option to the states to choose whether Union law or state law applies. More practical so far is the situation in which the Union decides to apply its law as a minimum standard (directives) or as a maximum standard (mainly fundamental freedoms) and to allow the states to regulate above or below these minimum and maximum standards. Leaving the choice to parties may mean both that they can choose between different solutions offered by the Union and one or more or all states, and that they can choose between different solutions offered by different states, potentially again all states.

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[31] See for the following: S. Grundmann, W. Kerber and S. Weatherill (eds.), *Party Autonomy and the Role of Information in the Internal Market* (Berlin/New York, de Gruyter, 2001); S. Grundmann, 'Information, Party Autonomy and Economic Agents in European Contract Law', (2002) 39 *CMLRev.* 269.

[32] Normally other issues than that of passing on information are the core issues of the contract. In most contracts, the giving of information is only an ancillary duty, often a prerequisite for a 'good' contract.

[33] Too little information can lead to adverse selection: see A. Schwartz, (1995) 151 *JITE* 31, 46; S. Strassner, *Verbraucherinformationsrecht – rechtliche Grundlagen und rechtsökonomische Aspekte* (Saarbrücken, ÖR-Verlag, 1992), 133–136; Th. Wein, 'Consumer information problems – causes and consequences', in: Grundmann, Kerber and Weatherill (n. 31), 80, 91–96.

It can, however, also mean that parties can choose party-made rules as well, sets of standard terms or individual agreements (traditional freedom of contract).

b) Modalities – Opt In and Opt Out

The most important modality of choice is that of opt in or opt out. As typically there are alternatives, choosing an opt-in design for the one means choosing an opt-out design for the other. The law from which the decision maker has to opt out has certainly a cost advantage or even other advantages. If the state is the decision maker, the burden of political action is on the other alternative; if it is the parties, agreement has to be reached for the other alternative and moreover the party for which the other alternative may be favourable has to be active enough to raise the question at all. In many cases the parties in question do not even want to incur the costs of investigating whether the other alternative might be more favourable. Therefore, if the European Code is applied on an opt-out basis, the evaluation will come closer to that of a solution where the European Code completely replaces the national contract laws. This is one question where distinguishing between cross-border or domestic cases may well seem important: it may be advisable to ask parties to opt out of the European Code in cross-border cases and to opt in in domestic cases (subject otherwise to national law). This is so because in cross-border cases, there is at least one additional argument in favour of the application of a European Code which does not have its equivalent in purely domestic cases: whereas applying one national law gives an advantage to one party in cross-border cases, applying the European Code means eliminating this inequality in access to the law, and potentially also courts.

c) Cross-Border Contracts only?

The cross-border character of a transaction can already be important with respect to the question whether a rule is ultimately binding or not.[34] The cross-border character of the transaction is, however, also important in another respect in the discussion about a European Contract Law Code: a potential design could be to *draft a European Code only for cross-border contracts* first.[35] This is the approach already taken in the (Vienna) Convention on the International

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[34] For this aspect, see above n. 30.

[35] See more extensively the proposal by Drobnig which is expressed in his contribution to this volume; and S. Leible, 'Die Mitteilung der Kommision zum Europäischen Vertragsrecht – Startschuss für ein Europäisches Vertragsgesetzbuch?', *EWS* [2001], 471, 480 *et seq.*

Sale of Goods (CISG),[36] the most prominent piece of international uniform law. Cross-border transactions amount typically to about 20 per cent of all transactions in the bigger Member States (only). For default rules, this solution would come close to the opt-in and opt-out design considered above: it is accepted in principle also for the CISG that even in purely domestic cases parties can choose this Convention to apply (opt-in).[37] In cross-border cases, they have to opt out (Art. 6 CISG).

For mandatory rules, however, a restriction to pure cross-border cases would mean cutting back on the *acquis communautaire*. Only in one case, the payments directive,[38] mandatory EU law applied only to cross-border cases and this meant giving the Member States the freedom to opt in for purely domestic cases (but also to leave it). For mandatory rules, it is particularly important that the options can be given to states or parties.

There may be theoretical[39] and practical concerns[40] with a European Code applying to cross-border cases only. For a map of potential designs, however,

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[36] Art. 1 *et seq.* of the (Vienna) UN Convention on Contracts for the International Sale of Goods of 11 April 1980, United Nations, Official Records, 1981, 178 (German O.J.) BGBl. 1989 II, 586 (English, French, German); for the states adhering to the Convention (altogether 58 at the end of 2000) see annex B to (German O.J.) BGBl. 2000 II, 595 or J. Honnold, *Uniform Law for International Sales* 3rd edn. (The Hague, Kluwer, 1999), 577 (53 in June 1998).

[37] F. Ferrari, in: P. Schlechtriem (ed.), *Kommentar zum Einheitlichen UN-Kaufrecht – das Übereinkommen der Vereinten Nationen über Verträge über den internationalen Warenkauf-CISG* (3rd edn., Munich, Beck, 2000), Art. 6 paras. 39–43.

[38] European Parliament and Council Directive 97/5/EC of 27 January 1997 on cross-border credit transfers, (EC) OJ [1997] L 43/25.

[39] In one integrated market, where different laws, states laws and EU law, are offered as solutions, and if fundamental freedoms and economic arguments speak in favour of doing so, also in domestic cases, the distinction between cross-border and domestic is bound to fade away. Integration is about diminishing borders, but adjusts very well with the idea of offering different legal solutions as options.

[40] The problem with Conventions applying only to cross-border cases is that there is too little case law (and legal security) building up because of small numbers. Even the UN Sales Convention (n. 36) was only moderately successful, despite its good reputation: see J. Lindbach, *Rechtswahl im Einheitsrecht – am Beispiel des Wiener UN-Kaufrechts* (Aachen, Shaker, 1996), 349; the Convention is not very important in practice according to K. Tonner, 'Die Rolle des Verbraucherrechts bei der Entwicklung eines europäischen Zivilrechts', *JZ* [1996], 541. This is so although, among the international Conventions, the UN Sales Convention is probably still the most successful. M.R. Will, *International Sales Law under CISG – the UN Convention on Contracts for the International Sale of Goods (1980) – the first 555 or so Decisions* (Geneva, Univ. de Genève, 1999) reproduces the case law on the Convention, about 200 cases in Germany. This means that only about 15–20 cases are decided worldwide each year (outside Germany), in most cases by lower courts.

this proposal does not create particular problems. If the European Code covered cross-border cases only, then cases of European law only or of state option would simply be less numerous with respect to mandatory substantive and mandatory information rules. Therefore the advantages and disadvantages named below for these case patterns would remain the same, but apply to a reduced number of cases. For its default rules, even a European Code restricted to cross-border cases could also be chosen within the domestic freedom of contract in domestic cases (as is the case with the UN Sales Convention).

IV. A MAP OF POTENTIAL DESIGNS IN A EUROPEAN SYSTEM OF CONTRACT Laws

1. A Map of Dimensions

From the two core dimensions the following map can be derived which will be taken as the basis for sections 2–4. Within this map, opt-in and opt-out solutions will be taken into account in that the standard from which the decision maker has to opt out is favoured (at least in cost aspects) by the legislator. Therefore the opt-out solution comes closer in policy questions to the next more binding variant of this standard than an opt-in solution.

Choice made by	Mandatory Substantive Rules	Mandatory Information Rules	Facilitative Law
(a) Union			
(b) States having part choice			
(c) States having full choice			
(d) Parties having some choice between			

2. Mandatory Substantive Rules

a) Characterisation and Importance

Mandatory substantive rules in European Contract Law exist or could exist mainly in *two areas*: in *consumer contract law*, potentially also in (contract related) *competition law in the large sense.* Indeed, currently there are two scopes which inspire mandatory law and regulation of the formation, content and

termination of contracts. They are protecting the weaker party (mainly inferiority situations as to information)[41] and protecting free competition in markets.[42]

b) EU law only

aa) This solution is the simplest and can be *described* as follows. The Union would prescribe that only its mandatory substantive law applies. There would be no options for states or private parties as to consumer (and potentially also competition) law standards imposed by EU law, for instance termination rights, nullity of diverging solutions, quality standards imposed or also possibly imposed maximum prices.

bb) As *practical examples*, one would have to name legal measures in European Contract Law which prescribe a minimum and at the same time a maximum standard. The only example so far in contract law is not yet in force, the Commission proposed such standards for distance contracts in financial services.[43] Maximum standards are problematic under subsidiarity aspects.[44] Even EC competition law which could be named here applies only to situations with

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[41] Consumer law is convincingly explained mainly as a law curing information asymmetries. See R.R. Kerton and R. Bodell, 'Quality, choice and the economics of concealment – the marketing of lemons', (1995) 29 *Journal of Consumer Affairs* 1, esp. 20–24; H.-B. Schäfer, 'Grenzen des Verbraucherschutzes und adverse Effekte des Europäischen Verbraucherrechts', in: S. Grundmann (ed.), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts – Gesellschaftsrecht, Arbeitsrecht, Schuldvertragsrecht* (Tübingen, Mohr, 2000), 559, 559–564; A. Schwartz, (1995) 151 *JITE* 31, esp. 35–46; S. Strassner (n. 33) 126–136; and monographically for information asymmetries: H. Fleischer, *Informationsasymmetrie im Vertragsrecht* (Munich, Beck, 2001).

[42] This is true mainly for the prohibition of cartels, block exemptions, public procurement rules and some rules in intellectual property law (see decompilation of computer programs, etc.); commentary for these areas and more extensive on these areas under the competition law approach: S. Grundmann, *Europäisches Schuldvertragsrecht* (Berlin/New York, de Gruyter, 1999), 905–1171; *id.*, (2001) *ERPL* 505, 515 seq. and 518 *et seq.*; C. Quigley, *EC Contract Law* (London et al., Kluwer, 1997), 81–112.

[43] Proposal for a Directive of the European Parliament and of the Council concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, (EC) OJ [1998] C 385/10, COM(1998) 468 final; Common Standpoint (EC) of [2002] C 58 E/32.

[44] See ECJ 19.11.1996 – case C-42/95 *Siemens/Nold* [1996] ECR I–6017, 6034–6036 (invoking mainly the scope of the directive); H. Merkt, 'Europäische Rechtsetzung und strengeres autonomes Recht – zur Auslegung von Gemeinschaftsnormen als Mindeststandards', *RabelsZ* 61 (1997) 647, esp. 669–684; for company law M. Lutter, 'Die Auslegung angeglichenen Rechts', *JZ* [1992], 593, 606; for environmental law H. Jarass, 'Binnenmarktrichtlinien und Umweltschutzrichtlinien – zur Abgrenzung des Anwendungsfeldes und zu den Möglichkeiten nationalen Abweichens', *EuZW* [1991], 530, 532.

cross-border implications (and is perhaps not core contract law). A third and the most important example could be a European Code to come comprising consumer contract law. From the aforesaid follows, however, that this would be a fundamentally new approach. Not even competition law, which was so important from the founding days of a European Community, is EU law only.

cc) Basic features of evaluation would include those named in pure form.[45] There would be serious inroads into the capacity of the law to serve and allow the serving of heterogeneous preferences, into the capacity of law to adapt to new needs in a highly dynamic world and into the capacity of law to use multiple sources for learning about better solutions and not to stay in tendency once and for all at one level of knowledge (already imperfect at the time of its use in the legislative process). On the other hand, the typical advantages of centralised rule making may well be not very strong in this situation: standardisation as a device (saving of transaction costs) is important mainly for mass transactions and parties which consciously plan transactions, i.e. for the side of supply, possibly not so much for the consumer. For the side of supply, however, standardisation can also be reached in a minimum harmonisation situation. A potential race to the bottom may well be reduced by EU law only but, again, it can be reduced also by minimum harmonisation.[46]

c) States having part decision power (maximum/minimum fixed by EU)

aa) This solution can be *described* as the now predominant in European Contract Law (in domestic cases). The Union prescribes a uniform mandatory substantive standard to be applied, but only as a minimum or a maximum. Neither states nor parties may deviate from it. Above this level or below this level, however, national law may regulate contracts by its own mandatory substantive standards. In this case, national law would impose its standard, insofar that parties would not have the choice.

bb) The *practical example* for a minimum level fixed by centralised rule making, i.e. Community law, is the law contained in directives which in contract law allow more stringent national law in all cases but one.[47] In purely domestic cases, Member States can certainly apply their more stringent law in a mandatory

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[45] See above text accompanying n. 8 et seqs.

[46] For both statements about effects of minimum harmonisation see below text accompanying n. 48 et seqs.

[47] This is the Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, (EC) OJ [1986] L 382/17; see S. Grundmann, *Europäisches Schuldvertragsrecht* (Berlin/New York, de Gruyter, 1999), 77–79 for a list of articles in the other directives which explicitly allow more stringent national law.

way. Conversely, in cross-border cases, Community law probably obliges them to leave some (restricted) choice to the parties: more stringent law cannot be opposed to supply from abroad using its home country law.[48] Thus, for questions of more stringent state law, parties can choose between domestic supply under domestic mandatory law and supply from abroad under other state laws. In the future, there could also be EU model rules for more stringent standards besides the state laws. The rest of the mechanism would not change. An opt-out solution would come close to such options opened in directives, for instance that of reducing the cut-off period contained in article 5(1) of the Sales Directive from two years to one in the case of used goods.[49]

The example for a maximum level set by Community law is fundamental freedoms. They apply only to mandatory state law[50] and forbid a higher level of state regulation (mandatory substantive law) than needed according to EC standards. These standards are quite demanding: national mandatory law has to be justified by mandatory reasons of public good; it has to be carried through

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[48] This is disputed. See for the position which holds that harmonisation consumes the justification by mandatory public good standards because it defines what is strictly indispensable: A. Bleckmann, 'Probleme der Auslegung europäischer Richtlinien', *Zeitschrift für Gesellschaftsrecht* [1992], 364, 373; S. Grundmann, 'Binnenmarktkollisionsrecht – vom klassischen IPR zur Integrationsordnung', *RabelsZ* 64 (2000) 457, 471–476; E. Steindorff, *Grenzen der EG-Kompetenzen*, (Heidelberg, Recht & Wirtschaft, 1990), 84; and rather uniform in this sense, the Italian doctrine, see P. Mengozzi, 'La seconda direttiva bancaria, il mutuo riconoscimento e la tutela dell'interesse generale degli Stati Membri', *Riv. dir.europ.* [1994], 447, 459 *et seq.* The opponents hold that domestic law can still apply if there are mandatory reasons of public good for doing so. See mainly W.-H. Roth, in: Grundmann, Medicus and Rolland (n. 25), 113, 123–126; and A. Baumert, *Europäischer ordre public und Sonderanknüpfung zur Durchsetzung von EG-Recht*, (Frankfurt, Lang, 1994), 232–234; B. Smulders and P. Glazener, 'Harmonization in the Field of Insurance Law through the Introduction of Community Rules of Conflict', (1992) 19 *CMLRev.* 775, 797.

[49] 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, (EC) OJ [1999] L 171/12; for this directive see M. Bianca and S. Grundmann (eds.), *EU Sales Directive – Commentary* (Antwerp-Oxford, Intersentia-Hart, 2002).

[50] Indeed, the ECJ does not submit to a fundamental freedoms scrutiny national rules from which parties can opt out in cross-border cases under art. 3 Rome Convention (n. 30): ECJ 24.1.1991 – case C-339/89 *Alsthom Atlantique* [1991] ECR I-107, 124; some authors criticise this rule invoking additional information costs for one party: J. Basedow, 'A Common Contract Law for the Common Market', (1996) 33 *CMLRev.* 1169, 1174–1178; P. v. Wilmowsky, 'EG-Freiheiten und Vertragsrecht', *JZ* [1996], 590, 595 *et seq.*; and E. Steindorff, *EG-Vertrag und Privatrecht* (Baden-Baden, Nomos, 1996), 78 *et seq.* (without, however, even referring to the decision). A justification of the Court's position is given by S. Grundmann, 'Europäisches Handelsrecht – vom Handelsrecht des laissez faire im Kodex des 19. Jahrhunderts zum Handelsrecht der sozialen Verantwortung', *Zeitschrift für das gesamte Handelsrecht (ZHR)* 163 (1999) 635, 656–659.

in a fully consistent and in the least intrusive way possible (principle of proportionality); this means also that state legislators have to prefer mandatory information rules to substantive mandatory rules whenever sufficient for the protective purpose.[51]

If the *acquis communautaire* is to be maintained[52] the minimum standards on a centralised level would not be questioned. What is important is that, so far, most EU contract law minimum standards contain only information rules and therefore fall into another category (see 3 below).[53] Conversely, maximum standards fixed by the EU typically focus on mandatory substantive rules. As mentioned, they even prescribe that priority has to be given to mere (mandatory) information rules if ever possible.

cc) Basic features of evaluation would include a balancing of the danger of market failure – which mandatory substantive regulation should fight in order to be justified – and the danger of state failure which nowadays is accepted to exist as well. The danger of state failure, i.e. the failure to judge market failure correctly and to react to it by the appropriate regulation (potentially also by no regulation), is due mainly to two facts: states may have knowledge problems (distance from the relevant problems; impossibility of full knowledge; rapidly changing knowledge); and they may have incentive problems (rent seeking, lobbyism, public choice).[54]

It may well be that one solution only is not appropriate in the same way to all contract law regulation rules. One should, however, make further investigations in the following direction: both types of regulation possible – regulation on the Community level and regulation on national level – can be too weak or too heavy. They can be exposed to more or less pressure though and thus respond to these concerns in a different way. Regulation on the national level may have a problem of under-regulation. This risk (potential race to the bottom) may well justify minimum regulation on the Community level – a traditional justification given in harmonisation theory. Thus, the risk of under-regulation is reduced by the imminence of harmonisation. The more competition is distorted by under-regulation on the national level the more the pressure for harmonisation increases. Moreover, if there is under-regulation on the Community level, states can still regulate on a higher level and if they do so efficiently the scenario

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[51] See the standard commentaries for all these maximum standards set by EC Treaty Law; for the supremacy of information rules see references below n. 66.

[52] See above n. 24.

[53] See Grundmann, Kerber and Weatherill (n. 31).

[54] For this risk, discussed under the term of public choice, see most prominently: J.M. Buchanan and G. Tullock, *The Calculus of Consent – Logical Foundations of Constitutional Democracy* (Ann Arbor, Univ. of Michigan Press, 1962); J.M. Buchanan, *The Limits of Liberty – between Anarchy and Leviathan* (Chicago, Chicago Univ. Press, 1975); J.M. Buchanan, *Liberty, Market, and State* (New York, New York Univ. Press, 1986).

of rise to the top becomes likely. Thus the main problem in a two-level system is over-regulation.[55] In this respect state regulation can have a real advantage which then speaks in favour of a solution which consciously reserves to state regulation any experimentation with cases and rules where regulation might potentially be too heavy. Over-regulation on the Community level may still be more of a problem because it is typically less put to a test. It may therefore be helpful if the Community regulates only where the need and the tools used are almost unanimously consented. Thus, the need of consent in almost 15 states can serve as a mechanism against state failure. The Commission should deduce from this that regulation should be envisaged only if the consensus in expert (and benevolent) circles is broad and not where the risk of error is considerable. These cases should then be left to state regulation. In order to make this mechanism work smoothly state regulation would, however, have to be put to a test. This test already exists in current EU law: fixing a maximum level means that national regulations are checked against a principle of proportionality and compared against foreign laws which might reach the protection looked for with less intrusive methods. A second test is that of the market. Then not the European Court of Justice would compare solutions, but the side of demand.[56]

d) States having full decision power

aa) This solution can be *described* as one where not even an EU minimum (or maximum) standard is imposed on Member States. The *practical example* would be that of an EU Model Code including those rules which typically are mandatory even in cross-border cases, i.e. also including consumer protection rules. Member States could opt out of this or would have to opt in. Politically, this solution is not likely, because it would mean cutting back on the *acquis communautaire.*

bb) Discussing *basic features of evaluation* means comparison: the split competence solution described (section c above) may be apt to contain the risk of under-regulation without, however, running serious risks of over-regulation. Giving the option to the states to apply their regulation not only for the more stringent rules but generally, may well not have any advantage over this solution. As long as the choice by the parties was not opened up (see section e below), there would be no additional structural mechanism which could help to reduce the risk of over-regulation.[57] Conversely, the powerful mechanism containing the risk of

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[55] In this sense also the contribution by R. van den Bergh in this volume. This author, however, would also do away with minimum harmonisation.

[56] This scenario exists; it falls, however, into another category. See below section e (text accompanying n. 58 *et seq.*).

[57] If the EU could not even set the maximum level (via fundamental freedoms) the risk of over-regulation would even be increased.

under-regulation which exists in the minimum harmonisation approach would be eliminated. Therefore, the full state option model discussed here could well only have an advantage over the minimum harmonisation model if the regulation on the central level developed in a way where it can often be asked whether this central regulation is not heavy regulation and potentially over-regulation. The advantage would be reduced or even absent, however, if, for mandatory rules (here mandatory substantive rules), the Community legislator followed the above stated counsel and keep central (minimum) regulation at the level which meets virtually unanimous acceptance.

e) Parties having a choice

aa) Already in European Contract Law, there is quite some degree of party choice for internationally mandatory rules.[58] Choice can be given also only as to parts of the solution, for instance for the more stringent rules. Choice in case of mandatory rules never means that parties can completely opt out; they can do so only in combination with opting into another set of mandatory rules. In the following, *three quite representative combinations are discussed.*

bb) The first is represented by current European Contract Law, the *acquis communautaire.* Here, a *minimum set by the Union is not open to party options.* This set is, however, combined with a freedom of choice between different state laws *as to more stringent regulation. The freedom of choice is restricted.* Under current fundamental freedoms doctrine, suppliers from abroad can act under their home country rule.[59] Therefore the side of demand can choose between different sets of more stringent state laws (also state laws with zero more stringent rules). These sets can, however, only be chosen in combination with a supplier having its origin in the country whose law should be chosen. As the more stringent law follows the origin of supply, there is no opt-in and opt-out problem so far.

cc) In the second situation, *choice could be broadened as to the more stringent rules.* The minimum would remain firm. There are three particularly prominent designs. They start from what is well established as home country principle: any supplier can design his conditions taking into account only the rules of his home country (including the more stringent which go beyond the EU minimum standard). In the three designs, the origin of supply would gradually become less

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[58] This is due to the dual fact that most mandatory EU Contract Law consists of information rules only and that above that minimum, in principle, host countries may not impose their standards on foreign offers (the latter is disputed). See references above nn. 53 and 48 and more in detail S. Grundmann, (2002) 39 *CMLRev.*

[59] For dispute about this, see above n. 48. For a potential right to also opt for the host country standard, see n. 61.

important.[60] A first step would be (1) that the supplier from abroad can alternatively choose the host country's (more stringent) rules.[61] Choice would be more extended if (2) any supplier had to make an offer under his home country rules but was allowed also to make alternative offers under any other law. In this case, in any country the standard of this country would still be offered (home country rule of the domestic supply). Choice would still be broader if (3) any supplier could choose the law under which he wants to make his offers. This would no longer guarantee that the host country standard is offered at all. If the suppliers do not make a choice there would have to be a default solution. This could be either the law of the home country of the supplier or that of the host country. There would certainly be a prerequisite of transparency (otherwise the host country standard should apply).

dd) In the third situation, the parties would have a *choice also as to the minimum* itself, between EU law and one or more state laws. This would mean cutting back on the *acquis communautaire*. Such a solution would only be realistic if it meant that EU law really sets only the scope to be aimed at and that EU and states give a model of how they would accomplish this task with more detailed rules. The parties could then choose.

ee) Basic features of evaluation have to build on the aforesaid: if in fact a split competencies approach could well be structurally superior to a full state option whenever the EU minimum really is restricted to what is basically consented, one should investigate broadening choice primarily with respect to the more stringent rules.

Here, one could investigate in the following direction. Freedom of choice in this area may potentially create a danger for those who cannot inform themselves or understand the differences. This speaks in favour of having one fall-back position where the local regulator – which is particularly responsive to the needs in this market, i.e. the client's home – sets the measure of regulation. This solution is certainly offered, if in purely domestic cases (i.e. between local customers and local supply), domestic law is applied. Any customer can choose to buy home, under his law. This fall-back position would be maintained if suppliers

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[60] For an in-principle critique see Kerber (n. 9), 67, 88–96; see furthermore the EC law evaluation of this approach by G. Koenig, J. Braun and R. Capito, 'Europäisches Systemwettbewerb durch Wahl der Rechtsregeln in einem Binnenmarkt für mitgliedstaatliche Regulierungen?', *EWS* [1999], 401.

[61] Most favourable law principle, advocated under current fundamental freedoms doctrine by W.-H. Roth, 'Der Einfluß des Europäischen Gemeinschaftsrechts auf das Internationale Privatrecht', *RabelsZ* 55 (1991), 623, 645–662; also J. v. Hein, *Das Günstigkeitsprinzip im Internationalen Deliktsrecht* (Tübingen, Mohr, 1999), 423–433; U. Höpping, *Auswirkungen der Warenverkehrsfreiheit auf das IPR – unter besonderer Berücksichtigung des Internationalen Produkthaftungsrechts und des Internationalen Vertragsrechts* (Frankfurt, Lang, 1997), esp. 169–178.

were at least asked to also make an offer under their law, but were given the option to make alternative offers under a foreign law. Giving foreign suppliers the freedom to make offers under their laws does not take away this fall-back position. Any customer in the Union should be able to learn that foreign offers may deviate in law and that they are risky in this sense. If he is not sure, he may buy in a conservative way. Otherwise he has to invest in advice, leave it, or take a risk. Conversely, giving at least some freedom of choice may increase advantages for other customers. They may have their preferences better served. If they cannot judge on this a market for information intermediaries may evolve[62] if information really can be used to take options. Moreover there is more potential of innovation and experimentation. This speaks in favour of offering even local supply the possibility to design offers, at least as an alternative under foreign laws. This also speaks in favour of offering supply from abroad the possibility to design their offers under any national law if only this is made transparent.

3. Mandatory Information Rules

a) Characterisation and importance

Mandatory information rules are the dominant regulatory tool in current European Contract Law.[63] They are hybrid in nature in that they are mandatory in legal construction; as to the capacity of the parties, however, to design the contract and the capacity of the substantive law to evolve, they are basically facilitative or enabling. They leave this design to the parties and are fundamentally aimed at helping them in choosing better designs.

Mandatory information rules are mainly those which prescribe the giving of information and the sanctions if the information is incorrect or incomplete. For the first group of rules, centralised rule making is strong already, for the second, it is weak.

b) EU law only

aa) This situation can be *described* as one in which the question how much information has to be passed from one party to the other is completely fixed by

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[62] See Th. Gehrig, 'Intermediation in search markets', (1993) 2 *Journal of Economics and Management Strategy* 97; S. Grundmann and W. Kerber, 'Information Intermediaries and Extending the Area of Informed Party Autonomy – as in Capital Markets and in the Insurance Business', in: Grundmann, Kerber and Weatherill (n. 31), 264; F. Rose, *The economics, concept, and design of information intermediaries* (Heidelberg, Physica, 1999); A. Yava, 'Search and Trading in Intermediated Markets', (1996) 5 *Journal of Economics and Management Strategy* 195.

[63] See Grundmann, Kerber and Weatherill (n. 31).

(mandatory) EU law or in which the question of liability for incorrect or incomplete information is completely decided on by EU law.

bb) The *practical example* could be a future European Code if it replaced the national regimes on information. Another example could be directives which fix the minimum level and at the same time also the maximum level. A closer look at current EU law shows that this situation already partly exists. Contrary to what is the case for mandatory substantive rules, information rules are numerous in current European Contract Law and they can often be understood as more than minimum rules. They prescribe exact amounts of content (as minimum) which, however, may not be extended or only moderately, by the Member States. This is the case with all rules which prescribe that all material information be given but at the same time that it be given in a clear and understandable way. Thus, information overkill will be avoided, the information has to be kept at a level which can easily be digested. The corridor left to Member States is thus narrow, if not reduced to one optimal solution. This type of information rule is to be found in article 11 Investment Services Directive for all transactions in securities markets,[64] but also in directives which describe the items about which information has to be given in an enumerative way. There may even be a general principle in this sense inherent to all European information rules.[65]

cc) Basic features of evaluation have to do with the nature of mandatory information rules as opposed to mandatory substantive rules. The evaluation structure is not the same. An EU law only solution has, first, less adverse effects, because the particular shortcomings of centralised rule making are weaker. Mandatory information rules are less intrusive than mandatory substantive rules and even have a liberalising effect: they are an alternative to mandatory substantive rules already on Community level and push back this type of rule on this level; moreover they have their effect also on mandatory substantive rules on the state level. Fundamental freedoms prescribe that national legislators choose mere

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[64] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, (EC) OJ [1993] L 141/27; amended in (EC) OJ [1995] L 168/7. Article 11(1) reads: '... must be applied in such a way as to take account of the professional nature of the person for whom the service is provided [and] ... that the investment firm ... makes adequate disclosure of relevant material information in its dealings with its clients ...' The text is so open because the information to be given depends so much on the individual situation and the needs are difficult to standardise (professionality, investment scopes, etc.). The rule is even designed such that the intermediary should transpose standardised primary securities markets information (prospectuses, etc.) to the individual needs of the individual investor in each case. See Grundmann and Kerber (n. 62), 264; S. Grundmann, in: C. Ebenroth, K. Boujong and D. Joost, *Handelsgesetzbuch* (Munich, Vahlen, 2001), Bankrecht para. VI 31; S. Heinze, *Europäisches Kapitalmarktrecht – Recht des Primärmarktes* (Munich, Beck, 1999), 376–386.

[65] In this sense now, even the Commission, see COM(2001) 398 final, pp. 59, 61.

information rules where this is sufficient protection.[66] This means that one of the two types of market failure which are really important in contract law – and even the one which is still more core contract law – is mainly solved by information rules leaving all advantages of potential variety in substance intact. EU law only in mandatory information rules may be problematic as to the question how much information should be given.[67] It does not, however, restrict the variety of solutions for different preferences and the capacity of law for innovation in substantive law questions. In the case of information rules, EU law only is, second, also a stronger option on the side of advantages of centralised rule making. Standardisation advantages of an EU law only solution may well not be so important in the case of substantive mandatory rules. The side of demand often does not know the law and does not consider it to be so important. And for the side of supply, standardisation advantages can also be reached in a split competencies solution.[68] Conversely, standardisation seems to be important for the side of demand as well in the case of information rules. These rules are more about the product itself even though they may also inform about the law.[69] For a comparison of products, it is certainly helpful exactly for the side of demand that information be standardised and thus easier to compare.

c) States having decision power partly (maximum/minimum fixed by EU)

aa) This situation can be *described* parallel to the one in which mandatory information rules are fixed partly by the Union, but only at a minimum level or a maximum level.

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66 ECJ 20.2.1979 – case 120/78 *Cassis de Dijon* [1979] ECR 649, 664; 22.6.1982 – case 220/81 *Robertson* [1982] ECR 2349, 2361 *et seq.*; 11.7.1984 – case 51/83 *Commission v. Italy* [1984] ECR 2793, 2805 *et seq.*; and also for the freedom of establishment: ECJ 9.3.1999 – case C-212/97 *Centros* [1999] ECR I–1459, 1495.

67 Here there can be over-regulation and – less likely – too little regulation. Typically, it is rather information overkill which is feared with respect to Community law: see, for instance M. Martinek, 'Unsystematische Überregulierung und kontraintentionale Effekte im Europäischen Verbraucherschutzrecht oder: Weniger wäre mehr', in: S. Grundmann (ed.), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts – Gesellschaftsrecht, Arbeitsrecht, Schuldvertragsrecht* (Tübingen, Mohr, 2000), 511, passim (for huge parts of consumer contract law); H.-D. Assmann, 'Die Regelung der Primärmärkte für Kapitalanlagen mittels Publizität im Recht der Europäischen Gemeinschaft', *AG* [1993], 549, 560; *id.*, 'Die rechtliche Ordnung des europäischen Kapitalmarkts – Defizite des EG-Konzepts einer Kapitalmarktintegration durch Rechtsvereinheitlichung "von oben"', *ORDO* 1993, 87, 103 (for capital market law).

68 See above, text accompanying n. 48.

69 Examples are to be found in virtually all directives, for instance, the Package Travel Directive, the Distance Selling Directive and also in art. 6 of the Sales Directive (reference above n. 49). For this latter example, see explanation in: E. Hondius, *Consumer Guarantees – towards a European Sale of Goods Act* (Rome, Unidroit 18, 1996), 17 *et seq.*

bb) The *practical examples* diverge – first for fundamental freedoms (maximum level). These do not play an important role for mandatory information rules.[70] Mostly fundamental freedoms even impose the use of information rules on national legislators (supremacy of information rules).[71] The picture diverges, second, also with respect to minimum standards, again in various aspects: mandatory information rules in European Contract Law are more numerous than mandatory substantive rules. At the same time the proportion of minimum rules and minimum/maximum rules is changed. Among these numerous information rules there are many which also fix a maximum standard (see section b above) so that the (remaining) mere minimum rules may not even be information rules in majority.[72]

cc) Basic features of evaluation are concerned with the fact that in EC contract law information rules are more numerous than mandatory substantive rules and that they more often also fix maximum standards. Thus the EU law only solution is more predominant. As fundamental freedoms are not so important for information rules we need not discuss EU law fixing a maximum, but compare EU law only with EU law fixing a minimum standard.

In this case, the basic potential advantage of a split competences solution for substantive mandatory rules was seen in that the EU can avoid over-regulation and that at the same time there is no serious risk of under-regulation because Member States can react. The evaluation is not completely the same in the case of mandatory information rules. If information allows comparison in markets, the case for standardisation is stronger. At the same time, over-regulation is less of a problem if the setting of the standard is left to the segments of the markets concerned to a certain extent. This is the effect of a transparency rule which says that all material information has to be given in a way which is clear and understandable to the client. Then the segment itself decides to a certain extent what are the contents needed (material) and allowed (not abundant and therefore

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[70] Different only where information may lead to discrimination of foreign offers, mainly with respect to language requirements. See, for instance, ECJ 3.6.1999 – case C-33/97 *Colim v. Bigg's Continent Noord* [1999] ECR I–3175; in detail: Usher, 'Disclosure rules (information) as a primary tool in the doctrine on measures having an equivalent effect', in: Grundmann, Kerber and Weatherill (n. 31), 152, 160–164.

[71] See references in n. 66.

[72] One example is the Council Directive 84/450/EEC of 10 September 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising, (EC) OJ [1984] L 250/17; amended in (EC) OJ [1997] L 290/18 (now including comparative advertising, but not strictly contract law). Another example could be the Unfair Contract Terms Directive (n. 29) where little is said about the handing over of the standard terms themselves or about information on them. Different, for instance, sec. 2 of the German Unfair Contract Terms Code, now sec. 305 (2) of the German Civil Code as of 1 January 2002.

reducing transparency). Thus the EU law only solution has more advantages than the split competences approach and less disadvantages in the area of mandatory information rules than in that of mandatory substantive rules. The evaluation is not so clear in favour of a split competences approach. In fact, the contrary seems plausible in many cases.

d) States having full decision power

This situation is difficult to imagine (EU law as a mere model code). The solution seems at least as unlikely politically than in the case of mandatory substantive rules (*acquis communautaire*). As its structural inferioriority to a split competences solution has been shown to be plausible and as standardisation is even more important for mandatory information rules than for mandatory substantive rules this solution does not seem very attractive theoretically either. For these two reasons, it should not be discussed at length.

e) Parties having a choice

aa) As in the case of substantive mandatory rules,[73] giving parties a choice can mean only that they have the choice between two or more mandatory information regimes, not that they can opt out completely (default rule). Again the choice may be split, for instance different for the minimum standard and for the more stringent rules.

bb) The first – *lex lata* – example would again be that the *minimum is set by the Union and not open to party options* and that there is *restricted freedom of choice as to more stringent national information rules* – if they are admitted at all, which is less universally the case with mandatory information rules.[74] If admitted at all, these more stringent information rules may in principle not be imposed on suppliers from abroad if the rules are burdensome and thus constitute an obstacle to their offers.[75]

cc) Broadening the choice of parties as to more stringent information rules could mean that suppliers can choose to act under their home country rule but also under the host country rules.[76] It could also mean, second, that any supplier has to comply with his home country rules (his 'origin'), but in addition may design an offer under a set of information rules which he chooses (his chosen 'origin'). This would be similar to offering alternative sets of standard terms at

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[73] See above, text accompanying n. 58.

[74] See above, text accompanying n. 64.

[75] See above, n. 48.

[76] See references in n. 61.

different prices.[77] Broadening the choice of parties as to more stringent information rules can go still further. Then, yes, there would be a default rule (for instance home country or host country) but suppliers could opt out of it (without making any offer under it) and choose another set of national information rules, potentially also one which did not have any rule going beyond the Community law minimum. One could also imagine that opting out has to be accompanied by an explanation of what are the main differences between the chosen regime and the default regime.[78] In this last solution, the default standard would not necessarily be offered at all.

dd) Again, making the *minimum really optional* is politically not very likely and probably not to be wished for.[79]

ee) Basic features of evaluation of these three situations would include: the problems centralised rule-making raises are less important in the case of mandatory information rules. In contract law this is so, first, because freedom of design remains intact and, second, because in contract law (perhaps contrary to company law), the best producer and supplier of information as to the product is virtually always the side of supply. Thus information rules prescribing the disclosure of all material product related information in contract law do not seem to raise considerable doubt. Experimentation is less needed. Conversely, the problems of decentralised rule-making, i.e. mainly complexity, are more important in the case of information rules. Complexity is potentially more detrimental here because the very feature of information is comparability. This seems to indicate that for information rules a cautious approach by the Community legislator would allow an EU law only solution to be acceptable in virtually all cases of contract law.

4. Facilitative Law (including Default Rules)

a) Characterisation and importance

Facilitative law consists mainly of *default rules.*[80] Individual drafting of the contract would be possible in all solutions named below at b–e – with one

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[77] See for the (very positive) German view about this kind of contract drafting: H. Brandner, in: P. Ulmer, H. Brandner, H.-D. Hensen and H. Schmidt, *AGB-Gesetz – Kommentar* (9th edn., Cologne, Schmidt, 2001), § 9 para. 112; M. Wolf, 'Freizeichnungsverbote für leichte Fahrlässigkeit in Allgemeinen Geschäftsbedingungen', *NJW* [1980], 2433, 2439.

[78] Traces of such an approach can be found in the Community law on stock exchange prospectuses, see arts. 38 *et seq.* of Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, (EC) OJ [2001] L 184/1.

[79] See above, text at n. 56.

[80] For the different groups of facilitative law and examples see above, text at n. 22.

important exception: as far as *standard term contracts are used* unfair contract terms law renders default rules partly mandatory, i.e. sets a narrow corridor, because only minor divergence from the default solution is allowed.

b) EU law only

aa) This solution can be *described* as one in which the Union is the only statal body which has the competence to supply parties with the standard default rules. Within the Union (i.e. EU 'domestic' cases) this would be the law from which parties cannot opt out by genuine choice of law (art. 3(3) of the Rome Convention on the law applicable to contracts of 1980).[81] There could be the choice of foreign law rules (also sets of rules) only within internal EU law freedom of contract and the limits which EU law would set. The narrow corridor for standard contract terms is probably the most important of the limits.

bb) The *practical example* is the European Code which replaces national contract laws.[82] This Code would decide both on the default rules and – as second branch of facilitative law – on the enforceability of the contract. The latter cannot be EU law only. For instance, a European court system is utopic today, there could only be minimum rules, for instance on duration of court proceedings. In the following, the focus is on default rules. One second example is those – not very frequent – cases in which rules contained in directives are not really mandatory, but default rules. The outstanding example is article 2 of the Sales Directive. Here, the standard of the quality owed is that of the average – the normal aptitude for use and other qualities normally expected. This standard is, however, subject to changing by party agreement – above and also below average if the deviation is made sufficiently transparent.[83] So-called general principles of con-

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[81] See reference above at n. 30. This solution is already so universal (at least there are no more liberal conflicts rules abroad) that it is taken as given.

[82] One of the alternatives in option IV according to COM(2001) 398 final, p. 21 (para. 67).

[83] S. Grundmann, in: M. Bianca and S. Grundmann (eds.), *EU Sales Directive – Commentary* (Antwerp-Oxford, Intersentia-Hart, 2002), Art. 2 paras. 8–10; M. Lehmann, 'Informationsverantwortung und Gewährleistung für Werbeangaben beim Verbrauchsgüterkauf', *JZ* [2000], 280, 283; P. Romana Lodolini, 'La direttiva 1999/44/CE del Parlamento europeo e del Consiglio su taluni aspetti della vendita e delle garanzie dei beni di consumo – prime osservazioni', *Europa e diritto privato* [1999], 1275, 1284; not entirely clear: M. Tenreiro and S. Gomez, 'La directive 1999/44/CE sur certains aspects de la vente et des garanties des biens de consommation', *REDC* [2000], 5, 14; opposite view in: H. Beale and G. Howells, 'EC Harmonisation of Consumer Sales Law – a Missed Opportunity?', (1997) 12 *Journal of Contract Law* 21, 28; G. de Cristofaro, *Difetto di conformità al contratto e diritti del consumatore – l'ordinamento italiano e la direttiva 99/44/CE sulla vendita e le garanzie dei beni di consumo* (Padova, Cedam, 2000), 76–79; H.-W. Micklitz, 'Die Verbrauchsgüterkauf-Richtlinie', *EuZW* [1999], 485, 492; D. Staudenmayer, 'Die EG-Richtlinie über den Verbrauchsgüterkauf', *NJW* [1999], 2393, 2397; see also the subtle

tract law are not a third example, because outside areas of exclusive EU competence they are not binding law.[84]

cc) Basic features of evaluation are, first, about measurable[85] advantages of a European set of default rules. Such a set furthers the scope which default rules have more generally – reduction of transaction costs.[86] A European set would add to this scope at least in the situation of cross-border transactions, because only in the case of a European set of default rules do parties have easy and equal access to the set of default rules. This helps reduce transaction costs at least for one side (not having to inform itself about a completely foreign law), possibly for both sides if they do not yet know which law will be chosen or applied. Otherwise, in cross-border cases one party has to accept a set of default rules typically better known to the other – an old problem of unfair contract terms law – and more accessible in case of dispute. It is, however, disputed how high these gains are.

There are also disadvantages of a European Code only. Sets of standard terms provided by a legislator have advantages over sets of standard terms provided by other bodies. Parties often think of them as being less biased, and they typically cover more broadly all problems. Having only one set of standard terms with statal origin means that only one type of preference structure is served, only for one type all the cost advantages of a set of default rules are given. Offering more statal default solutions gives a broader range of preference structures in the population the possibility to use one supposedly balanced set of default rules. EU law only could raise a second problem whenever parties want to deviate by using standard contract terms. And this may be the case in the overwhelming majority of contracts today.[87] In these cases, the default rules

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analysis by W. van Gerven and S. Stijns, in: Bianca and Grundmann (this n.) Art. 7 paras. 23–26.

[84] See S. Grundmann, 'General Principles of Private Law and Ius Commune Modernum as Applicable Law?', *Festschrift for R. Buxbaum* (2000), 213; an example may be *pacta sunt servanda*: see W. Lorenz, 'General Principles of Law: their Elaboration in the Court of Justice of the European Commmunities', (1964) 13 *Am. J. Comp. L.* 1, 11 *et seq.* (general yes, but not detailed enough in concrete cases).

[85] We do not discuss whether 'the' Code would be a political symbol important for the Union. Possibly lawyers take their perspective too absolutely and therefore might overrate the symbolic importance of such a Code in the public at large.

[86] See above section II 2.

[87] Especially if unfair contract terms law also applies to pure commercial contracts as in Germany. Besides the problem raised here, there are good theoretical arguments for such an approach. See M. Adams, 'Ökonomische Begründung des AGB-Gesetzes – Verträge bei asymmetrischer Information', *Betriebsberater (BB)* [1989], 781, 787; J. Köndgen, 'Grund und Grenzen des Transparenzgebots im AGB-Recht – Bemerkungen zum "Hypothekenzins-" und zum "Wertstellungs-Urteil" des BGH', *NJW* [1989], 943, 946 *et seq.*; I. Koller, 'Das Transparenzgebot als Kontrollmaßstab Allgemeiner

define the legal paradigm from which parties may no longer deviate considerably. Therefore, the problems of having only one set of default rules in nowaday's world – which uses and must use standard contract terms in the large majority of cases – are more or less the same as having only one set of mandatory (substantive) rules: There would be serious inroads into the capacity of law to serve heterogeneous preferences, to adapt to new needs in a highly dynamic world and to use multiple sources for learning about better solutions. The latter two disadvantages would not be eliminated even if the EU chose to offer different sets of default rules itself (for serving different preferences).

c) States having part decision power (maximum/minimum fixed by EU)

aa) In *this situation*, default rules are fixed partly by the Union, but only at a minimum level or a maximum level. This is not so easy to conceive, if party wishes are the main guiding line and not protection of one party or third parties. There can be more protection, but a more for one party typically can deviate more from the wishes of the other party.

bb) The *practical examples* in the Union are only minimum standards. Fundamental freedoms do not apply to default rules and thus do not impose maximum levels for them.[88] Minimum standards are at least on the agenda. The Communication raises the question whether differing default rules do not create different practices in different countries from which parties of that country cannot easily deviate.[89] The same is true for diverging interpretation or diverging transposition of Community law. One could therefore imagine that European law would set standards in a uniform way from which national legislators can not deviate (minimum), but leave it to national legislators to decide on other aspects of the same question. Community law could say, for instance, that there is a right to rescind any contract of a certain type after ten years and leave it to national law to fix shorter terms. It is still easier to imagine that not all questions are subject to a default rule in the European Code – as is already the case, for instance, in the Sales Directive: there may be a duty to deliver goods in conformity with the contract, but the question of after-sale services may be left open. Theoretically, one could again imagine that the European Code treats only the questions where a concurring will of both parties is very much beyond doubt and that other questions are again left to national laws.

cc) Basic features of evaluation have to do with the advantage of the split named in mandatory substantive law. There the interplay reduced the danger of under-

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Geschäftsbedingungen', *Festschrift for E. Steindorff* (1990), 667, 669 *et seq.*; and from an economist's perspective: Schäfer and Ott (n. 4), 420–422.

88 See references at n. 49.

89 COM(2001) 398 final, p. 11 *et seq.* (paras. 29–32).

and of over-regulation equally. This is not a danger in facilitative law unless it becomes mandatory and has to be judged accordingly. On the other hand, the solution is complex and thus does not fulfil the cost reduction function of default rules ('*Reservevertragsordnung*') ideally. A full set of EU law, not reduced only to minimum rules, seems preferable in this respect. Moreover, the advantages of innovation and experimentation are less well used under a split competences solution where there is only one solution (EU) for one part than if there is full party choice between different sets of rules offered.

d) States having full decision power

aa) In *this situation* states could fully opt out of European default rules. They would not even be obliged to keep a core of it. The choice would not be left to the parties.

bb) Practical examples are likely in two forms (so far not in directives). A European Code could be drafted only as a model code – like the Uniform Commercial Code in the United States. States would be free to opt in. Basically this can be achieved by recommendations.[90] If, after having opted in, states may not opt out again, the solution is afterwards that of EU law only. States could also be asked to opt out, otherwise the European Code applies. In practical outcome, this solution would come close to that of EU law only again. A European Code could also cover only cross-border cases as the only model (EU law only), but also domestic transactions if states do not opt out of it or opt into it. The latter would always be possible. The former would again come close to an EU law only solution in practice also for the domestic cases. Under the CISG which certainly offers this possibility as well signatory states did not opt in so far. The combination described here is one of EU law only in some cases (the cross-border cases, less numerous) and states having full decision power in others (the domestic cases).

cc) Basic features of evaluation would have to be developed by comparing this situation with that of full party choice. In case of full party choice, the decision how to best serve individual preferences is with the party concerned. This solution probably also gives more incentives for experimentation and innovation. However, the state could opt for more uniformity in that he opts into the European Code abolishing his own law (and nevertheless serve as an innovator of last resort if EU law does not develop). This reduces complexity as compared

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[90] For instance, Recommendation 97/489/EC of the Commission of 30 July 1997 on transactions via electronic payment instruments (in particular as to the relationship between issuers and holders of such instruments), (EC) OJ [1997] L 208/52; see, however, 'Communication from the Commission to the Council and the European Parliament – electronic commerce and financial services', COM(2001) 66 final, 18 *et seq.*

to a party choice solution. The amount of complexity seems, however, not to be enormous, and therefore the advantages named of the party choice solution could easily be higher.

e) Parties having a choice

aa) Parties may have the choice of the set of default rules, first, in *cross-border cases.* This means simply extending the solution contained in article 3 of the Rome Convention on the law applicable to contracts:[91] a European Code would then be optional, i.e. it would constitute one more option (not EU law only). Then, in cross-border situations it would be likely that the European Code would be the default set of rules from which parties would have to opt out – as in the case of the UN Sales Convention. This would give parties equal access to the law from the beginning.

bb) A choice could be given also in *domestic cases.* Even without an optional European Code, there would be a further development also if other states' laws could be chosen without the limitations of article 3(3) of the Rome Convention on the law applicable to contracts. If there was an optional European Code the choice could either be given between this Code and internal state law or between the optional European Code and several or all state laws. The default set of rules, however, could only be the European Code or the internal law in both cases.

cc) Basic features of evaluation can best be given for a solution in which the European Code is the default rule in cross-border cases and the national set of rules in domestic cases. Minimum protection of third parties or of one party is not a dominant issue in facilitative law, nor is under- and over-regulation. This speaks for reducing complexity – because the cost saving aspect is paramount – and having several full sets of rules available for diverging preferences, thus also fostering innovation and experimentation. National rule making is legitimate if at all because the national legislator is closer to potentially diverging preferences. Moreover, having national law as the default solution in domestic cases helps to keep these sets alive. Having full sets (not split competences) both on EU and on the national level thus seems to be preferable for facilitative law. There is one tough question. This is whether full choice of law should also be given with respect to other national laws in purely domestic cases. Even for this choice, there are good reasons: in an integrated system of laws, cross-border cases where such choice would certainly be possible become 'normal' day-to-day life. Thus, parties should be prepared for options in each case. One would have to see whether such a solution (all states' laws can always be chosen) would go beyond

[91] See reference above at n. 30. This solution is already so universal (at least there are no more liberal conflicts rules abroad) that it is taken as given.

the capacity of court systems. An option between domestic law and the European Code should not.

V. SOME CONCLUSIONS AND EVALUATIONS

1. Designing European Contract Law as a Two-level System of Contract Laws

In section II we suggested that the problem of the future design of contract law in the EU should be conceived within a two-level system of contract laws, with both European and national contract law rules. In section III the main design dimensions of such a European system of contract laws were elaborated. By combining these different design dimensions many potential design options can be deduced. In section IV the most important of these design options have been analysed. Each of these design options were described and illustrated by legal examples, which already exist or are discussed. It was also given a short evaluation in form of the advantages and disadvantages of these options in comparison with other options. But these evaluations should not be seen as complete and exhaustive. An all-encompassing evaluation would have implied the assessment of these options in regard to all advantages and disadvantages that have been presented in section II. This is neither possible in one article nor was that the intention of this paper. The main intention was (1) to illustrate that the concept of a European two-level system of contract laws is very suitable to discuss the problem of centralised and/or decentralised contract laws in Europe in a productive way, and (2) to elaborate the most important design options of such a Europan system of contract laws – in the form of a mapping. Our, to some extent, preliminary evaluations of the design options in section IV should show how the criteria of section II can be used for the evaluation of these design options. But much more research is necessary before a well-considered proposal for the design of a whole European system of contract laws can be presented. However, we think that our analyses in section IV allow for two well-founded conclusions that we present in the following.

2. European Mandatory Law – Mainly Information Rules

Two mechanisms may well keep regulation at a balanced level between over- and under-regulation, considering also the risk of state failure. Mandatory substantive rules and mandatory information rules have to be distinguished.

a) Minimum on EU level, competition for more stringent rules

The first mechanism consists of properly allocating legislative powers. Regulation on the Community level and regulation on a national level are exposed to different degrees of pressure. The former needs to win in the discussion among

the 15 Member States, but it is exposed to less pressure. There is more competition if the players can move capital, products or other factors more easily. Certainly within an internal market this is easier than on a global level. Therefore regulation on the national level is under more pressure: in harmonised areas this is market pressure already within the Community because – as far as it reaches beyond the directive – it must not be imposed onto suppliers from abroad.[92] In the remaining areas not harmonised (the exception in contract law) there is at least justification or scrutiny pressure: regulation has to be justified by mandatory reasons of public good and this has to be ascertained by the Court of Justice as an independent body.[93]

For the question how to allocate legislative powers for regulating market failure, the line of arguments could be:[94] states (and supranational Communities) are at risk not to ascertain the risks of market failure correctly or to regulate it poorly or both. There is limited knowledge in both questions. And decision makers can be guided by other concerns than to find the most efficient solution (personal advantages, e.g. in elections).[95] Therefore, the risk of market failure has to be set off against the risk of state failure.

Having regulation on Community level only where the need and the tools used are almost unanimously consented in 15 states can serve as a mechanism against state failure. The Commission should deduce from this that regulation should be envisaged only if the consensus in expert (and benevolent) circles is broad. It should not propose regulation where the risk of error is considerable. This is so because there is still the possibility of regulation on national level. And on this level the risk of state failure is considerably reduced by the types of pressure named.

To sum up: regulation on the national level is subject to market and justification pressure to an extent which in the long run should efficiently do away with gross over-regulation. The risk of under-regulation (potential race to the bottom) remains and may justify regulation on the Community level. Thus, on the state level, although only the risk of over-regulation is subject to market and justification pressure the risk of under-regulation is reduced by the imminence of harmonisation. The more competition is distorted by under-regulation on the

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92 See text accompanying n. 48.

93 See text accompanying n. 51.

94 More in detail for the particular case of the European Community (discussing the role which the fundamental freedoms with the home country principle, the minimum harmonisation concept and the legislative procedure in the Community play for the concept of jurisdictional competition): see S. Grundmann, 'Wettbewerb der Regelgeber im Europäischen Gesellschaftsrecht – jedes Marktsegment hat seine Struktur', *Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR)* [2001] 783; W. Kerber, (2000) 23 *Fordham Int'l Law J.* S217, S228–S248.

95 See references above at n. 54.

national level the more the pressure for harmonisation increases. On the Community level the mechanism against over-regulation is weaker (reduced market and justification pressure). A real risk of under-regulation is minor as the states can regulate on a higher level and if they do so efficiently the scenario of rise to the top becomes likely. If the risk of over-regulation on Community level is really the one least taken care of by countervailing market or scrutiny pressure, the decision makers should be aware of it. Lean solutions should deliberately be preferred here.

b) Minimum on EU level typically information rules

The second mechanism is concerned with substance. According to the case law of the European Court of Justice, information rules have to be preferred to substantive mandatory rules whenever they grant sufficient protection.[96] This approach is very much also taken by the Community legislator. This is precisely targeted regulation which at the same time leaves space in substance for individual preferences, innovation and experimentation.

3. European Facilitative Law Supplementing, not Substituting National Facilitative Law

a) Advantages

European facilitative law supplementing, not substituting national facilitative law would largely serve the aims of uniform facilitative law, including the gains in transaction costs because of decreases in information costs, etc. At the same time, the core advantages of decentralised rule making would largely remain. These are, first, a serving of different preferences with different sets of default rules which are in the market and which are developed by bodies which have high potential in needs like thorough investigation, transparency to an interested public, high-quality personnel participating in the process. These are, second, that more experimentation takes place and thus more solutions are tested, reducing knowledge problems which any rule-making encounters because of the complexity of questions treated. And these are, third, the potential of innovation which is higher in a competitive situation – and be it only competition in prestige and in indirect and slowly developing advantages.[97]

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[96] See references above, n. 66.

[97] Indeed these factors seem to suffice. At least in company law, also under the seat theory, most reforms were apparently driven by concerns about competitiveness: see for the three big Member States and their last company law reforms C.P. Claussen, 'Aktienrechtsreform 1997', *AG* [1996], 481; P. Hommelhoff and D. Mattheus, 'Corporate Governance nach dem KonTraG', *AG* [1998], 249; J. Zätzsch and M. Gröning, 'Neue Medien im deutschen Aktienrecht – zum RefE des NaStraG', *Neue Zeitschrift für Gesellschaftsrecht (NZG)* 2000, 393; *Modern Company Law – For a Competitive Economy – The Strategic Framework – A*

The one difficult question, therefore, is whether more freedom should be given to the parties even in domestic cases.

b) Comparison with EU facilitative law only and/or with state law only

aa) A solution *EU law only* in facilitative law would considerably reduce some of these advantages. Even if the national laws were not used so often any longer they would still be there as an alternative – comparable to the considerable advantages of potential competition. In an EU law only situation, the potential of innovation, of testing different sets of knowledge embedded in different sets of rules and of serving heterogeneous preferences would be reduced. This is still more important (and the above reasoning, section 2, applies) whenever default rules become mandatory to a certain extent such as namely in the case of standard terms contracts (potentially only in consumer contracts).

Certainly, even if there was EU only high potential private law subjects could step in and procure the public with additional sets of default rules. These could be chosen under the freedom of contract offered by EU facilitative law. There is one concern though (irrespective of potentially stricter limits to freedom of contract). Such an initiative is not likely to come. The incentive for an international group such as the Lando Group would be reduced after the entering into force of a European Code. And even with the incentive given today, the group took decades for the drafts. Moreover, such drafts would have to build up case law and a potential of knowledge, now existing for national laws. This need is potentially too high an entry barrier. Thus probably no alternative set of default rules would successfully develop – excepting certain particular contracts by a legislator, such as the International Chamber of Commerce, which is perhaps less accepted generally (representation!) and declining in importance.

These advantages of a solution with national sets of default rules continuing to exist and with party choice have to be set off against certain disadvantages of such a two-level system. The main disadvantage is that of higher complexity, of having more knowledge to administer. This argument, however, never led anyone to propose that the alternative of different types of limited liability companies should be abolished and that one set of rules would be sufficient.[98] Moreover, the problems of complexity can considerably be reduced by the particular design of the choice (see section c below). Therefore, efforts should rather be invested in optimising the design of choice.

Consultation Document from the Company Law Review Steering Group (2/1999), passim; Y. Guyon, 'Présentation générale de la société par action simplifiée', *Revue des Sociétés* [1994], 207, 209.

[98] And this is the other huge field of the law in a market economy: see R.H. Coase, *The Firm, the Market, and the Law* (Chicago, Univ. of Chicago Press, 1988). Contract is the core tool of market.

bb) The reasons named against an EU law only solution apply partly also to solutions in which *states could decide that their facilitative law applies* instead of EU facilitative law.[99] This solution would be weaker than party choice solutions for the advantages of decentralised rule making. Other sets of rules could either be chosen under national freedom of contract – then, the solution would partly be that of party choice, but only private party rule setters would step in. Or the choice would be reduced in internal law – then different preferences would less be served, parallel experimentation and innovation would be reduced. Moreover and perhaps even more important, a state option solution would not even guarantee the advantages of centralised rule making either (which a party choice solution does in principle).

c) Opt in and opt out as refinement tools

The choice of opt in or opt out can influence complexity and also the question which advantage is stressed still a bit more.

Using EU facilitative law as the default rule in cross-border cases helps to build up case law and expertise for the EU set of rules. This is needed for having the advantages of centralised rule making. Moreover, both parties would be treated equally as to transaction costs. Complexity would not be higher than in an EU law only situation. There, standard terms would have to evolve for serving deviating preferences. It should be even easier to apply foreign statal default rules – typically only a few of them – than evolving (at best international) sets of standard terms.

In domestic situations, national facilitative law could be the default solution. This would keep the alternative lively and with it the potential of innovation and of parallel experimentation. The arguments named in favour of centralised rule making do not apply here. Parties would have equal access to the law, transaction costs would not be very high. And if there are differences in preferences, the local default rule has better chances to mirror the regional preferences. The only costs are those of administering two sets of default rules in each member state. Even if other national facilitative laws can be chosen, they are not default solutions and thus do not add much complexity.

VI. SUMMARY

1. a) This paper is concerned with option IV of the EC Commission's Communication on European Contract Law. Indeed, there is only the option either to keep the status quo (improving it gradually) or to introduce another kind of instrument. Among the options in Option IV, that of an optional

[99] Solutions in sections IV 4 c and d. The solution is in fact closer to EU law only if states have to opt out.

European Code, i.e. of leaving national contract laws to run parallel, is discussed in more detail. The idea is that in economic theory, it is virtually universally agreed that centralised rule making has advantages and decentralised rule making also has important advantages. Why, then, not combine both by establishing a certain mix. The *mix would be that of a European System of Contract Laws* – in the plural. It is a system, not a solution for transition. The system should be designed (and core elements are presented here) for keeping flexibility intact in a long-term perspective and to procure standardisation tools (through unification) nevertheless.

b) An efficient contract law that helps parties to solve transaction and cooperation problems and that contributes to the avoidance of market failures is an essential precondition for the workability of market economies. Contract law consists both of mandatory rules, which primarily have the task of reducing potential market failures, and of facilitative law, which should help the parties to enforce their contracts (*pacta sunt servanda*) and to reduce transaction costs by offering legal standard solutions (default rules).

c) For the future contract law evolution in Europe it is necessary to take into account (1) that in the EU already fifteen well-established national contract laws exist, and (2) that it is necessary that the contract law in Europe has the capacity to adapt to the ever-changing transaction and cooperation problems, i.e. that within the European contract law system the possibility of legal evolution by legal innovations is of great importance. From this perspective we want to suggest that the aim of ensuring an efficient and adaptable contract law within the EU can best be attained by establishing a *consistent two-level system of contract laws* in the European Union. Since both an entirely decentralised and an entirely centralised contract law system suffers from serious disadvantages, the basic idea is to design a European system of contract laws in such a way that the advantages of centralised and decentralised rule-making are cumulated and the disadvantages avoided as far as possible. This two-level system would encompass both mandatory and facilitative law. An important implication is that the future perspective of contract law in the EU should not be seen as the transition from national contract laws to one European contract law, but to one in the long run stable European two-level system of contract laws, within which the specific legal contract law rules can evolve.

d) As an analytical basis for assessing different design options for such a European system of contract laws, the most important *advantages and disadvantages of centralised and decentralised* rule-making are summarised. Static and dynamic economies of scale favour centralised rule-making. The same is true for the aim of reducing transactions costs. The heterogeneity of preferences and transaction and cooperation problems in different countries is a powerful argument for decentralisation. The emergence of externalities and inconsistencies

within a legal order is less likely in a centralised system. The serious knowledge problems about the best legal rules (including problems of local knowledge) and the necessity of adapting legal rules to changing problems are strong arguments for a decentralised system of legal rules, in which the capacity for legal innovations is larger due to the possibilities of decentralised experimentation and mutual learning. This argument is strengthened if a workable regulatory competition can be established within a decentralised system of law. Also, rent seeking problems might be solved better in a decentralised legal order. But in a centralised legal system there will be less problems of obstacles of trade and distortions of competition. Finally, the status quo situation in the EU with its well-established national contract laws has to be seen as a strong argument for a more decentralised system.

2. There are *two core design dimensions*. The first is how binding a contract rule is. There are default rules, mandatory substantive rules and also mandatory information rules. The latter are mandatory but leave the parties the possibility to design the content nevertheless. They therefore do not share the core characteristic of mandatory substantive rules which reduce the design possibilities to a small range or even to one solution only. In many cases, unfair contract terms law may render default rules mandatory to a certain extent. The second dimension is which body decides on the question which set of mandatory substantive, mandatory information or default rules applies to the particular case. It can be the Union (European Code substituting national laws), the states which have an option to make their law applicable (instead of EU law, Optional European Code), possibly also only above or below a minimum or a maximum level set by the Community (fundamental freedoms and directives or again an Optional European Code) or also the parties. The latter is yet another design of an Optional European Code. Within these dimensions, one can also place the distinctions cross-border cases only or also purely internal cases and opt in/opt out.

3. For all three kinds of rules one can distinguish four situations: a) EU law only, b) and c) an option for the states to opt into or out of EU law, possibly only above or below a minimum or maximum level set by the EU, and d) different types of party autonomy. In case of *mandatory substantive law*, this concerns mainly the minimum or the more stringent rules.

a) EU law only would be introduced with a European Code containing, for instance, mandatory substantive consumer protection. This would be basically new in Community law. Even in competition law, there is no EU law only approach. The disadvantages would be that of a restricted range of solutions and thus a restricted potential to serve diverging preferences, a restricted potential of innovation and of experimentation. The standardisation advantages of centralised rule making can be reached for the side of supply also by different means

and are less important for the side of demand with respect to substantive mandatory law.

b) EU maximum standards for national laws is the scenario of fundamental freedoms, minimum standards that of directives which allow more stringent national rules (in domestic cases). A full opt-out solution for states (section c below) would cut back on the *acquis communautaire*. Fundamental freedoms prescribe that states may not enact mandatory substantive rules whenever information rules would do. Conversely, there are not many substantive mandatory rules in contract law directives so far. Minimum regulation on EU level reduces the risk of under-regulation (by states and in the whole two-level system). If at the same time it concentrates on cases of market failure and rules reducing market failure which are undisputed, the risk of over-regulation is also considerably reduced in the whole system. Therefore, supermajority prerequisites and a careful comparative law discussion within the legislative process are welcome. Above the level universally consented, regulation is disputed. Now, in cases of knowledge problems competition is particularly important, here between the different states and their proposals for more stringent rules.

c) States laws substituting EU mandatory substantive rules is a solution which is not very likely. Core advantages of the split competences approach (section b above) would be given up. If indeed EU law regulation is restricted to rules universally consented the split competences approach could be structurally superior.

d) Party autonomy with respect to mandatory substantive rules can only mean choice between different sets of mandatory law. Three situations are of particular importance. As to more stringent rules, parties can choose under current fundamental freedoms doctrine between domestic supply under domestic law and foreign supply under the supplier's home country rules. The freedom would be extended if suppliers could tell under which law they want to act, perhaps imposing on them to offer also the alternative of their home country law. Indeed, those other laws can be offered in the market anyway already under current law by suppliers based in those other jurisdictions. It is less likely that a choice will be given also for the minimum set by the EU (or all rules). Those who can not or do not want to exercise their autonomy in a meaningful way enjoy enough protection if the domestic law standard is offered at all. For this purpose, local suppliers may need to remain forced to offer this standard for domestic supply. There is no need, however, that they may not offer in addition also under another national law. Other customers, potentially using information intermediaries, should have the option to choose foreign supply and foreign standards. Diverging preferences can better be served, the competitive pressure for innovation and experimentation is higher. The customer in need of conservative protection does not lose, the other customers can win. Therefore, one should allow

supply from abroad to act under his home country rule but also under a chosen rule of another Member State if this is made transparent.

4. *Mandatory information rules* are also mandatory, but very different in function. So far, most mandatory rules in European contract law are information rules.

a) EU law only would be introduced with a Code containing rules which prescribe the giving of information and the sanctions if the information is incorrect or incomplete. Already today, many rules in EU directives do not prescribe a minimum level only ('all material information' or certain items) but also a maximum level. This can well be, if information has to be given in a 'clear and understandable' way. EU law only in information rules does not have the same negative effects on the matching of diverging preferences, on the potential of innovation and experimentation, as the substance of the contract (law) is still open to choice. On the other hand, a uniform rule is here more important also for the side of demand, as information is given about the whole product now (clients being more interested in information about the product than about the law) and standardisation helps to compare.

b) That EU laws set a maximum level for national mandatory information is a very atypical situation. More important are more stringent national information rules. However, the proportion of mandatory minimum information rules (as compared to all mandatory information rules) is much lower than that of mandatory minimum substantive rules. The split competences solution is much better to defend for mandatory substantive law: there it is a tool to avoid over-regulation; information rules, however, are already rather lean and focused regulation (directly curing the information asymmetry). And on the other hand, in the case of mandatory substantive rules, standardisation was not so important for the side of demand and can be reached for the side of supply by other means. In information rules, standardisation is important also for the side of demand and can be reached only by uniform rules.

c) States laws substituting EU mandatory information rules is still more unlikely and – because of the reasons given above in a and b – probably not to be preferred as a solution.

d) Giving parties a freedom of choice as to mandatory information rules can again only mean that they can choose between different sets. Again the first choice is that under current fundamental freedoms doctrine parties can choose supply from domestic suppliers under the more stringent rules of domestic law or from foreign suppliers under the more stringent rules of the supplier's home country rules. The only reservation to be made is that more stringent information rules are not so often allowed at all. The other two options would again be parallel to those named for mandatory substantive rules (summary section 3d above). For two reasons, these options are less important than for mandatory

substantive rules: first, the freedom to design the content is left untouched, anyway – and with it the higher possibility of serving a large range of preferences and the higher potential of innovation and experimentation; second, prescribing disclosure of relevant product related information in contract law constitutes an almost universally accepted rule. Conversely, two-level complexity appears to be more problematic because comparability is a core quality of information which is better served by standardisation.

5. *Facilitative rules* (mainly default rules) allow in principle diverging party agreement which, however, does not profit from the cost advantages of the use of the default rules. Moreover, unfair contract terms law may render them quasi-mandatory.

a) This renders an EU law only solution questionable even in the case of facilitative law. The practical example would be a European Contract Law Code which substitutes national contract laws completely. In cross-border cases, an EU set of default rules helps at least one party to reduce information costs – in the long run it is cheaper to know one international set of default rules than many different foreign laws. Moreover it guarantees equal access. However, having only one set of default rules with statal origin means that only one type of preference structure is served, i.e. is given the cost advantages. Moreover, experimentation and innovation would no longer be carried forward for default rules by different statal – i.e. typically neutral and well equipped – legislators. If default rules are in fact mandatory (because of standard contract terms law), the considerations on EU law only in mandatory substantive law apply.

b) States having partial options is conceivable only in combination with EU minimum standards (fundamental freedoms do not apply to default rules). For default rules, even the split with minimum standards is difficult to conceive. Split competences are good in that they may equally reduce the risk of over- and of under-regulation. This is, however, no risk in facilitative law. Then the solution is too complex and thus not ideal for the (predominant) cost-saving function; moreover it does not have the advantages of full choice (see section d below).

c) States would have full options if an EU contract law code was enacted only as a model code. This solution could be chosen only for one part of the transactions (for instance the purely domestic cases) and be combined with an EU law only solution for other cases (those concerned with cross-border transactions). This solution is inferior to the party choice solution in that it is not the party concerned who decides about his preferences and potentially also with respect to experimentation and innovation incentives. If the state opts into the EU Code and abolishes his own state law, this may, however, reduce complexity.

d) If parties are given a choice, in cross-border cases this would be between the different states' laws (already happening today) and an optional European Code.

This latter would be default if one wanted to guarantee equal access to the parties and inspire life into such Code. In domestic cases national law would potentially remain the default rule and at least opting for the European Code should probably be possible. This solution allows for better serving of diverging individual preferences and maintains the potential of innovation and experimentation. Moreover, it is less complex than split solutions and thus better serves the cost-saving function of facilitative law.