Proposed Common European Sales Law

Preliminary position paper on Legal Basis

I Introduction

1. In October 2011 the European Commission adopted a proposal for a regulation creating a Common European Sales Law (“CESL”).¹

2. The Bar Council has voiced its reservations about the project throughout the 10 year period of EU institutional activity preceding the proposal’s adoption, whilst striving always to provide constructive input into the process. Our substantive reservations have, in recent years, been amplified by concerns about the process itself, and about the Commission’s choice of legal basis.

3. The Bar Council is currently reviewing the text of the October 2011 proposal, and will produce a position paper thereon. However, as a preliminary matter, it is our view that the Commission’s chosen legal basis, Article 114 of the Treaty on the Functioning of the European Union (TFEU), is not available for this proposal. The rest of this paper sets out the reasoning behind this proposition.

II The October 2011 proposal

4. The October 2011 proposal takes the form of a Regulation, preceded by an Explanatory Memorandum, and with attached to it an Annex, the latter forming the proposed Common European Sales Law (“CESL”). The body of the Regulation itself sets out the background and supporting arguments and its 12 articles provide the objective, subject matter, definitions; optional nature; scope of application and other basic principles.

5. The Commission claims that this proposal creates an optional, autonomous second national (sales) contract law regime, to be used initially in cross-border B2C contracts and B2B ones involving at least one SME. There is an inherent contradiction here: the proposed Regulation cannot be autonomous, and contained in an EU Regulation, and at the same time be accurately described as part of the national law of the Member States. The Commission’s Explanatory Memorandum and the recitals to the proposed draft Regulation, claim that the

CESL will be a “second contract law regime within the national law of each Member State” with a view to justifying the use of article 114 TFEU as its proposed legal basis. However, Court of Justice case-law, discussed below, makes it abundantly clear that the Regulation cannot be validly based on article 114.

II.1. **There is no legal basis for a CESL in article 114 of the Treaty**

6. The Common European Sales Law Regulation purports to be based on Article 114 TFEU. Article 114 provides, so far as material, that

> “Save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26. The European Parliament and the Council shall ... adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in the Member States which have as their object the establishment and functioning of the internal market.”

7. Article 26 TFEU refers to measures “with the aim of establishing or ensuring the functioning of the internal market”. Since Article 114 refers to “measures”, in principle any form of EU measure can be adopted. But a measure can only be adopted on the basis of article 114 if that measure is:

(a) “for the approximation of” national law or administrative practice; and
(b) “with the aim of establishing or ensuring the functioning of the internal market”.

*The proposed Regulation is not for the approximation of national law*

8. There is a well established line of European Court case-law which holds that creating a new legal form to exist alongside existing legal forms under national law rights does not amount to approximating national law and cannot be done under article 114. The case-law goes back at least to Opinion 1/94 (on the competence of the Community to enter into the TRIPS agreement) [1994] ECR I-5267, where the Court observed (at paragraph 59) that

> “at the level of internal legislation, the Community is competent, in the field of intellectual property, to harmonise national laws pursuant to article 100 and 100a and may use article 235 as the basis for creating new rights superimposed on national rights, as it did in Council Regulation (EC) No 40/94 ... on the Community trade mark”.

(The then article 100a was the predecessor to article 114; the then article 100, now article 115 TFEU, need not be further considered as it only gives power to adopt Directives. Article 235 was the predecessor to the current article 352 TFEU, giving the Council a residuary power, which can only be exercised by a unanimous vote, to take measures to attain a Treaty objective in the absence of specific power elsewhere in the Treaties.)

9. That statement by the Court has been repeated in subsequent cases. The context in which the Court was speaking in the passage quoted was intellectual property law; the Court was drawing a distinction between the harmonisation of national intellectual property
law – which could be done under what is now article 114 – and creating “new rights superimposed on national rights”, which could not be done under article 114. The same distinction has been applied in subsequent case-law on patents, and the unavailability of article 114 as a legal basis for creating European law forms of intellectual property was recognised by the Member States when they introduced, by the Lisbon Treaty, a new legal basis for measures creating EU intellectual property rights in article 118 of the TFEU.

10. The same distinction as was drawn in Opinion 1/94 was drawn in the different context of the creation of the European Co-operative Society in Case C-436/03 Parliament v Council [2006] ECR I-3733. In that case the Court held that a Regulation creating a European form of co-operative society to exist alongside national co-operative societies was correctly adopted on the basis of the residual power in what is now article 352 TFEU and could not have been based on article 114.

11. For the purposes of this present paper, it is not proposed to set out the Court’s reasoning in detail, but the reader is referred to paragraphs 37 – 46 of the Court’s judgment which analyses the pertinent characteristics of the proposed European Cooperative society.

12. In summary, and based on that analysis, the Court found that the European Co-operative Society was a new legal form; it existed alongside co-operative societies formed under national law, which was “left unchanged” (paragraphs 43 and 44); it had its own specific characteristics, referred to in paragraphs 41 and 42. It left some matters to be governed by local national law, but these were “of a subsidiary nature” (paragraph 45) and moreover, the subsidiary national law was not harmonised by the Regulation.

13. That analysis is directly applicable to the proposed Regulation on the CESL. Its title – “Common European Sales Law” – accurately describes what it is: a proposed common code of sales law, to be enacted in the EU legislative form of a Regulation and to co-exist with national contract law.

14. The preamble to the proposed Regulation refers to the CESL as a “single uniform set of contract law rules” (see recitals 6 and 8 and article 1). It can only be a single uniform set of rules across all the Member States if the terminology it uses is given an “autonomous” meaning, independent of the meaning ascribed to the same or similar terms in national law; accordingly, recital 29 recites that

“the rules of the Common European Sales Law should be interpreted autonomously in accordance with the well-established principles on the interpretation of Union law2. Questions concerning matters falling within the scope of the Common European Sales Law which are not expressly settled by it should be resolved only by interpretation of its rules without recourse to any other law.”

15. The self-contained nature of the CESL is reinforced by draft article 11, which provides that:

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2 The description of the CESL here as a piece of Union law is, moreover, inconsistent with the claim, discussed at paragraphs 17 to 21 below, that it will exist ‘within each Member State’s national law’.
“Where the parties have validly agreed to use the Common European Sales Law for a contract, only the Common European Sales Law shall govern the matters addressed in its rules. Provided that the contract was actually concluded, the Common European Sales Law shall also govern the compliance with and remedies for failure to comply with the pre-contractual information duties.”

16. The new code of contract law is fairly – though not completely – comprehensive. Recital 26 says that “the rules of the Common European Sales Law should cover the matters of contract law that are of practical relevance during the life cycle of the types of contracts falling within the material and personal scope”. This echoes recital 6, which says that the “uniform set of contract law rules should cover the full life cycle of a contract and this comprise the areas which are most important when concluding contracts. It should also include fully harmonised provisions to protect consumers”. A number of areas are left to be regulated by local national law (some are mentioned in recital 27) but, as with the European Co-operative Society, these are portrayed as subsidiary and, moreover, there is no harmonisation of the national law in these areas.

17. Accordingly, just like European intellectual property rights and the European Co-operative Society, the Common European Sales Law will exist alongside national codes of contract law, which will be unaffected by it. Proposed recital 9 recites that the “second regime should be identical throughout the Union and exist alongside the pre-existing rules of national contract law”. Section 3 of the Explanatory Memorandum, discussing the principle of proportionality, emphasises that:

“The Common European Sales Law will be an optional regime in addition to pre-existing contract law rules without replacing them.”

18. In what appears to be an attempt to circumvent the case-law discussed above, the Commission’s terminology has altered over the lifetime of the project. Whereas it was once content to refer to the CESL as a “28th regime” additional to the national contract laws of the 27 Member States, the preamble to the proposed Regulation goes out of its way to insist, in somewhat laboured language, that the Regulation:

“harmonises the contract laws of the Member States not by requiring amendments to the pre-existing national contract law, but by creating within each Member State’s national law a second contract law regime for contracts within its scope”

and that:

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“the agreement to use the Common European Sales Law should therefore not amount to, and not be confused with, a choice of the applicable law within the meaning of the conflict-of-law rules”.

19. The Regulation cannot turn itself into a Regulation that harmonises (or, in the language of article 114, ‘approximates’) national law simply by claiming in its preamble that that is what it does. Whether it does so or not is an objective matter to be ruled upon if necessary by the Court of Justice.4

20. The question therefore remains whether the proposed CESL Regulation approximates national law. It does not, for reasons already mentioned: it leaves the separate national laws of contract untouched. The claim is made that it approximates national law by “creating within each Member State’s national law a second contract law regime”. The proposition that the Regulation creates the CESL “within each Member State’s national law” is presumably intended to displace the conclusion that it is (in the words of the European Co-operative Society judgment, quoted above) “a new legal form in addition to the national forms of [contract law]”.

21. However, the claim that the CESL is created “within each Member State’s national law” does not displace the conclusion that it is a new legal form in addition to the national systems of contract law, which is plainly what it is. The proposition is, moreover, at best misleading and at worst inaccurate.

22. In EU law a dichotomy is traditionally observed between national law and EU law; it is present in the terms of article 114 itself when it refers to measures (i.e. measures of EU law adopted under the article itself) for the approximation of provisions laid down by law, regulation or administrative action in the Member States (i.e. national law). The proposed Regulation, if it were adopted under article 114, would self-evidently be a measure of EU law having no impact upon national law (because it leaves the national systems of contract law untouched, as demonstrated in paragraphs 14 to 17 above).

23. Because it would be a Regulation, to which article 288 TFEU would apply, it would be “binding in its entirety and directly applicable in all Member States”; national courts would apply it, just as they apply other provisions of EU law that are relevant to a piece of litigation, such as for example Regulation 593/2008 (the ‘Rome I Regulation’ on the law applicable to contractual obligations) or Regulation 864/2007 (the ‘Rome II’ Regulation on the law applicable to non-contractual obligations). But they would be applying it – as with those two other Regulations – pursuant to their duty to give effect to EU law.

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4 “In the context of the organisation of the powers of the Community the choice of the legal basis for a measure may not depend simply on an institution’s conviction as to the objective pursued but must be based on objective factors which are amenable to judicial review”: Case 45/86 Commission v Council [1987] ECR 1493 at paragraph 2. For example, the preamble to Directive 98/43 claimed that the Directive removed obstacles to the single market; objectively the Directive not do so and the Court annulled it: Case C-376/98 Germany v Parliament and Council [2000] ECR I-8419.
24. A further obstacle to adopting the proposed Regulation under article 114 TFEU is that a measure can only be adopted under that article if it genuinely has the object of removing obstacles to the internal market. Again, the Court of Justice will verify whether this is the case (an example of a measure which failed the test is Directive 98/43, referred to in the footnote to paragraph 19 above). In the *European Co-operative Society* case the Court has expressed the relevant requirements of article 114 as follows:

38 Article [114 TFEU] empowers the Community legislature to adopt measures to improve the conditions for the establishment and functioning of the internal market and they must genuinely have that object, contributing to the elimination of obstacles to the economic freedoms guaranteed by the Treaty, which include the freedom of establishment (see, in particular, Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419, paragraphs 83, 84 and 95, and Case C-491/01 *British American Tobacco (Investments) and Imperial Tobacco* [2002] ECR I-11453, paragraph 60).

39 Recourse to Article [114 TFEU] as a legal basis is also possible if the aim is to prevent the emergence of obstacles to trade resulting from heterogeneous development of national laws; the emergence of such obstacles must, however, be likely and the measure in question must be designed to prevent them (see, to that effect, *Spain v Council*, paragraph 35; *Germany v Parliament and Council*, paragraph 86; *Netherlands v Parliament and Council*, paragraph 15; and *British American Tobacco (Investments) and Imperial Tobacco*, paragraph 61).

25. The proposed Regulation will not remove obstacles to inter-state trade, as required by Article 114 TFEU. At the heart of the Commission’s justification for a CESL is the alleged barrier to cross-border trade caused by divergences in national laws. This is said to place “high costs” on traders to find out what the law is in the foreign states in which they wish to trade, and may even cause them not to trade in foreign states at all.\(^5\) It is argued, therefore, that having an alternative common European sales law which parties can choose to regulate their relations will do away with these costs, which provide an unnecessary barrier (or obstacle) to cross-border trade.

24. A significant flaw in this deceptively simple narrative, however, is that not only are some of the substantive provisions of the CESL (e.g. those concerned with good faith) likely to impose even greater legal costs than those which the proposal seeks to avoid – e.g. necessitating legal advice on what will likely need to be done in order to satisfy the obligations imposed by the CESL (not to say still larger costs when those issues fall to be resolved in legal proceedings) – but it is not even the case that the CESL will do away with important differences between national laws which may impact upon cross-border sales contracts which parties have entered into on the terms of CESL. This is because, although the CESL is heralded as providing for “a single uniform set of harmonised contract rules”\(^5\)

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\(^5\) See, e.g., EC Green Paper COM(20100348 final, paras. 3, 3.1; Results of Feasibility Study, pp. 1, 3-5; Proposal for a Regulation on a Common European Sales Law (COM 2011 635 final), pp. 1-4
(Proposal for a Regulation on a Common European Sales Law (COM 2011 635 final), p. 9), a closer examination of the proposal makes clear that this is not the case.

25. This arises because, even were the proposed Regulation implemented, it does not lay down a common set of rules governing all aspects of the legal relationship which the parties to a sales contract enter into. Identifying the full gamut of these continuing “gaps” is not easy because the text of the CESL does not expressly identify the areas of law which fall outside its province. One has to deduce what they are, therefore, from the absence of any specific provisions dealing with them in terms. In one of the preparatory texts, however, it has been acknowledged that questions of capacity, representation (which is understood to refer to agency) and assignment are not covered by the proposal. In another, gaps are again referred to: this time, however, illegality, as well as representation.

26. Even if the areas already identified as not being covered by the CESL (and so still being governed by the differing national laws of Member States, even when two parties opt to apply the CESL to their contractual relationship) were the only aspects to fall outside the alleged “single uniform set of contract rules”, it will be appreciated that they significantly undermine the argument that the CESL will increase cross-border trade by doing away with the need to investigate the content of other countries’ national laws. Particularly if a trader is selling products likely to be attractive to the young, it will still need to be apprised of the national laws of the countries in which it wishes to trade concerned with when someone has full capacity to enter into a contract, and what the remedies may be when a party falls below the age of full capacity. In the case of traders who are SMEs, they may still need to know who they can safely deal with as having authority to represent and bind the company with which they are dealing, and what remedies they may have if it is not the case. If it is the practice of an SME to encourage cash flow by factoring its debts, it (or its factor) will still need to know the circumstances in which the trader’s debt can safely be assigned without being subject to a potential defence being raised by the purchaser. Traders will also still need to be alive to the differing circumstances in which a contractual transaction may be held to be illegal by the laws of another country and, if so, what the consequences of that are.

27. It might be thought that this issue of illegality has especial potential to cause legal complications which bedevil contracts subject to the CESL. Illegality is a notoriously complicated area of the law in terms of deciding when the enforceability of a contract is adversely affected by infringing some statutory provision or some perceived public policy, and what remedies the parties may still have in such circumstances. Across the EU, there are doubtless significant differences on both aspects of this question. In the recent Advice to the Government given by The Law Commission and The Scottish Law Commission (“An Optional Common European Sales Law: Advantages and Problems”), it is pointed out that, although there are some things which everyone will recognise as being illegal, difficulties come when particular goods are not obviously illegal, but may be so in a particular State (e.g. it is unlawful to bring pepper spray into the UK, but not so in other States), or when goods may not be sold to specific classes of people (e.g. in the UK, but not universally elsewhere, tobacco and glue cannot be sold directly to children). On top of all this, national

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6 Results of Feasibility Study, p. 6
7 Proposal for a Regulation on a Common European Sales Law, in the Explanatory Memorandum, at p. 6
laws can differ over the circumstances in which one or both parties can still enforce a contact which is prima facie illegal, or seek some other relief.

28. Our concerns as regards the legal uncertainty that would accompany the application of the CESL, and thus the reason why we do not believe that the proposal fulfils the requirement of Article 114 that it remove obstacles to the Internal Market, can thus be summarised in a few simple questions:

- How does the CESL fit into existing national/ EU/International Private, law?
- How are lawyers to advise on the interpretation of terms such as “good faith and fair dealing” without recourse to national law, nor to any existing body of jurisprudence, nor even any non-binding guidance?
- How are judges to arrive at decisions thereon?
- What court will have the final say on interpretation and how will it/ they cope?
- In its response to the Feasibility Study, the Bar made the point that autonomous interpretation of an EU law can only be provided by the Court of Justice of the European Union (ECJ). The ECJ has not, hitherto, fulfilled the role of final arbiter in respect of a sector-wide measure of private substantive law, and it is not clear to us, how, as presently constituted, it could efficiently do so.
- Moreover, references to the ECJ for a preliminary ruling are, intrinsically, costly in time and money. Yet, unless such references are pursued, the law will remain uncertain, and interpretation of the instrument will inevitably diverge as between the Member States over time.
- How are businesses to predict the effect of the applicable law in areas that the CESL does not cover – e.g. agency; legal capacity?
- What will be the advice in the event of conflict between the CESL and a provision of national law that applies to the contract alongside it?

29. In the above circumstances, and even if one accepts the premise (for which there appears to be little direct empirical evidence) that differences in legal systems give rise to a significant barrier to cross-border trade because of the costs of investigating the national laws of other countries, it is far from clear that the proposed common European sales law will do away with the need to investigate significant areas of national law where differences will still remain. The failure of the CESL even to identify those aspects of law potentially affecting a contract which the CESL does not purport to regulate only makes the position worse.

30. In summary therefore, the Bar Council considers that the Commission not merely should not have chosen Article 114 as the legal basis for this proposal, but cannot do so.

13 January 2012