

Desirability of European Contract Law

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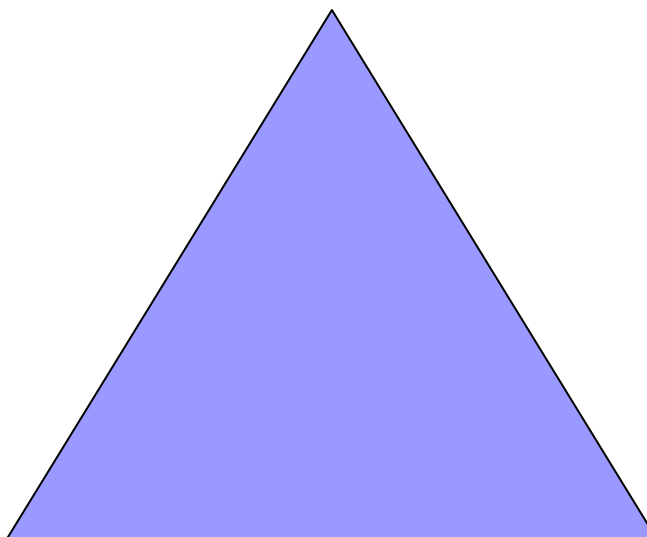
Brousseau & de Figueiredo 2008



Oliver Williamson



S. Masten

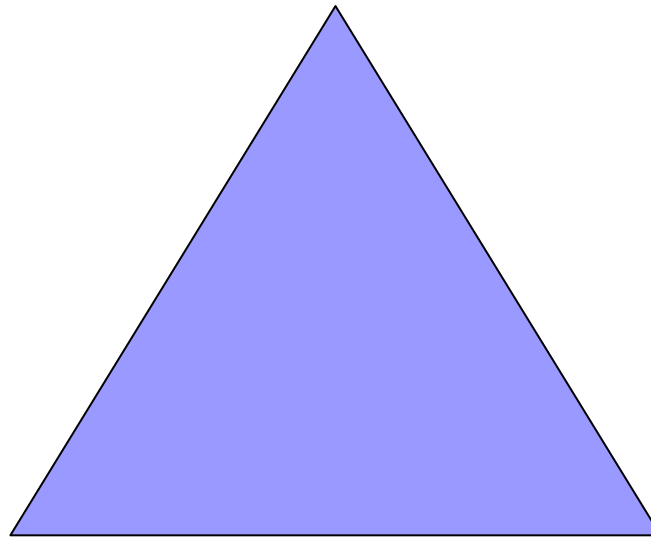


Open Position

With a crowd of holy brothers and sister

The Power of Threes

What I'm going to tell you



Tell you

What I've told you

Overview

- Background: European Contract Law
- Why? The standard view and what's wrong with it
- Economic analysis
 - An empirical attempt
 - Theoretical contribution
 - Guest stars: our morning lecturers

Background

- Contract law is for Member states, not EU
- BUT:
 - Ten EU directives touching upon certain aspects of contract law, and nine more on related areas
 - Soft law: EC Communications and Action Plan, EP Resolutions
- Legal basis: removing obstacles to the functioning of the internal market (differences in national law)
- “Common Frame of Reference” - CFR (i.e. a EU Code)
 - Drafted by law scholars – not law!
 - May become law
- What for?
 - Reviewing and systematising the *acquis* (existing EC law)
 - Model for national law makers and/or private parties
 - ...maybe an “optional instrument” (i.e. a Code)

What's the problem?



Guest Star: Jackson Nickerson: A solution in search of a problem?

- Do we need a supranational law governing contracts when we have already national laws?
 - Why centralisation?
- Contractual parties are free to choose the applicable law anyway
 - Role of EU code in economic relationships?
- What should European Contract Law be like?
 - Function of contract law?
 - Design of European Contract Law?

Answers



■ EU Commission:

- “Better regulation [...] means remedying legislative inconsistencies, and removing obstacles to the internal market arising from variations between national legal systems.”

■ EU Parliament:

- Not only better regulation. It’s a step towards a full-blown European Civil Code, whose adoption must however be a political, not academic or administrative decision. It should deliver: high consumer protection, SMEs protection, harmonisation (to make the internal market function) while respecting legal traditions and European social model.

Academics (comparative law)



European Contract Law will reduce cross-border transaction costs, but this is not all that matters: the most important goal of this exercise is to deliver “high quality” contract law. It will be useful for parties and lawmakers and will help creating a “European culture”

Summarising: European Contract Law – why

- One Europe, one Contract Law
- Reduction of cross-border transaction costs
- Supplying high-quality contract law
- Remedying legislative inconsistencies
- Protecting consumers
- Enhance consumer welfare
- Contributing to freedom and social security of EU citizens
- Create European culture
- Solve climate change

But...

- Besides sounding nice: why one EU requires one ECL?
- What are we trading off to achieve centralisation?
- What costs are we talking about?
- What is high quality contract law?
- What's the function of European contract law?
- Is European contract law supposed to do all?
- If there's a conflict of goals, how do we decide which one prevails?

How economics can help

→ Economists asked to perform a broad impact assessment

- Empirical approach
- Theoretical approach



Empirical approach

- ***Guest star: Peter Murrell: economic impact of changes in institutional setting***
- What is the economic impact of legal divergence?
- What is the impact of *alternative* legal rules?
- How do changes in rules impact on the economic environment?
 - How do economic operators respond to changes in legal rules?
 - What's the impact on trade flows? On economic indicators?
- Problem: no data available
- Example: survey

Clifford Chance (2005)

- 175 companies surveyed
 - 8 countries
 - 7 sectors (transport, healthcare, manufacturing, energy, etc.)
 - 34 SMEs
- Qualitative research (perceptions, opinions)
 - Are there obstacles to trade, to what extent they discourage trade, how do you see a European instrument, would you choose it for your contract, what matters most to your business

Table 1: To what extent do obstacles to cross-border trade exist between EU member states?

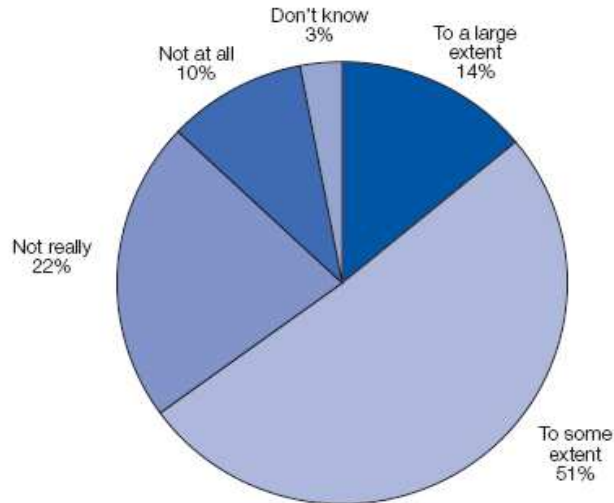


TABLE A5

Of those who considered that there are obstacles to cross-border trade in the EU, how often did the obstacles and their financial impact deter them from conducting cross-border transactions? – By country and size

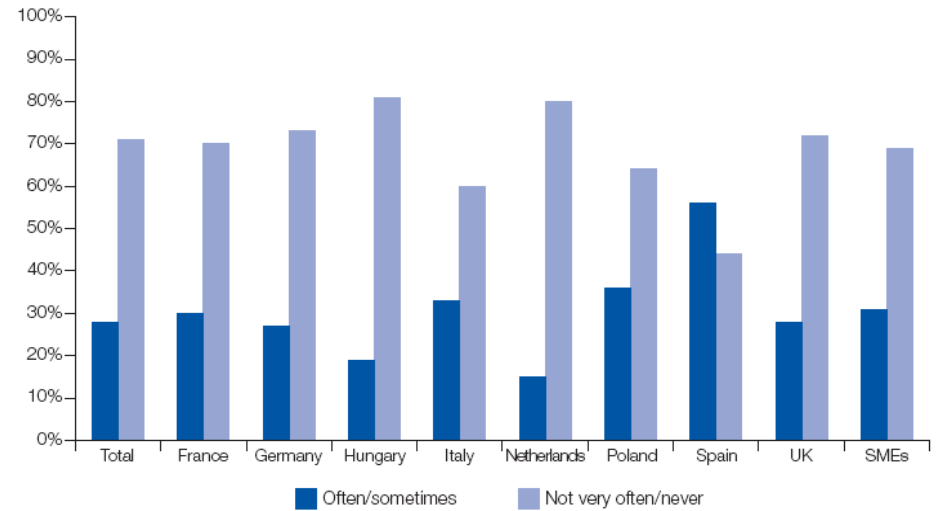
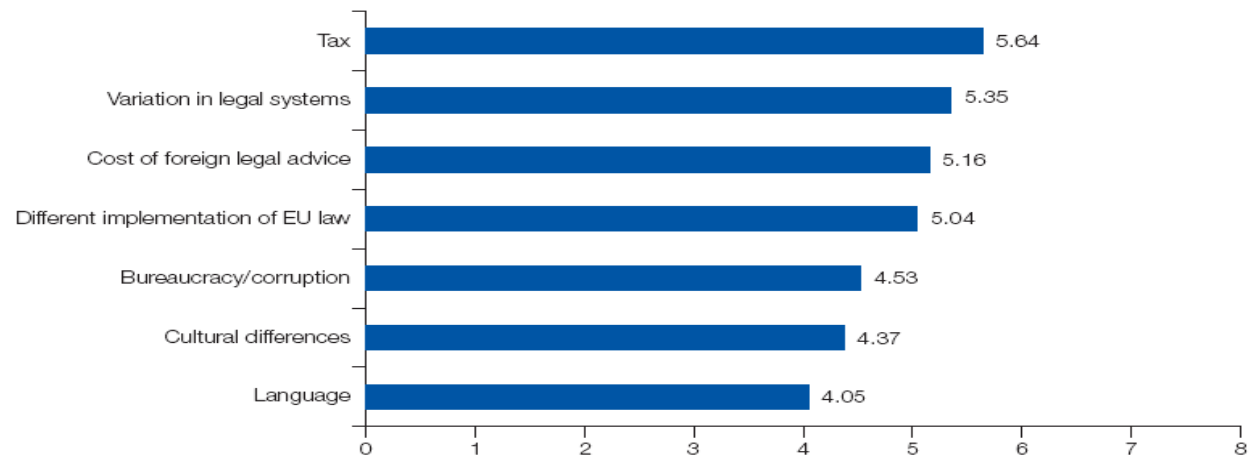


TABLE A11

Of those who considered that there are obstacles to cross-border trade in the EU, how much do the following factors impact on your ability to conduct cross-border transactions? – Average scores (standard deviation) by country and size (1 = no impact, 10 = high impact)



Results

- There are extra costs for cross-border transactions
- Differences in legislations matter – to some extent, but trade is discouraged only in a limited number of cases
- What matters most is the ability to choose the law applicable to the transaction

Problems

- Why Centralise?
 - Actual magnitude of cross-border TC in commercial contracts?
 - Costs of changing the current system for a European one?
 - Only costs savings or do we gain something?
- Role within multi-level governance structure?
- Design of the new European system?

A Theoretical Contribution



- **Guest star: Scott Masten's questions: why contract, design of contracts**
- Why we need European Contract Law and what it should be like are interdependent questions
- To fulfil the function of contract law:
 - What's the most appropriate regulatory level
 - What is the best rule ("good quality" European contract Law)
 - How does the whole (multilevel) legal system contribute to it?
- Which evaluative criterion?

Let's go back to the lawyers



- Normative criterion: 'aims' of European Private Law
 - include '*at least*': justice, freedom, protection of human rights, economic welfare, solidarity and social responsibility, promotion of the Internal Market, preservation of cultural and linguistic pluralism.
 - Moreover: Rationality, legal certainty, predictability and efficiency
- Method:
 - based on national experiences and existing EU legal principles, choose rules "best suited to the economic and social conditions in Europe"

Contrast the Economic Method

- ***Guest star: Ken Binmore: fairness for equilibrium selection***



- Evaluative criterion: welfare maximisation
- Consequentialist method
 - “helps developing alternative legal proposals, helps ascertaining their consequences and assesses which consequences best advance the established ideals”
 - Economic analysis does not choose ideals
 - Not about irrelevance of justice/fairness
 - Warns against risks of a rights-based approach and of valuing consistency/coherence in itself

Economic theory and European Contract Law



Guest star: John Wallis: Third party enforcement

- Contracts: tools at private parties' disposal to regulate their relationship when certain risks are connected to an exchange
- Contract law – and the whole legal system – help making private commitments credible
 - Complementarity of contracts and law
- Cooperation produces gains for society
 - Doesn't mean *duty* to cooperate (found in a number of legal systems)

How contract law maximises welfare

- Cooter & Ulen
 - induce cooperative behaviour, optimal disclosure of information, optimal performance, optimal reliance,
 - minimise transaction costs of negotiating (by supplying efficient default rules)
 - foster long-run relationships (hence reducing the very need of a contract).

- R. Posner
 - prevent opportunism;
 - interpolate efficient terms;
 - prevent avoidable mistakes in the contracting process;
 - allocate risk
 - reduce the costs of legal disputes

Good quality

- Creating value for society
 - Effects of law on (comprehensive set of) incentives
 - Which contracts must be enforced
 - Awareness of trade-offs

- Different economic rationales for different rules
 - Correct market failures – regulation
 - Cost reduction/gap filling
 - Information disclosure

- Minimisation of costs from market imperfections, coordination failures and regulatory costs

Optimal regulatory level

- Opening up the black box of “legal culture”
 - Lawyers have a monopoly on own “legal culture” and seek to protect it by rising barriers to entry
- Divergence in existing legal systems is not fortuitous
 - Local preferences within a jurisdiction, Information imperfections, Path dependency and Interaction with other parts of legal system, Pressure from interest groups
 - When is that wrong? → Depends on costs *during interactions*
- Harmonisation (centralisation) not a value in and of itself (*NB for lawyers in the room: see also EU Court*)

Optimal regulatory level

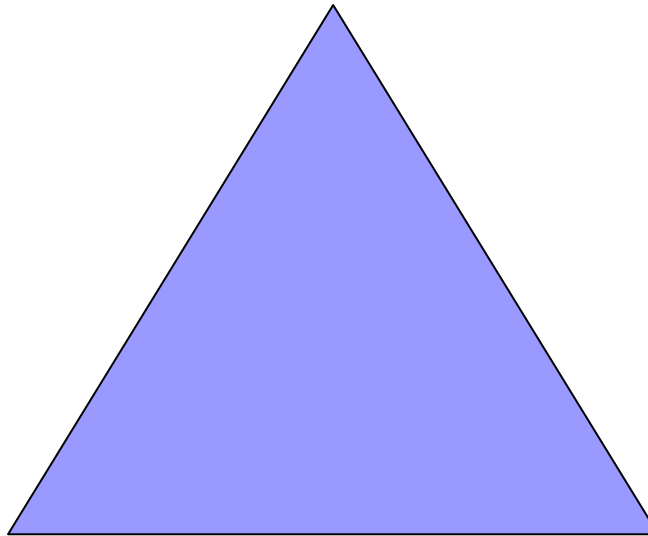
- Benefits of centralisation (harmonisation)
 - Economies of scale/scope in legal reform
 - Transaction cost reduction
 - Trans-boundary externalities
 - Network effects/Technical standardisation
 - Reducing information asymmetry
- Costs of centralisation
 - Satisfaction of preferences → mis-implementation
 - Legislative costs
 - Costlier enforcement
 - Experimentation

Optimal regulatory level

- Comparative efficiency of different convergence levels and mechanisms
 - Shock therapy
 - Piecemeal approach
 - Regulatory competition/emulation
 - Procedural harmonisation (private international law)
 - Facilitative institutions (example: ECN)
 - Body of optional rules
- For different issues, different coordination problems and heterogeneous needs, the optimal level and mechanism of centralisation may be different
- Optimal regulatory level and “good quality” are part of the same assessment

The Power of Threes

3 slides left



3 lessons

3 questions

Three Lessons

- Everybody talks about transaction costs (and forget everything else)
 - No use of hiding behind “culture” or technicalities
- Economic analysis can help solving methodological hiccups and shed light on substantive issues
 - Empirical research needed
- Determining the optimal design of (European) contract law (regulatory level, role and substantive rules) is a holistic assessment
 - Dealing with centrifugal (divergence) and centripetal (convergence) forces is about trade-offs – at each level, for each problem

Three Questions

- Peter Murrell: Big Bang or Evolution?
 - “Creeping centralisation” or new EU instrument?

- Ken Binmore: Fairness to govern European contract law?
 - Good faith? Consumer contracts?

- Scott Masten: Keep courts out of my contract
 - Does (European) contract law matter at all?

Law... and Economics



- **Guest star: Michele Boldrin: my copy is different from your copy**