Studies in European Economic Law and Regulation 3

Kai Purnhagen
Peter Rott *Editors*

Varieties of European Economic Law and Regulation

Liber Amicorum for Hans Micklitz

Springer

Studies in European Economic Law and Regulation

Volume 3

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ISSN 2214-2037 ISSN 2214-2045 (electronic)
ISBN 978-3-319-04902-1 ISBN 978-3-319-04903-8 (eBook)
DOI 10.1007/978-3-319-04903-8
Springer Cham Heidelberg New York Dordrecht London

Library of Congress Control Number: 2014939612

Printed on acid-free paper

Springer is part of Springer Science+Business Media (www.springer.com)

Foreword

It is easy to honour an academic such as Hans Micklitz. The list of contributors and the richness of contributions to this book prove the obvious: The jubilee has earned and still earns manifold merits among young and established scholars. There is hence no need for songs of praise, we simply let the contributions speak for themselves.

What is needed to address here, however, is the need for a *liber amicorum* for Hans Micklitz. There is criticism that needs to be taken into account. Some of them target the tradition of Festschriften as such. Ingo von Münch once complained that those Festschriften seldom contained original scholarship; they would rather be a vanity fair for the authors, editors, and jubilees.[1] The other issue may be the timing—Hans Micklitz celebrates his 65th birthday, while he is still fully integrated into the European University Institute as Head of Department of Law with no sign of resting and no prospect of retiring.

A humorous answer to the issue of timing would be: If we waited until Hans' retirement, we might never be able to hand over this *liber amicorum* to him in person. But then, the answer to why we nonetheless ignored all that and decided to organise this *liber amicorum* is simple: We had no idea what else we could present to Hans Micklitz on his 65th birthday but true and excellent European legal scholarship, firmly rooted in the realities of life. And this is also the reply to the other potential critique: This book is not the type of Festschrift that Ingo von Münch may have had in mind, it is a true *liber amicorum*, a present from friends to Hans Micklitz. It is also a mix of true European scholarship by most distinguished and established scholars and youngsters alike. A book which shall be interesting not only for those who honour the work of Hans Micklitz, but for all who have an interest in academic debate on most timely topics of European Economic Law and Regulation.

The contributions were due on 1st of December 2013.

Kai Purnhagen
Peter Rott

[1] I von Münch, 'Das Festschriftwesen und –unwesen' (2000) *Neue Juristische Wochenschrift* 3253.

Hans Micklitz: An Homage

An academic career presents many opportunities for growth, both intellectual and personal. There are the countless conferences, articles, books, and events which supply the opportunity for dissemination of ones ideas. Over time, the accumulation of professional experiences makes for an enriched and enervating life. I have had my share of these experiences. Some of my best moments—times when I felt I had obtained real insight—were with Hans Micklitz.

In 2009, I joined the Law Department of the European University Institute. At the time, I knew the academic reputation of Hans Micklitz (we are both private lawyers) but had not yet met him. Our first event together was a dinner welcoming the new PhD researchers in the law department. As luck would have it, I needed a ride back to Florence from the countryside Tuscan villa where the event was held. In the hour we spent together returning to Florence, Hans and I spoke of our formative intellectual years. We had much in common. We spoke of Marx on Hegel on law, the theory of the State, transnational law, and the need for interdisciplinary post-graduate legal education. It was a thrilling start to what has been an amazing five years.

During our time together in Florence, I have had the privilege of teaching seminars with Hans, attending conferences and discussing our several mutual interests. I have never met a person more gifted in argument, sensitive to nuance, and more generous with his time and thought. Hans is the genuine article: a scholar's scholar. As the contributions to this volume demonstrate, he is held in the highest regard by his peers.

We live and work at a time when the law and legal theory are in flux. The Westphalian Nation State has evolved to the point where the national has given way to the transnational. Hans Micklitz has been at the forefront of scholarship assessing and evaluating the changing nature of law in a variety of transnational and post-national contexts. His work has had wide influence and will continue to do so. Everyone who writes on these subjects reads Hans' work.

I close with a personal reflection. Hans is selfless in the time he devotes to making better the lives of all around him. No one accomplishes anything alone. For myself, it is with the utmost gratitude that I acknowledge the importance of his

devotion to our work and ideas. I have learned so much from Hans. The last five years have been unlike any period in my professional life. I look forward to the future, knowing that Hans will continue to be a strong influence and a great friend. I thank him for all he has given me.

Chair in Legal Theory and Legal Philosophy Dennis Patterson
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Part I
Foundations of (Private) Law

Chapter 1
Three Views on Negotiation—An Essay Between Disciplines

Stefan Grundmann

Abstract The paper discusses a core feature of contract law—negotiation and the justificatory role which consensus resulting from it can claim. The paper does so by discussing and confronting three seminal texts stemming from three of the most relevant disciplines in this respect: law (legal theory), economics and behavioral sciences. The underlying—and explicitly discussed—rationale of this approach is that *broad* interdisciplinarity (not just law & *one* discipline) is required, preferable, and indeed fruitful. Such broad interdisciplinarity is still not an approach generally used in law and—as applied to particular and concrete (!) core questions—would need to be developed.

1.1 Introduction

Son of German refugees, Hans Micklitz has lived an adventurous life, in which prominent elements have been intellectual adventure and discovery. He has always navigated his way between disciplines: between public and private law[1], between substance and remedies, as well as procedure[2], and, of most interest here and

[1] Most recently and prominently: H-W Micklitz (ed), *The Many Concepts of Social Justice in European Private Law* (Cheltenham, Elgar, 2011); B de Witte and H-W Micklitz (eds), *The European Court of Justice and the Autonomy of the Member States* (Cambridge, Intersentia, 2012); I Benöhr and H-W Micklitz, 'Consumer Protection and Human Rights' in G Howells, I Ramsay and T Wilhelmsson (eds), *Handbook of Research on International Consumer Law* (Cheltenham, Elgar, 2010); H-W Micklitz, 'Consumer Rights' in A Cassese, A Clapham and JHH Weiler (eds), *European Union—the Human Rights Challenge, Human Rights and the European Community: The Substantive Law* (Florence, European University Institute, 1991) 53.

[2] Rather recently and again very prominently: F Cafaggi and H-W Micklitz (eds) *New Frontiers of Consumer Protection—the Interplay between Private and Public Enforcement* (Cheltenham/Northampton, Elgar Publishing, 2009); H-W Micklitz and F Cafaggi, 'Collective enforcement of consumer law: a framework for comparative assessment' (2008) *European Review of Private Law*

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_1,

perhaps as well what was most demanding, between private law theory and social science disciplines. A meaningful discourse between private law theory and insight from the social sciences broadly speaking is as well the topic of this contribution—a true essay (in the French sense of essayer)—and, more importantly, of our first large size cooperation.[3] Having said this, if one area of the law is still more prominent in Hans Micklitz's work than all the others, it is certainly (European) consumer law[4]—which he increasingly conceived as part of (European) economic law[5] and as well as clearly the cutting edge of what he has termed as 'European regulatory private law',[6] which focuses on the regulated industries and their interplay with the demand side.

Negotiation would now seem to be the part of private law where the assumed 'weakness' of consumers is most prominent (besides probably remedies)—a 'weakness' which has to be well defined as it justifies the whole body of law. Thus negotiation would seem to be the 'Gretchenfrage' of consumer law or what justifies its existence—in the same way that for Gretchen, the answer to her question is a prior issue to eternity, in the case of consumer law and hence also for Hans Micklitz's

391; H-W Micklitz and A Stadler, 'The Development of Collective Legal Actions in Europe, Especially in German Civil Procedure' (2006) 17 *European Business Law Review* 1473; H-W Micklitz, 'Collective action of Non-governmental Organizations in European Consumer and European Environmental Law—A mutual learning Process' in R Macrory (ed), *Reflections on 30 Years of EU Environmental Law A High Level of Protection* (Groningen, Europa Law Publishing, 2005) 451.

[3] S Grundmann, H-W Micklitz and M Renner, *Privatrechtstheorie/Private Law Theory*, forthcoming in German (Tübingen, Mohr-Siebeck, 2014) and in English (2015).

[4] Most prominently: N Reich and H-W Micklitz, *Europäisches Verbraucherrecht*, 4th ed (Baden-Baden, Nomos, 2003); H-W Micklitz, *Do Consumers and Business need a New Architecture for Consumer Law? A Thought Provoking Impulse* (Florence, EUI Working Paper 2012/13) (English version of his report for the *Deutscher Juristentag*); R Brownsword, H-W Micklitz, L Niglia and S Weatherill (eds), *Foundations of European Private Law* (Oxford, Hart, 2011); H-W Micklitz, J Stuyck and E Terryn (eds), *Cases Materials and Texts on Consumer Law* (Ius Commune Casebooks for the Common Law of Europe) (Oxford, Hart, 2010); H-W Micklitz and N Reich, *The Basics of European Consumer Law* (Macão, Centro de Formação Jurídica e Judiciária, 2007); N Reich, H-W Micklitz, P Rott and K Tonner, *European Consumer Law* (Antwerp, Intersentia, 2014).

[5] Indeed, the treatise written by N Reich and H-W Micklitz has as sub-title: 'Eine problemorientierte Einführung in das Europäische Wirtschaftsrecht' (an introduction to European economic and business law). Most prominently otherwise: H-W Micklitz and S Weatherill, *European Economic Law, Casebook* (London, Dartmouth, 1997); and more recently H-W Micklitz, H James and H Schweitzer, *The Impact of the Financial Crisis on the European Economic Constitution* (Florence, EUI Working Paper, 2010) 1–49; and also Micklitz, Reich and Rott, *Understanding EU Consumer Law*; for this concept see already S Grundmann, 'The Structure of European Contract Law' (2001) *European Business Law Review* 505; id, *Europäisches Schuldvertragsrecht—das Europäische Recht der Unternehmensgeschäfte (nebst Texten und Materialien zur Rechtsangleichung)* (Berlin, de Gruyter, 1999); id, 'Europäisches Handelsrecht—vom Handelsrecht des laissez faire im Kodex des 19. Jahrhunderts zum Handelsrecht der sozialen Verantwortung' (1999) 163 *Zeitschrift für das gesamte Handelsrecht* 635.

[6] See namely Micklitz (ed), *The Many Concepts of Social Justice in European Private Law*; H-W Micklitz, 'The Visible Hand of European Private Law' (2010) *Yearbook of European Law* 2009, 3; H-W Micklitz, *The Politics of Judicial Co-operation in the EU—the Case of Sunday trading, Equal Treatment and Good Faith* (Cambridge, Cambridge University Press, 2005).

core area, negotiation is a prior issue to the very foundational questions of private and regulatory law. As negotiation is much too large a topic for an essay, the theme is arranged around three seminal articles only. The essay is focused on whether these three texts really 'speak to each other'. Three texts: one from legal theory, one from behavioural empirical research and game theory, and one from institutional economics!

1.2 Why and How Between Disciplines?

Interdisciplinary research is so obvious an objective of contemporary research that it does not even seem worthwhile spending time insisting that it is the case. Nevertheless, it would seem as if the texts which are compared and contrasted in this essay have never thus far been so analyzed in the literature. This is despite the fact that each of them would seem to be a key text in their discipline and that each of them speaks about 'negotiation', and in particular the function of contracts and the 'justice of consensus'. This may in part be due to the fact that the texts are taken not only from different disciplines—from legal theory and scholarship, from behavioural empirical research and game theory, and from institutional economics—but also due to the fact that they are embedded in different discussion circles and language traditions.

1.2.1 Broadly Comparative and Interdisciplinary Approach

This essay proposes to be a test case for two approaches—or rather a combined twofold approach—to a 'foundations of private law' discussion[7] which hitherto does not exist, or does not appear to exist, or at the least not in the form of a consistent and systematic approach.

This is, on the one hand, a broadly interdisciplinary approach centring on sufficiently concrete questions—such as negotiation and the justificatory power of consensus, or, not dealt with here, information rules and their justification or concepts of long-term contractual relationships or reliance and its relationship to contracts and to torts etc. The idea is thus twofold: to extend interdisciplinary perspectives in the consideration of legal questions from a law & one discipline perspective, for instance a law & economics perspective, to a law and (all) relevant neighbouring disciplines perspective—bringing law together with the insight from all social sciences, but as well behavioural sciences and philosophy pertinent to the problem. The idea behind such an arrangement around sufficiently concrete 'substantive' questions—core questions—of private law is to render possible an approach which in fact encompasses not just one neighbouring discipline, but hopefully all those which meaningfully contribute to answering the question at stake—or at least give

[7] See, once again, Brownsword, Micklitz, Niglia and Weatherill (eds), *Foundations of European Private Law*.

a greater chance of success to such an approach. Therefore, this first part of the new approach is that of really 'applying' the insight and 'knowledge' which exists in a whole range of disciplines outside legal dogmatic thinking on concrete core problems with which private law deals.

The approach is 'new' also in a second respect. This is indeed, on the other hand, an approach in which as much as possible strands of methodological and foundational discussion, which are rooted primarily in one country or language tradition, are brought together—not world-wide, but at least European-wide and between Europe (not just one European country) and (US) America because of their closely related development. Such an approach is meant to replace bilateral approaches—often between strands of though rooted in *one* European country and those rooted in the US—by a multilateral approach encompassing all key jurisdictions in Europe and in the US. In this essay—just an essay—this second approach is more inherent than it becoming really visible: it can be sensed rather as a promise for the future.

1.2.2 Broadly Comparative and Interdisciplinary Approach—A Legal Scholarship Approach?

In an essay such as this one, such an approach could as well just be proposed … and then explained and applied. Any lengthy justification why this is nevertheless an approach relevant also for legal (also dogmatic) scholarship would seem to go beyond the scope of such an essay. This is so despite the fact that there had been fierce discussions in quite a few European countries in the 1990's on whether 'efficiency' may at all be a guiding principle in legal doctrinal thinking and whether 'law and economics' is a method legitimate also in questions of adjudication.[8] For a private law perspective transcending national frontiers, these, of course, may appear to be questions of legitimacy, which today have somewhat lost their 'sting' because of overwhelming US developments. These developments are so powerful in law & economics—increasingly in the form of a consideration of institutional economics arguments in law and of a (corporate, market or contract etc.) governance debate—and have reached private law mainstream also on the European continent![9]

[8] See, for instance, for the German debate, on the one hand: J Taupitz, 'Ökonomische Analyse und Haftungsrecht—eine Zwischenbilanz' (1996) 196 *Archiv für die civilistische Praxis* 114, 127 et seq., 135 et seq.; and to some extent even H Eidenmüller, *Effizienz als Rechtsprinzip—Möglichkeiten und Grenzen der ökonomischen Analyse des Rechts* (Tübingen, Mohr-Siebeck, 1999) 451 et seq.; and on the other: S Grundmann, 'Methodenpluralismus als Aufgabe—zur Legalität von ökonomischen und rechtsethischen Argumenten in Auslegung und Rechtsanwendung' (1997) 66 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 423, 430–443; more generally survey in AN Hatzis (ed), *Economic Analysis of Law: A European Perspective* (Northampton, Edward Elgar, 2003).

[9] See namely K Hopt, H Kanda, M Roe, E Wymeersch and E Prigge (eds), *Comparative Corporate Governance—the State of the Art and Emerging Research* (Oxford, University Press, 1998); S Grundmann, F Möslein and K Riesenhuber (eds), *Contract Governance—Dimensions in Law and Interdisciplinary Research* (Oxford, University Press, 2014).

Setting therefore aside questions of admissibility in doctrinal thinking/adjudication and a more thorough discussion of them, does, however, not imply that some considerations on the methodological approach taken would not be welcome. In this regard, this essay is based on hermeneutics as the core approach in contemporary communication theory and therefore also legal reasoning. Certainly in its philosophical foundations,[10] but in my view also in its application to legal reasoning,[11] this is the most satisfactory explanation of the communication process which takes place and which should take place, also in legal reasoning. In its core, the idea, as applied to law, is that communication is an ongoing process, an act developing in the interplay between the parties to the communication, and not a one-sided act of sending a message from the one party to the other, and that in this process the different preconceptions are relevant, to be brought together, and to be corrected over and again. With regard to law, the tension between fact and legal rule has to be at the core of communication and interpretation. All of this is captured in the famous image of the eye—the regard—which has to travel from one to the other and back again, from facts to rules and back again, over and over again in the 'hermeneutical circle', with a view to inspire the understanding of the one by the understanding of the other. Preconception in all this, is neither objective nor subjective, it describes the challenge to create inter-subjectively acceptable results despite the fact that a certain position is always the starting point of any understanding and that there cannot be any 'neutral', completely objective understanding and communication. In law, the challenge is to create and reason a result, which given the value judgments in the legal community, can claim acceptance in this community, even though interpretation is a creative act, influenced by the personality and the preconception of the interpreter. In this act, written law, precedent etc., but also convictions of what is legally justified, embedded in society, are integrated and brought in ever closer union. In this respect, a reformulation of what other social or behavioural sciences opine about a legal rule or only a legal problem, can also be integrated into the process, 're-formulated' because acceptability in the realm of law and the legal community is to be positively created and looked for—taking the core legal evaluation parameters as the guiding framework, for instance fundamental rights or fundamental principles of the field of law at stake.[12]

[10] Path breaking: H-G Gadamer, *Wahrheit und Methode*, 1st ed (Tübingen, Mohr, 1960); in English: *Truth and Method*, 2nd ed (London, Sheed and Ward, 1989); on this work, see namely G Figal (ed) *Hans-Georg Gadamer. Wahrheit und Methode* (Berlin, Akademie-Verlag, 2007); PC Lang: 'Hans-Georg Gadamer. Wahrheit und Methode—Grundzüge einer philosophischen Hermeneutik' in *Hauptwerke der Philosophie. 20. Jahrhundert* (Stuttgart, Reclam, 1992) 256.

[11] Path breaking: J Esser, *Vorverständnis und Methodenwahl* (Frankfurt, Athäneum, 1972) namely 116–141; see, more in detail: S Grundmann, 'Chapter 1: The Inside and the Outside of Law' in Grundmann, Micklitz and Renner, *Privatrechtstheorie*, 1 et seqq.

[12] Beautiful account of a very similar reasoning in G Teubner, 'Rechtswissenschaft und –praxis im Kontext der Sozialtheorie' in S Grundmann and J Thiessen (eds), *Law in the* Context *of Disciplines—Interdisciplinary Approaches in Legal Academia and Practice—Recht und Sozialtheorie—interdisziplinäres Denken in Rechtswissenschaft und -praxis* (Tübingen, Mohr Siebeck, 2014).

Today, one should not see this approach as esoteric: on the contrary, hermeneutics, understood in this way, is not really very distant from the most modern positivist approaches, namely in one of its major strongholds today, Oxford. Taking the last publication by Joseph Raz, one would in fact reach a very similar methodological stance:[13] his starting point is that freedom, also freedom for drafting the parties' own solutions, requires a 'stable, continuous legal framework' within which then this source of 'legal innovation and change' could flourish (p. 48). The chapter on interpretation starts out with the tension which is the concern of this essay: it analyzes what is a 'creative' or 'innovative' interpretation—advocating such interpretation and even 'legal innovation'—interpretation as a highly innovative and creative endeavor! If interpretation—as Raz starts out—is the uncovering of a meaning, it can nevertheless be good (successful) or bad, even though both are still interpretations.[14] Uncovering of meaning alone is not sufficient: uncovering of meaning is interpretation only if it is less mechanical, more creative than mere analysis of the meaning of single words, like in a dictionary (semantics, 'rendering only in one language what is said in another', p. 300). The aspects treated at the end of the chapter—pluralism and innovation—are of core interest for our essay. Section 1.1.2 clarifies first pluralism—not of methods or disciplines, as introduced in this essay, but of interpretative results which are logically incompatible with each other, but can all be acceptable under the given norm and among which one may be 'novel', others not. Thus pluralism and innovation are closely linked to each other, but innovation is also linked with the very essence of what interpretation is (according to Raz). The core question is, if innovative interpretation 'explain(s) or reveal(s) a meaning which was not there all along', how then can it be interpretation (uncovering of meaning) at all? (p. 303). Is not innovation logically different from uncovering of meaning (and therefore cannot be 'true') or does not uncovering of meaning, an explanation, exclude innovation, as the meaning is in the object of interpretation already? Raz explains it with Hamlet, the Israel born philosopher with the prince of Denmark, both united in British art (of thinking): of course, when Freud interprets that Hamlet is courageous in all matters but in taking revenge on his uncle, murderer of his father and new husband of his mother, because he himself has had the hidden dream—the famous Oedipus complex—to dethrone his father and be with his mother, this was unheard-of before. And, one might add, Shakespeare had not understood it himself—though somehow has apparently sensed it as the deepest artistic truth. At the same time, uncovering this truth, Freud did not uncover some-

[13] See J Raz, *Between Authority and Interpretation: On the Theory of Law and Practical Reason* (Oxford, University Press, 2009) namely chapter 12 on interpretation; on positivism (also in the shape given to it by J Raz) see, for instance: J Gardner, 'Positivism—5 ½ Myths' (2001) 46 *American Journal of Jurisprudence* 199; also in id., *Law as Leap to Faith—Essays on Law in General* (Oxford, University Press, 2012) 19–53; *Stanford Encyclopedia of Jurisprudence*, 'Legal Positivism' (L Green); on the confrontation with J Esser and also on positivism more generally, see as well: Grundmann, 'Chapter 1'.

[14] In sharp contrast to R Dworkin's belief in just one really correct interpretation and his image of the Herculean judge who finds it: See R Dworkin, *Taking Rights Seriously* (Cambridge/Mass., Harvard University Press, 1977) 105–130 (on the Herculean judge) and 279–290 (on the sole possible solution).

thing which was not in the text already: '[n]o interpretation, however innovative, changes its object.'—and yet this is a 'paradox' (p. 304). At this juncture, the three core categories—pluralism, innovation and good or bad interpretation—are tied together … and at the same time the link back to positivist authority is stressed: the 'heart of the matter [is] explanations can be good or bad, and they can be more or less good. Their success is determined by criteria, or rules for excellence in interpretations … [and these] are independent of the interpretations,' (p. 304) i.e. they are in legal scholarship and the rules interpreted (and, as explicitly Raz admits, they even change over time). The core ('key') of solving the paradox—novel, yet already there—is found in that interpretation has 'cultural objects' as its object. This extends 'positivism' to its limits: 'The contingency of socially dependent meanings makes ample room for innovative interpretations which show new ways of understanding their objects, and in so doing establish new meanings for their objects' (p. 311 et seq.). This opens the argument to a lot of inroads from society, change in society, new systems of value judgement accepted in society—namely if change of society in time is indeed important (see above): indeed, Raz explicitly stresses that good interpretations are 'fragile and changeable' (p. 312). He sees his text to 'present some reasons for empowering the courts to engage in innovative interpretation in cases to which they apply.' (p. 318).

1.2.3 Justifying a Broadly Comparative and Interdisciplinary Approach

If hermeneutics and advanced positivist legal theory would seem to allow such 'innovative interpretation', the core question—following Raz—would seem to be whether we can expect good results from extending it to the broad insight from social and behavioral sciences as advocated above. The question is twofold, relating, on the one hand, to the multiple disciplines pertinent to law and, on the other, to the role of institutional economics and law and economics, namely in areas related to economy, among them the problem of negotiation.

When it comes to insight from multiple disciplines, it seems, on the one hand, beyond doubt that further insight into questions of structure and value underlying problems which are the object of legal rules cannot help but also advance legal scholarship and practice. This would seem to imply that these questions do not require any further discussion, but that there is at most a question of feasibility—and perhaps as well space for the amazement that reference to the whole corona of disciplines surrounding legal rules and problems is not the normal and universally accepted approach in legal scholarship. On the other hand, at least some discussion is nevertheless helpful. In fact, when one refers to the 'wisdom' of those other disciplines this goes to the heart of creation and use of knowledge (for instance, in legal scholarship). In this respect, reference to two important, perhaps even *the* two outstanding theories on knowledge in markets, economics and psychology is helpful. This is, on the one hand, the idea (advanced mainly by v. Hayek) that decentralized knowledge residing in many decision takers with divergent approaches

is likely to produce more and better (use of) knowledge than centralized knowledge residing in one decision taker[15]—an idea on which he based his prediction that market economies would prove superior to centrally planned economies and an idea for which he then coined the concept of 'markets as a discovery device'. This is, on the other hand, Surowiecki's concept of the 'wisdom of the crowds', applied mainly to markets and to mass psychology, reaching beyond v. Hayek, namely also in the explanation of situations in which masses are likely not to produce better results (but bubbles), that is to say when they act in too homogeneous a way, an insight which strikingly well explains the financial crisis of 2008.[16] Both approaches are interesting for the question raised here as well with respect to the basic mechanism they describe: the beneficial use of dispersed knowledge is seen in both approaches to depend on the diversity (creation of much useful knowledge) and on the existence of mechanisms of making the pieces of knowledge overlap, i.e. on the existence of sufficient means of communication and 'unity' within this diversity.[17] This system of overlapping of theories from different disciplines is yet to be established for much of private law scholarship and this essay is advocating efforts to be taken in this respect.

The second part of the answer is about one particular kind of interdisciplinary collaboration which today can be seen as dominant at least in all those areas of private law which are related to markets and (business) organizations, dominant certainly in US-American literature and practice,[18] but increasingly as well in Europe: this is law and economics and namely the use of institutional economics in the discussion of normative legal issues. While economic theory is admirable in that it did indeed succeed in re-constructing the whole corona of disciplines around economics within economic theory—law in institutional economics, psychology and behavioural sciences in behavioural economics, mathematics namely in game theory, sociology in economic sociology etc.—and while this may even have contributed to the status of economics as a lead social science, this does not dispense of the need of legal scholarship to examine the same type of re-constructing the neighbouring disciplines under the auspices of its own value system. What economics achieved under the auspices of the paradigm of efficiency, in legal scholarship

[15] Path breaking: FA v Hayek, 'The Use of Knowledge in Society' (1945) 35 *The American Economic Review* 519. For 'competition as a discovery device' see, for instance, FA v Hayek, 'Competition as a Discovery Procedure' in id, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (London, Routledge & Kegan Paul, 1978) 179.

[16] J Surowiecki, *The Wisdom of Crowds—Why the Many Are Smarter Than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations* (New York, Random House, 2004): Creation and use of knowledge by individuals deciding independently, yet collectively as a mass is likely to produce better decisions and predictions than those taken by individuals or even experts (individually better trained than the members of the mass).

[17] v Hayek, 'The Use of Knowledge in Society', namely at 525–530; Surowiecki, *The Wisdom of Crowds*, namely 29–39.

[18] See only the beautiful account of the very far reaching limitations of a law and economics approach, but still the intellectual dominance of this approach: E Posner, 'Economic Analysis of Contract Law after Three Decades—Success or Failure?' (2003) 112 *Yale Law Journal* 829.

must be achieved under the auspices of the ultimate foundations of legal legitimacy: while efficiency is spelt out as one of the core aims to be reached in some areas, perhaps even as the core objective,[19] and while such a role can be implied for efficiency in many other areas as well, it is equally true that efficiency is not the sole value and not even the supreme value in the hierarchy of legal architecture. Democratic legitimacy and respect of fundamental rights (and the rule of law) typically rank higher and in fact highest.[20] These do not need to and in fact do not even typically coincide completely, sometimes not even largely, with the paradigm of efficiency as conceived in economic theory. Therefore, while institutional economics has the huge advantage of producing results which can easily be 'applied' and while it has an admirably consistent set of tools of analysis, it clearly cannot be regarded as the sole social sciences approach relevant for legal scholarship. This is so irrespective of how well the assumptions—such as the assumption of rational decision taking—catch and describe real life, i.e. irrespective of whether in this respect there is additional ground for questioning the claim to exclusiveness which typically is inherent in law and economics inquiries.

Such core concepts as negotiation and as the 'justice of consensus' show that the task of reconstructing social sciences approaches in legal scholarship—all pertinent approaches!—is a herculean task. This essay cannot but make a first step. It does so by simply confronting three pieces of theory which originate in different disciplines and which hitherto have not been confronted.

1.3 Three Views on Negotiation and on the 'Justice of Consensus'

1.3.1 A Proper Function of Contracting as the Outer Limits of the 'Justice of Consensus' (L. Raiser)

The first view is the one taken by L. Raiser in 1960 in what can be considered to be his key-note speech as principal of Tübingen university, the then leading law faculty in Germany.[21] It is also to be considered as the key paper addressing the overall picture of contract law and its function in this important moment of time.

[19] See, for instance 4th, 27th, and 43rd recitals of Dir 2007/64/EC on payment services in the internal market, [2007] OJ L 319/1; or as well 6th recital of Dir 2008/48/EC on credit agreements for consumers, [2008] OJ L 133/66.

[20] This is as well the basis of J Rawls' distinguishing the political freedoms and rights to equality from merely economic ones in his treatise which certainly constitutes the most important piece of moral philosophy of the 20th century: J Rawls, *A Theory of Justice* (Cambridge/Mass., Belknap Press of Harvard Univ Press, 1971, revised ed 1999) chapter III: The Original Position, 118–166.

[21] L Raiser, 'Vertragsfunktion und Vertragsfreiheit' in E von Caemmerer et al (eds), *100 Jahre Deutsches Rechtsleben—Festschrift zum hundertjährigen Bestehen des Deutschen Juristentags 1860–1960* (Karlsruhe, Müller, 1960) 101.

This was done by examining mainly, but not exclusively, the emerging new market economy in Germany and (implicitly) also in the European Union as a whole[22] and any Western market economy. The paper starts by analysing the German Civil Code which to this day puts its whole emphasis on the will of the individual—philosophically embedded in German idealism where the will and dignity of the individual are considered as the supreme (philosophical) value (pp. 101–103). While Art. 1 of the German Constitution of 1948 enshrined human dignity as now what becomes the highest legal value—an inalienable and inalterable fundamental right—Raiser nevertheless questions the exclusiveness of this value and forecasted very clearly the development of the next decades: he asks the question whether such an unlimited will dogma is not instead a rather rare exception in history and, more important and more normatively still, whether it can be justified at all given the (social) function of contracting and of contract freedom. This strikes at the heart of the issue: how, from the perspective of the function of contract law, contract freedom, but also limits to contract freedom, can be justified (hence the title of Raiser's paper).[23]

Raiser was particularly well positioned for raising this question in a way which develops what is today still the prevalent framework. On the one hand, he himself was the first to combine an empirical inquiry into a core market phenomenon in mass transactions—standard contract terms—with normative considerations, specifically with the idea that the functioning of contract formation can be adversely affected in situations where the preconditions for such functioning are structurally and systematically destroyed, these being the preconditions of free choice.[24] The core insight of this work was that protection had not only to be granted in (individual and exceptional) cases of fraud and overreaching, but more generally and quite systematically if there was structural asymmetry in the contractual relationship. On the other hand, Raiser wrote the text discussed here in 1960, i.e. at a moment when, in Germany and Europe, the idea that market order had to help maintain the preconditions of free choice, namely through antitrust law, gained particular momentum. Indeed, it was not only the main antitrust legislation which was developed at this time, both at the EU and at the national level, but also an overarching theory of ordo-liberal market

[22] For Italy (the other big country in Europe where an open market economy had to be installed in order to replace a highly cartelized, planned economy developed under a Fascist regime), in a very similar vein and almost contemporaneously: L Mengoni, 'Forma Giuridica e Materia Economica' in D Pettiti (ed), *Studi in Onore di Alberto Asquini*, vol III (Padova, CEDAM, 1963) 1075.

[23] Raiser, 'Vertragsfunktion und Vertragsfreiheit', 103 et seq. and then the whole text: 'Contracts serve the purpose of giving legal order in interpersonal relationships via autonomy of the parties in situations not vitiated by private power.' (104). ('Verträge dienen der rechtlichen Ordnung zwischenmenschlicher Beziehungen durch Selbstbestimmung der Beteiligten im herrschaftsfreien Raum.').

[24] L Raiser, *Das Recht der allgemeinen Geschäftsbedingungen*, 1st ed (Hamburg, Hanseatische Verlagsanstalt, 1935); see F Kübler, 'Ludwig Raiser' in S Grundmann and K Riesenhuber (eds), *Deutschsprachige Zivilrechtslehrer des 20. Jahrhunderts in Berichten ihrer Schüler: eine Ideengeschichte in Einzeldarstellungen*—vol 1 (Berlin, de Gruyter, 2007) 287 (forthcoming also in English in 2014).

structure and the concept of a private law society, which was based on the combination of contractual freedom and market order helping to maintain it.[25]

Raiser's key findings and statements can be summarized as follows: the core function of contracting within a legal framework is that it (i) builds upon the advantages of autonomy and (ii) does so under the umbrella of law—that is to say accepted and fostered by law, but as well respecting the limits law can set. It thus combines autonomy with respect for the social order (namely p. 105). Neither is contract separate from the objective legal order nor could an objective legal order reach this optimum result. In this respect, the idea of the superiority of individual plans of the parties with their higher innovative power is combined with the idea of protection against those forces which endanger the very preconditions of such autonomous decision-taking:[26] party autonomy is superior to (state made and general) 'objective' law in its potential for innovation ('markets as discovery devices', p. 119). For this reason, on the one hand, objective law can—and must—live with partial deviations from the common good, but on the other hand, contract freedom is not given to the parties outside and independent of the framework of social order, but rather within it and therefore taking into account its needs (namely p. 119).

When setting the framework as described, Raiser depicts, in fact, a trade-off. Inasmuch, it does not come as a surprise that the decision how exactly to strike the balance is seen as a highly political one, to be democratically decided (namely p. 131). He explicitly refers to social theory as well, to other disciplines of social sciences (p. 120, 131). Both points are paramount for the scope of this article, the priority of democratic decision-making—potentially different from state to state, the constitutional framework setting the overall 'tone' (p. 127 et seq.) –[27] and the integration of law and legal scholarship into social sciences more broadly conceived!

One last point is particularly interesting in comparison with the other two texts below: Raiser is very clear in that the limits to freedom of contract are not owed to considerations of distributive, but of corrective justice ('iustitia commutativa', p. 129), i.e. that the dynamics which stem from private autonomy should be maintained in principle and protected only against those forces which endanger the autonomy as such … and beyond that, i.e. for redistributive needs, only be corrected in extreme cases. In this respect, Raiser's reasoning is clearly supplemented by the

[25] For the theoretical foundations, see the two outstanding texts by: W Eucken, *Grundsätze der Wirtschaftspolitik*, 2nd ed (Tübingen, Mohr-Siebeck, 1952); and F Böhm, 'Privatrechtsgesellschaft und Marktwirtschaft' (1966) 17 *ORDO* 75. For an analysis of this concept, see S Grundmann, 'The Concept of the Private Law Society after 50 Years of European and European Business Law' (2008) *European Review of Private Law* 553.

[26] For the theoretical foundations of both claims, see references above Fn. 15 on the one hand and above Fn. 25 on the other.

[27] For Germany, Raiser stresses the foundations of the so-called *Rhenish* capitalism: 'The protection of public good—superior to the interests of the parties—[is paramount in all this] … The state governed by the rule of law and by social welfare considerations under the *Grundgesetz* in which fundamental rights are combined with strong social welfare guarantees can never reach simple solutions, without difficult questions of a weighing of interests and of rights.' See Raiser, 'Vertragsfunktion und Vertragsfreiheit', 128.

theoretical considerations of Kaplow and Shavell (below Sect. 1.3.2). Raiser gives as good historical example the struggle over 'iustum pretium' (p. 130), an example of how much important countervailing arguments speak against considering the private law 'objective' order as an order well equipped for providing for a 'just equilibrium' (see as well below Sect. 1.3.3).

Finally, Raiser stresses how much individual contracts and freedom of contract on the one hand and regulation of market order on the other are linked, i.e. the idea which was key to ordo-liberal thinking (and which was spelt out by Böhm soon afterwards) and which is also important in what follows (p. 133). In this context, Raiser makes it very clear that an order which helps the functioning of conscious choice has to be a prime object of systematic inquiry and that this even constitutes a true mega-field of inquiry and not just of some single cases decided on the basis of a general clause such a good faith (namely p. 131). All these points raised by Raiser open a discourse with other disciplines, with theories such as functional differentiation in matters of (distributive and corrective) justice (see below Sect. 1.3.2) or game theory in a context of bounded rationality (see below Sect. 1.3.3). Conversely however, all these theories have as well to be assessed against the background of these three guidelines, that is to say the constitutional order within which they should influence rule setting issues.

1.3.2 Elements of Redistribution as Part of the 'Justice of Consensus' (L. Kaplow/S. Shavell)?

A core issue in the framework which Raiser establishes for an equilibrium between autonomy (fostering individual interests and overall dynamics) and societal interests (including those of weaker parties' protection), is that this framework should be aimed at corrective and not at redistributive justice (social redistribution).

This is an issue which has aroused quite some debate between law and economics scholars, debate which has even focused very precisely on this point. As the point is so important to Raiser his text should not be read and assessed without reading it in conjunction with this later discussion. Likewise the scope of consumer law—a question foundational to the whole consumer law—should not be discussed without this compound of literature. This literature directly addresses substantive law, mainly tort but also contract law, rather than procedure in the narrow sense, but could be thought through for all important issues of consumer law (and beyond). The question would seem to have particularly high bearing on problems of negotiation as most rules focusing on the heterogeneity of the contract partners, directly or at least indirectly also on typical income and financial power ('deep pockets'), are related to contract formation. In other words, those rules are focusing on the question whether the framework of the negotiation should be adapted according to (typical) wealth of the contracting parties. One good example would be information rules or withdrawal rights where, when solving design questions, the argument can

be made and is made that consumer interests—as the interests of those typically financially weaker—should be furthered for reasons of redistribution.[28]

A very stringent and formalized version of the core argument was first made by S. Shavell in 1981. This was certainly not for the first time at all (Raiser had made it before), but for the first time in such a poignant, stringent and exclusive way.[29] More extensive and better known is an extended version written by L. Kaplow and S. Shavell some ten (still highly formalized) and then some 20 years later in which they formulate the argument not only in a formalized way, but expose it 'in prose', and in which they take up as well the first core counter-arguments made[30] … and to which, in turn, some of the most extensive criticism from legal scholarship was then directed. [31] The core argument advanced by Kaplow and Shavell and most systematically developed by them is that redistribution is better taken care of by the income tax system. The reason is that whilst the income tax system can be well calibrated to the aim of redistribution, fields of (private) law can only be so calibrated by adding to one kind of distortion potentially inherent in the tax system yet other types of distortion ('double-distortion' hypothesis). The main argument can be found on p. 823 and says that only the income tax system pervasively and systematically calculates the income (wealth) of people—and bases redistribution on this calculation—while in other areas, rules can favour or disfavour only groups which are much less homogeneously composed and assessed. Consumers, for instance, may be partly well-off, partly less well-off. Moreover, in many areas—'such as those of contract, corporate, and commercial law' (also p. 823)—the redistributive effect can even be eliminated by one class of contracting party calculating the burden put on them into the price at which they offer a good or service—for instance businesses in B2C contracts—and

[28] T Wilhelmsson 'Consumer Law and Social Justice' in I Ramsay (ed), *Consumer law in the global economy: national and international dimensions* (Aldershot, Ashgate, 1997) 217; I Ramsay, 'Consumer Credit Law, Distributive Justice and the Welfare State' (1995) 15 *Oxford Journal of Legal Studies* 177; for general contract theory see A Kronman, 'Contract Law and Distributive Justice' (1980) 89 *Yale Law Journal* 472.

[29] S Shavell, 'A note on efficiency vs. distributional equity in legal rulemaking: Should distributional equity matter given optimal income taxation?' (1981) 71 *Papers and Proceedings of the American* Economic *Association* 414; see also A Hylland and R Zeckhauser, 'Distributional objectives should affect taxes but not program choice or design' (1979) 29 *Scandinavian Journal of Economics* 264.

[30] L Kaplow and S Shavell, 'Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income' (2000) 29 *Journal of Legal Studies* 821; taking up and defending the arguments made in: L Kaplow and S Shavell, 'Why the legal system is less efficient than the income tax in redistributing income' (1994) 23 *Journal of Legal Studies* 667.

[31] Namlely R Markovits, 'Why Kaplow and Shavell's "Double-Distortion Argument" articles are wrong' (2005) 13 *George Mason Law Review* 511; reacting to the 1994 paper: CW Sanchirico, 'Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View' (2000) 29 *The Journal of Legal Studies* 797; see also K Logue, R Avraham and D Fortus, 'Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow and Shavell' (2004) 89 *Iowa Law Review* 1125; D Lewinsohn-Zamir, 'In Defense of Redistribution Through Private Law' (2006) 91 *Minnesota Law Review* 326; for a critique based on behavioural law and economics see C Jolls, 'Behavioral Economics Analysis of Redistributive Legal Rules' (1998) 51 *Vanderbilt Law Review* 1653; C Jolls, 'Behavioral economic analysis of redistributive rules' in C Sunstein (ed), *Behavioral Law and Economics* (Cambridge, University Press, 2000) 288.

in competitive markets, this is even the typical consequence.[32] In other articles, these two arguments have then even been combined, warning against the risk that strong protection of 'weaker parties', for instance consumers, may even typically favour those in the (heterogeneous) group of consumers who are the best of: this is the group which in case of damages to be paid are most likely to receive the highest quantum, for instance in the case of strict liability in product liability the harm done to their (rather luxurious) patrimony is likely to be systematically higher, and moreover they may systematically make use of their extensive consumer rights to a larger extent than less well-to-do groups. Then strong rules having redistributive effects would not only be calculated into prices, but even be calculated into prices in a way that poorer groups have to share the higher prices (the cost increase is socialised) while they do not equally profit from the effect of these rules (the gains are privatised).[33]

Thus there is not only the one distortion inherent also in the tax system according to Kaplow and Shavell—the distortion that taxing income induces (high) tax income payers potentially to work less than they would do otherwise and rather take time for leisure, a 'distortion' which the authors analyse for most of the rest of the paper (p. 823 et seqq.) and a 'distortion' which can certainly also be questioned with respect to desirability (might it not be that it is desirable that high income tax payers should also have leisure time, for instance time for their children?). Rather, this one 'distortion' is complemented by at least one more type of distortion ('double distortion'), and potentially by even some more—this is the rather powerful argument advanced by the authors, and to which even critics such as Markovits admit 'is correct' (p. 614). One reservation is, however, made: On the one hand, Kaplow and Shavell admit that the income tax system may not be optimal and that a well calibrated private law rule may help to remedy this failure in some rare cases, and indeed one of Markovits' main criticisms is that of a poor income and a poor heritage system (in which the definition of 'rich' is far from catching all relevant sources of fortune). On the other hand, good calibration of the private law rule is extremely difficult, if it is not in fact the case that really the rule directly refers to income … and then would again need to contain a good mode of assessing income (which in terms of design and administration, private law and private law courts are certainly less well positioned than tax law and fiscal authorities specialising in this question in particular). Enhancing the income or the heritage tax system (namely by broadening its scope to all relevant sources of fortune), or even introducing a well calibrated particular tax, is certainly the more direct way to remedy the failure.

[32] Path breaking R Craswell, 'Passing on the Costs of Legal Rules—Efficiency and Distribution in Buyer-Seller Relationships' (1991) 43 *Stanford Law Review* 361. In this sense for the proposed Draft Common Frame of Reference (for a European contract law) as well: G Wagner, 'Zwingendes Vertragsrecht' in H Eidenmüller, F Faust, HC Grigoleit, N Jansen and R Zimmermann, *Revision des Verbraucher-Acquis* (Tübingen, Mohr Siebeck, 2011) 44.

[33] O Ben Shahar and O Bar-Gill, 'Regulatory Techniques in the Consumer Protection: A Critique of European Consumer Contract Law' (2013) 50 *Common Market Law Review* 109; H-B Schäfer and C Ott, *Lehrbuch der ökonomischen Analyse des Rechts*, 4th ed (Berlin, Springer, 2005) 138 et seqq.: Wagner, 'Zwingendes Vertragsrecht', 45 et seq.

While Kaplow and Shavell discuss criticism made by Sanchirico based on a (rather unspecified) plea that more thought should be given to heterogeneity (p. 827 et seqq.), Markovits' arguments are much more powerful. The main point—besides criticising existent tax systems or inconsistencies in the use of the term of 'efficiency'—would seem to be the following: 'both "legislators" and "adjudicators" may be morally obligated to make economically-inefficient "redistributive" decisions in relation … [to] tort and contract law disputes that raise corrective justice issues …' (p. 617), and even more: not only moral, but constitutional values may oblige them to do so. Markovits makes it clear that, reconstructing the (powerful) argument advanced by Kaplow and Shavell in law and legal adjudication and interpretation requires as well a test against the constitutional values and the fundamental principles of the field of law involved. As long, however, as the redistributory effects of the income and heritage tax system are not so illusory that the social welfare state principle might be violated, the subsidiarity argument (double-distortion argument) which Kaplow and Shavell advance remains powerful even after such re-construction. On the other hand, however, Kaplow's and Shavell's line of arguments can nevertheless be further developed at least in certain cases in a way to justify redistributory effects also in private law, for instance contract law, wherever not even enhancing the tax system could cure a particular source of injustice in distribution and use of wealth (especially if, in addition, the group of the least well-off can be targeted fairly well). In such cases, such development of private law is even inherent in Kaplow's and Shavell's argument … and as well potentially in a consistent construction of constitutional values. These are cases where particular groups of less wealthy persons—not all and therefore not easily targeted by tax law—are exposed to a particular risk of losing all their economic subsistence where this is down to the use of contract. One example discussed over the last decade and particularly highlighted by the world financial crisis of 2008 is the practice of subprime lending. While traditional contract law, for the sake of an efficiently designed incentive structure, would leave it to each contract party to protect herself against dangers which she can clearly see for herself, a duty of banks not to give loans in subprime lending situations (a 'duty of responsible lending') might nevertheless be justified: it would lead to redistributory effects (or rather: to avoid redistribution from poor to rich) because consciously ruining or consciously creating an excessive risk of ruining the client's economic existence can thus be pushed back.[34] This could be seen as a line of arguments which is driven by constitutional values considerations even if considerations of economic efficiency may diverge, and this would be an interest which cannot be arranged for in income tax law.

[34] On a duty of responsible lending, see Art. 8–9 of the Proposal for a Dir concerning Credit for Consumers, COM(2002) 443 final; then omitted in Dir 2008/48/EC; today, for instance: Y Atamer, 'Duty of Responsible Lending—Should the European Union Take Action?' in S Grundmann and Y Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law—Failure and Challenges of Contracting* (Alphen, Kluwer International, 2011) 179 (favouring strong paternalism); C Sunstein, 'Boundedly Rational Borrowing' (2006) 73 *University of Chicago Law Review* 249 (favouring weak paternalism).

In most cases, however, it would seem as if the argument made by Kaplow and Shavell could be well reconstructed in contract law and in a regime on negotiation of contracts. Arguing that contract parties have or had diverging levels of wealth then appears to be highly questionable—such an argument would then be restricted to exceptional cases (where the economic existence is at stake) and would not apply as a general consideration, for instance as a basis for awarding consumer remedies.

1.3.3 Game Theory—'Justice of Consensus' Under the Auspices of Rational Choice or of Bounded Rationality (D Kahneman/A Tversky)?

The third 'view' (or text) chosen for this discussion might well be the one which goes most to the heart of what a broadly interdisciplinary approach might imply for legal scholarship, tentatively spelt out here with respect to problem(s) of negotiation. It is one of the founding texts of contemporary bounded rationality research,[35] the text with which a systematic research on (and the dressing of a list of) 'biases' took off, i.e. the research on those major deviations from the assumption of rational self-interested (welfare) maximizing behavior of the parties which are seen to be the most significant ones, specifically in situations of negotiation. This text is telling—in my view—both for the core problem of choice of theory (see below Sect. a) and for the difficulties in reconstructing it within the research program of legal scholarship (see below Sect. b). Moreover, it is very interesting for a broadly interdisciplinary approach in that it is interdisciplinary already in itself, drawing mainly on an empirical behavioural sciences approach, but used predominantly within the context of economic theory, in the field of 'behavioural economics', and today prominently also in law and economics.

(a) Which interdisciplinary theory is important and worth reconstructing within another discipline? This is a mega-question, perhaps even the most important one of all. Choosing the most relevant approaches for private law theory is a task which only legal scholarship and discussion at large can really achieve, by assessing systematically and discussing broadly.[36] The two core questions to be asked in this respect are probably: (i) how related the research question asked in the particular theory drawn upon is to questions which are asked and truly relevant in legal scholarship and practice, i.e. does the theory have any relevance for questions which are asked or should be asked in law, specifically with regard to legal ordering? And (ii) how well can the theory be reconstructed in the realm of law—a question which depends on, among other things, the assumptions made by the particular theory,

[35] D Kahneman and A Tversky, 'Judgment under Uncertainty—Heuristics and Biases' (1974) 185 *Science* 1124; for placing this text within the development of bounded rationality research (but also game theory), see below b).

[36] Therefore the choice proposed in Grundmann, Micklitz and Renner, *Privatrechtstheorie*, while being very conscious and based on considerations like the ones made in the following, is only—and can only be—a starting point for broader discussion.

specifically in how far they can also be accepted or used, albeit in a modified form, in the realm of law. In the following, these two questions are taken up in turn with respect to the use of game theory and bounded rationality research as 'applied' to questions of negotiation and the 'justice of consensus'.

'Negotiation' and 'bargaining' are often used synonymously. Game theory is often seen in mathematics, where it has its roots and basis, as the dominant theory on issues of bargaining. This view is equally strongly held in economic theory, one of its core fields of application.[37] This should not be astonishing given the object of game theory: the modelling and the forecast of decision taking in situations in which it is not a mechanically responding ('passive') world (parameter) which has to be decided upon, but in which the potential and most likely decision taken by one or several other(s) (other 'player[s]') has also to be taken into account when deciding oneself (interdependent decision taking). And, of course, bargaining is paradigmatic for these latter (non-parametrically shaped) situations.[38] Game theory could, however, be seen as the dominant theory of bargaining also for a second reason, related to its history and evolution: in fact, after the foundational step made by v. Neumann/Morgenstern in formalizing the decision taking process in interdependent decision taking situations, the analytical framework was first set by J. Nash with an article which focused precisely on bargaining.[39] This is, however, not the place to

[37] H Raiffa, *The Art and Science of Negotiation* (Cambridge/MA, Harvard University Press, 1982) (recognizing the value of game theory as a theoretical tool, but also its limits); HP Young, *Negotiation Analysis* (Ann Arbor: University of Michigan Press, 1991) 2 ('principle theoretical tool for analyzing negotiations'); also RJ Aumann and S Hart (eds), *Handbook of Game Theory with Economic Applications*, vol I (Amsterdam, North-Holland, 1992); D Ross, 'Game Theory' in EN Zalta (ed) *Stanford Encyclopedia of Philosophy* (2010), sub 1. ('… since at least the late 1970s it has been possible to say with confidence that game theory is the most important and useful tool in the analyst's kit whenever she confronts situations in which what counts as one agent's best action (for her) depends on expectations about what one or more other agents will do …'). Widely recognized as core concept, as can easily be inferred from the award of so many Nobel Prizes, first to *John Forbes Nash Jr.*, *John Harsanyi* and *Reinhard Selten* (1994), and later to *William Vickrey* (1996), *Robert Aumann* and *Thomas Schelling* (2005), and *Alvin Roth* und *Lloyd S. Shapley* (2012), but also to those developing the branch of bounded rationality, namely *Herbert A. Simon* (1978) and *Daniel Kahneman* (2002) (besides, to a certain extent, also *Reinhard Selten*).

[38] On this core characteristic which distinguishes game theory from any other decision theory (and also for the development of game theory), see, for instance, Ross, 'Game Theory', sub 1.; in game theory 'interdependent decision making' is nowadays mostly referred to as non-cooperative games see Aumann and Hart (eds), *Handbook of Game Theory*, preface ('Another such "bridge" between the non-cooperative and the cooperative is bargaining theory. Until the early eighties, most of bargaining theory had belonged to the cooperative area. After the publication, in 1982, of Rubinstein's seminal paper on the subject, much of the emphasis shifted to the relation of non-cooperative models of bargaining to the older cooperative models'); A Rubinstein, 'Perfect Equilibrium in a Bargaining Model' (1982) 50 *Econometrica* 97; more in general see RB Myerson, *Game Theory—Analysis of Conflict* (Cambridge/MA 1991, Harvard University Press 1997) sub 8.

[39] J v Neumann and O Morgenstern, *Theory of Games and Economic Behavior* (Princeton, University Press, 1944); J Nash, 'The Bargaining Problem' 18 *Econometrica* 155 (1950); J Nash, 'Non-cooperative Games' (1951) 54 *The Annals of Mathematics* 286.

expose game theory,[40] not even to focus more precisely on its relevance for law,[41] at least not before the first step is taken: this is to show how the (core) research question asked by the theory—by a theory of such universal and eminent importance as game theory—should contribute to deciding on the choice of theories on which to draw upon when reconstructing under the auspices of legal values.

Typically, one main criticism is made when it comes to applying game theory to real world negotiations, i.e. also its relevance in the realm of law. This is that the rational choice assumption is so unrealistic that the predictions it produces are not reliable—in fact, most empirical research points to considerable deviations from the predictions which classic game theory would make. This holds true both with respect to simple one shot games, such as the prisoner's dilemma,[42] and with respect to such fundamental conceptual instruments as backwards induction in the case of games with multiple, but not infinite, shot structure.[43] Even in repeated games without a known end, which game theory sees as fundamentally different (see Fn. 43), it is admitted that the 'rational' strategy of 'tit for tat' is by no means always the most promising.[44] Therefore, it is not astonishing that a whole—and certainly promising—'alternative' 'game theory', based on more realistic assumptions, has developed for questions of bargaining under the name of 'mutual aspiration approximation theory',[45] based on Simon's fundamental finding that most persons

[40] See namely SN Durlauf and LE Blume, *Game Theory* (Basingstoke/ New York, Palgrave Macmillan, 2010); D Fudenberg and J Tirole, *Game Theory* (Cambridge/MA 1991, MIT Press, 2002); Myerson, *Game Theory*. Nor is it really of importance whether in game theory, bargaining is dealt with today rather as a part of cooperative or of non-cooperative game theory (which is seen nowadays to dominate, see n 38). On these issues, see as well the references made.

[41] See D Baird, R Gertner and R Picker, *Game Theory and the Law* (Cambridge/MA, Harvard University Press, 1994).

[42] C Vogt, *Kooperation im Gefangenen-Dilemma durch endogenes Lernen—ein evolutionär spieltheoretischer Ansatz* (Magdeburg, VDM Verlag Müller, 2001) reports 21 % of cooperation in laboratory cases designed as simple prisoner's dilemma cases—where classical game theory would expect 0 %.

[43] Developed first by: R Selten, 'Spieltheoretische Behandlung eines Oligopolmodells mit Nachfrageträgheit' (1965) 121 *Zeitschrift für die Gesamte Staatswissenschaft* 301. For a description today, see RJ Aumann, 'Backward induction and common knowledge of rationality' (1995) 8 *Games and Economic Behavior* 6; more in general Fudenberg and Tirole, *Game Theory*, sub 3.5. In simple terms, the concept says that, if the number of 'shots' is not unlimited (or if the end is not unknown), rational parties can calculate how they (both!) should behave at the last shot and from there induce how they should behalf at the last-but-one etc. up the chain. For empirical studies considerably belying this mechanism: R McKelvey and T Palfrey, 'An experimental study of the centipede game' (1992) 60 *Econometrica* 803; R Nagel and FF Tang, 'An Experimental Study on the Centipede Game in Normal Form: An Investigation on Learning' (1998) 42 *Journal of Mathematical Psychology* 356.

[44] H Gintis, *Game Theory Evolving*, (Princeton, University Press, 2000); Ross, 'Game Theory', sub 4; see also Fudenberg and Tirole, *Game Theory*, sub 5.3.

[45] Ground breaking H Sauermann and R Selten, 'Anspruchsanpassungstheorie der Unternehmung' (1962) 118 *Zeitschrift für die Gesamte Staatswissenschaft* 557; today, for instance, M Ahlert and I Lajtos, *60 years after Nash's bargaining solution—trends in bargaining theory* (Halle/Saale, Martin-Luther-Universität, Jur. und Wirtschaftswiss. Fak., 2011).

are rather looking for satisfying levels of gains, also from cooperation, than for maximizing, thus being only 'satisficers' and not 'maximizers'.[46]

There is, however, a concern which is just as fundamental as, and perhaps even logically prior to, the concern over the appropriateness of the assumptions game theory makes—this concern is over the research questions it asks: in fact, the core research question for game theory—and therefore its scope—can be termed as follows: 'A set of strategies is a Nash Equilibrium just in case no player could improve her payoff, given the strategies of all other players in the game, by changing her strategy.'[47] In other words, game theory is looking for the optimum—or the several optima—which both parties can reach, in absence of cooperation or via cooperation, that is to say the so-called 'equilibria'. This, however, is certainly a core question for 'negotiation', but the question is whether it is as well for legal ordering on the problem of negotiation and the 'justice of consensus'. The answer turns around Raiser's account of the history of the search of a 'iustum pretium' (above Sect. 1.3.1). It seems obvious that long experience and consideration of countervailing arguments have led legal scholarship and practice rather unanimously to the decision that law should consciously stay out of the question of reaching the optimum on the pay-offs which both parties may have from a bargain: even under the current law of standard term contracts (i.e even in the area where scrutiny is strongest in contract law), the pay-off as such is consciously not scrutinized.[48] The countervailing arguments derive from questions like these: given non-perfect information, even less perfect with those standing outside the bargain, how can a judge be well positioned to decide on the optimum of the pay-off? Can a market economy based on private initiative function at all if every outcome of that private initiative can theoretically be second-guessed? Is there not such a thing as party autonomy based on fundamental rights and what would its role be if really judicial scrutiny could be made with a view to second-guess whether there was not another optimum than the solution found in the bargain? Rather, for all these reasons only the outer limits are scrutinized and this has been a conscious choice, made with regard to legal values. In fact, there are only two situations where legal ordering has stepped in with respect to negotiation and the 'justice of consensus' and both are at odds with the core question asked in game theory: that is (i) effect on those (third parties) who cannot influence the bargain (and therefore are not 'computed' into the game theory calculation)[49] and (ii) protection of the 'weaker' party—weaker namely because it

[46] H Simon, 'A Behavioural Model of Rational Choice' (1955) 69 *The Quarterly Journal of Economics* 99; id, 'Theories of Decision-Making in Economics and Behavioral Science' (1959) 49 *The* American *Economic Review* 253.

[47] On this core characteristic which distinguishes game theory from any other decision theory (and also for the development of game theory), see, for instance, Ross, 'Game Theory', sub 2.5; Fudenberg and Tirole, *Game Theory*, sub 1.2; Myerson, *Game Theory*, sub 3.2.

[48] See, for instance, even for the realm of consumer contracts, Art. 4(2) of Dir 93/13/EEC on unfair terms in consumer contracts, [1993] OJ L 95/29.

[49] How little this is a concern from 'inside' game theory can be inferred from the account on how to solve the prisoner's dilemma—making them cooperate in not confessing despite the adverse conditions around—Ross, 'Game Theory', sub 2.7. It is no concern for Ross that—for justice reasons

cannot come up to the standard assumptions which classic game theory makes. In reality, classic game theory struggles with the problem that one party is not behaving rationally and that this is even a problem for the other party if this other party is in fact rational (classical game theory computes action in the light of foreseeable rational behaviour also on the *other* side).[50]

For legal scholarship and practice, the task is to control those deviations from the possible optimum which no longer can be tolerated and is not at all to find the exact optimum possible. The latter is consciously left to negotiation—not to (generalized) 'ordering', be it public or private. This leads to another focusing of the choice of theories which should mainly be considered: alternatives rather than main stream game theory. At least for issues of negotiation and 'justice of consensus', classic game theory is not a promising research approach within the realm of law and for questions of legal scholarship—while it may well be for bargaining theory.

(b) Given all of this, the text quoted by Kahneman and Tversky (Fn. 35) may be more promising as a third 'view' to be considered in this essay: this is the first summary of empirical research which the authors undertook and it is primarily descriptive, listing three main biases which they detected, but from the existence of which they also draw some normative conclusions—albeit only in a very slim and preliminary way and certainly not yet with a regulatory perspective. The empirical research which had been undertaken—all duly recorded in the paper itself—equally forms part of the research base for a further systemization later on, namely with a (longer, and perhaps even better known) paper which addressed choices under risk and in which they develop the so-called prospect theory.[51] Even though this empirical research on biases was completely new and original, the concept and the term of 'bounded rationality' had already been developed in the 1950's, namely by H. Simon (above Fn. 46) who was the first to fundamentally challenge the assumption of rational self-interested (welfare) maximizing behavior and to replace it by the concept of the merely 'satisficing' man, using rational search strategies only in a limited way and aspiring only to a 'satisfactory' level.

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advanced for a principle of retaliation, but as well for the scope of general deterrence in criminal rules—the legal order indeed wants to prevent cooperation.

[50] Ground breaking in this respect the so-called 'trembling hand' problem: R Selten, 'Re-examination of the Perfectness Concept for Equilibrium Points in Extensive Games' (1975) 4 *International Journal of Game Theory* 22 (parties must forecast that the other side may commit mistakes when deciding on their 'shot', ie that the other side may have a 'trembling hand'); good account today in H Gintis, *The Bounds of Reason: Game Theory and the Unification of the Behavioral Sciences* (Princeton, University Press, 2009).

[51] D Kahneman and A Tversky, 'Prospect Theory: An analysis of decision under risk' (1979) 47 *Econometrica* 263. The bias described here (among others) is that persons when judging future prospects, typically set a certain expectation level below which outcomes are seen as losses and above which outcomes are seen as gains and that then, in a second step of evaluation, they typically judge the avoidance of a loss as more important than the acquisition of the same amount of gains (contrary to standard utility theory). Later on, the search for a systematic list of biases was continued and extended, namely in: A Tversky and D Kahneman, 'Extensional versus Intuitive Reasoning—The Conjunction Fallacy in Probability Judgment' (1983) 90 *Psychological Review* 293; id, 'Rational Choice and the Framing of Decisions (1986) 59 *The Journal of Business* 251.

Although Kahneman and Tversky build on this concept, they can, however, be seen as the start of the second contemporary research generation on bounded rationality research insofar as they now describe in more detail the situations and the dimensions in which exactly behavior which can be observed in real world deviates from rational maximizing behavior ('biases') and thereby create the basis on which tools for reacting to these biases can be considered and discussed. The text is often not even seen as part of game theory, not even an alternative strand of game theory, because it does not raise the issue of decision taking in an interdependent decision taking situation (non-parametrically). It can, however, easily be applied to such situations, i.e. to bargaining and negotiation situations.

In this paper, Kahneman and Tversky describe three biases which can be summarized as follows (giving an ample array of concrete examples for each group developed in a row of laboratory tests). All three are about the likelihood of events which have to be predicted or guessed, i.e. for which likelihood has to be established. Such computation—taken as granted and exercised in a (mathematical) way which avoids all these biases—is a core element which is assumed to exist when rational choice decision taking is assumed.[52] The basic argument made by Kahnemann and Tversky would seem to be that (i) persons use heuristics in such situations for computing the likelihood and in fact have to do so (see p. 1131), but (ii) that these heuristics do not always lead to realistic approximations to the real world. Later in the article, Kahneman and Tversky state (iii) that persons often do not really learn about these biases even when they already have suffered several times from their consequences (i.e. when they have experience, p. 1130)—and this finding strikingly diverges from what is typically suggested as a solution in rational choice oriented (though evolutionary) economic theory[53] (and this finding can best be explained by yet another bias, the self-serving bias). The text is rather straightforward and easy to read. The first bias which the authors term as the heuristics of 'representativeness' (pp. 1124–1127) consists in that a substantive description or more generally a certain sense of 'order' seems to impress people more than statistical probability and that therefore, once the former is given, the latter is (completely) disregarded—instead of combining both. Thus, for instance, if only a tiny fraction of the population has one profession and a large one has another profession, most observers would hold it to be more likely that a given person has the profession

[52] On the assumption that probabilities are correctly computed by decision takers under the paradigm of rational choice, see: CF Camerer, *Behavioral Game Theory Experiments in Strategic Interaction* (Princeton/NJ, University Press, 2003) Introduction ('Important steps in the 1960s were the realization that behavior in repeated sequences of one shot games could differ substantially from behavior in one shot games, and theories in which a player can have private information about her values (ore "type"), provided all the players know the probabilities of what those types might be'); see also Myerson, *Game Theory*, sub 1.1.

[53] A Alchian, 'Uncertainty, Evolution, and Economic Theory' (1950) 58 *The Journal of Political Economy* 211; RR Nelson and SG Winter, *An Evolutionary Theory of Economic Change* (Cambridge/MA, Harvard University Press, 1982); for a description today see MG Haselton, GA Bryant, A Wilke, DA Frederick, A Galperin, W Frankenhuis and T Moore, 'Adaptive rationality: An evolutionary perspective on cognitive bias' (2009) 27 *Social Cognition* 733.

named first, if characteristics ascribed to him are typical for this profession named first, for instance that a person being very meticulous and having fine fingers is a goldsmith rather than employed in some administration. Similarly, the question how reliable the information given may be is largely displaced by this sense for order ('representativeness'). A second bias has later received even more attention and this is choice of the parameters on which to base decisions under the auspices of 'availability'—and not under the auspices of degree of relevance for the decision to be taken (p. 1127 et seq.). The availability may even be conditioned by subjective elements and, therefore, those features which strike us more (more famous people in a list) are remembered better—a heuristic certainly useful in principle!—and then, however, also used primarily to answer unrelated questions such as how many persons of which sex were in the list. The third—rather closely related—bias/heuristic, so-called anchoring (pp. 1128–1130), has also received high attention in the ensuing discussion.[54] In this case, out of information available, one part is so dominant that it sets the 'trend' ('anchor'), such as where a high probability, even if applied various times, is discounted too little (conjunctive events) and vice versa (disjunctive events). An example of this would be where the probability to have seven times a white ball (from a box containing nine white and one black ball) is almost universally predicted to be higher than having only once a black ball in seven tries (although, statistically, the contrary is true). In the discussion of these findings, the authors, besides the difficulty of learning in these issues, highlight that also experienced people are subject to these biases (but, of course, enterprises can and do take systematic counter-measures). This list of biases has not only been taken up, largely extended and systemized by Kahneman and Tversky themselves, but also by a considerable number of other authors, also in a cross-disciplinary way, in behavioural sciences, in economic theory and also quite prominently with legal 'applications'.[55]

More interesting than further extending this list, however, is, in an essay like this, at least some sketch of a possible reconstruction in law and namely in the realm of

[54] For both biases, see more in detail: F Strack and T Mussweiler, 'Explaining the enigmatic anchoring effect: Mechanisms of selective accessibility' (1997) 73 *Journal of Personality and Social Psychology* 437; A Furnham and H C Boo, 'A literature review of the anchoring effect' (2011) 40 *Journal of Socio-Economics* 35; M Ross and F Sicoly, 'Egocentric biases in availability and attribution' (1997) 37 *Journal of Personality and Social Psychology* 322; N Schwarz, H Bless, F Strack, G Klump, H Rittenauer-Schatka and A Simons, 'Ease of retrieval as information: Another look at the availability heuristic' (1991) 61 *Journal of Personality and Social Psychology* 195.

[55] See only (with further references, also for the other disciplines): C Jolls, C Sunstein and R Thaler, 'A Behavioral Approach to Law and Economics' (1997/98) 50 *Stanford Law Review* 1471, List in Annex 1548 ff; see also C Jolls, 'Behavioural Law and Economics' in P Diamond (ed), *Behavioral economics and its application* (Princeton, University Press, 2007) 115; C Jolls, *Behavioral Economics and the Law* (Boston/ Delft, Now Publishers, 2011); RB Korobkin and TS Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 *California Law Review* 1051; for an application to tort and property law, see J Rachlinski, 'A Positive Psychological Theory of Judging in Hindsight' (1998) 65 *University of Chicago Law Review* 571; to finance and securities regulation see DC Langevoort, 'Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation' (2002) 97 *Northwestern University Law Review* 135.

negotiation. So far, a lot of the application has been proposed for criminal law and for government advertising. With respect to negotiation and the 'justice of consensus', besides 'softer solutions', for instance in default rules,[56] two applications might be particularly promising: first—and quite obviously and by no means completely new—disclosure and information rules could be reframed (or at least this issue could be discussed systematically), taking into account the heuristics biasing correct assessments which can be observed with the highest frequency. If it is typical in certain relationships that decisions are taken only on the basis of three or four criteria, disclosure rules could, for instance, also indicate the order in which certain key decision parameters are to be disclosed, particularly in consumer contract law—with a view to highlight at least these elements, perhaps also supplemented with the imposition of a certain maximum number of words to be used. This could further the better recognition of those elements which for most consumers are the most relevant. Potentially more demanding would be a reconstruction of these findings in questions such as defects of consent (such as mistake etc.) and when they should give rise to a right to void the contract. Second, it might also be quite promising to extend the idea of market failure (and of a need to regulate) from situations characterized by information asymmetries as they have been conceived traditionally to the area of systematic (ab)use of cognitive biases: If, on the basis of a structural, unavoidable information asymmetry, duties to disclose or even mandatory substantive rules have been formulated,[57] a parallel step might be to characterize it as an abuse of dominant position or as an unfair trade practice when one side of the bargain (typically the professional side) systematically uses well-known biases in order to induce the other side to enter into certain contracts or contract terms. Or one might at least attach a withdrawal right to such practices. These are lines of potential thought rather than propositions. They show, however, how demanding (but also rewarding) it often may be even to reconstruct rather straightforward findings from neighbouring disciplines.

1.4 Conclusions

We are still very much at the start of a broadly interdisciplinary legal research agenda, in reconstructing in the realm of law insight from all of social science, and even beyond, and in doing so with a range of theories stemming from a broad range of regional traditions (and languages).

It is therefore too early to draw conclusions. Only the starting point can be summarized: from a theoretical point of view, with respect to interdisciplinary research,

[56] For work pointing into this direction, see namely R Thaler and C Sunstein, 'Libertarian Paternalism' (2003) 93 *American Economic Review* 175.

[57] See, for instance, for standard contract terms, G Akerlof, '"The Markets for Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488; and Schäfer and Ott, *Lehrbuch der ökonomischen Analyse des Rechts*, 513–515.

three things would seem to be obvious (but have also been 'justified' at least in principle in this essay): (i) legal scholarship should strive for reconstructing all relevant insight from neighbouring disciplines in the realm of law, that is to say not just from law and economics or other law and one discipline approaches; (ii) in doing so, despite the need to make choices at a certain moment, it should start from as broad a basis as possible and, given the still existing fragmentation in national and regional discourse circles, should also reflect the regional diversity of theories developed; and, finally and absolutely crucial, (iii) such reconstruction will be different from the one which economic theory has already broadly achieved under the auspices of the paradigm of 'efficiency', namely in institutional economics; such reconstruction must instead take place under the auspices of the values fundamental to legal thinking, namely democratic legitimacy, rule of law and fundamental rights—this is as much true in private law as any other area of law.

All this is a huge research agenda, a research agenda for a whole community of legal scholarship. In practical terms, it may well be (iv) that such discussion is better arranged around more precise phenomena or single questions, such as negotiation, rather than being undertaken in an abstract and general way. Essays as this one can propose a first sketch, proposing some cardinal points and answers, but it is only by manifold reactions from many sides that the sketch becomes a full large painting truly filling and dominating the space with colour and composition.

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Chapter 2
Post-private Law?

Martijn W. Hesselink

Abstract In 2012, Hans Micklitz presented a report (*Gutachten*) for the German lawyers' association (*Deutscher Juristentag*) on the future of consumer law. The focus of the report was primarily on German law. However, as usual, Micklitz' main argument clearly had a broader, Europe-wide vocation. Therefore, it is particularly fortunate that the report recently was published also in English, entitled 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse'. Micklitz answers the question of whether there is a need for a new design of consumer law positively. Consequentially, he proposes to reshape consumer law into a special law. In this short contribution in his honour, I will take issue with that proposal and with the main reasons Hans Micklitz offers in its support.

2.1 A Thought-Provoking Impulse

In 2012, Hans Micklitz presented a report (*Gutachten*) for the German lawyers' association (*Deutscher Juristentag*) on the future of consumer law.[1] The focus of the report was primarily on German law. However, as usual, Micklitz' main argument clearly had a broader, Europe-wide vocation. Therefore, it is particularly fortunate that the report recently was published also in English, entitled 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse'.[2] Micklitz answers the question of whether there is a need for a new design of consumer law positively. Consequentially, he proposes to reshape consumer law

[1] H-W Micklitz, 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?', *Gutachten A zum 69. Juristentag* (Munich, CH Beck, 2012).

[2] H-W Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse' (2013) 32 *Yearbook of European Law* 266. The references will be to the English version.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_2,

into a special law. In this short contribution in his honour, I will take issue with that proposal and with the main reasons Hans Micklitz offers in its support.

2.2 The Tanker and the Sailing Boat

A decade after the reform of the German law of obligations (*Schuldrechtreform*), Micklitz takes stock of the integration of consumer protection law into the Civil Code (BGB). Micklitz' verdict is unequivocally negative: the integration has failed substantially. It could be characterised as a success only at a very superficial, conceptual level, but a true, normative integration has never taken place. Worse, it could not even have occurred since the private law of the BGB, on the one hand, and consumer law, on the other, are irreconcilably—indeed 'essentially'—different:[3] the private law of the civil code is essentially static, while consumer law is intrinsically dynamic.

Micklitz compares the BGB and consumer law, respectively, to a heavy tanker and a sailing boat. 'The heavy tanker BGB cannot keep up with the dynamics of the agile consumer law.'[4] This metaphor is powerful and imaginative. However, what exactly does it mean? It cannot be intended that developments in the civil code just take place more slowly than in consumer law, since presumably an oil tanker will cross the ocean much faster than a skiff. Nor can it mean that the BGB should carry bulk transactions while consumer law should remain reserved for occasional (and recreational) use. No, what Micklitz has in mind is another difference: a heavy tanker ship, he explains, 'can change its direction in only a limited way and needs time for every change of direction' while sailing boats 'can change their direction quickly and easily, but are exposed to wind and weather—that is to say political current—in a far stronger way.'[5] So, the metaphor is about the possibility for the captain to rapidly adapt its course, whenever there is a change of plan.

2.3 Forever Young?

At first sight this idea may seem plausible. However, upon further consideration, it is not entirely clear why consumer law would be intrinsically more dynamic than other parts of private law.[6] Is it because consumers are whimsical and inconstant, always running after the latest fashion? That does not seem to be what Micklitz means. He writes: 'The dynamic of consumer law cannot be harmonized with the static of the BGB. Consumer law presents itself as a restless field of law, subjected

[3] Ibid, 269.

[4] Ibid, 281.

[5] Ibid, 269.

[6] In the same sense, E Hondius in his contribution to this volume.

to continuous changes, which furthermore do not emerge from the centre of German law or German politics, but which 'invade' Germany via the European Union.'[7] However, this image seems to confuse the intrinsic nature of consumer law with characteristics that are more typical of youth. Are not all new legal fields for some time more dynamic and subject to rapid changes, especially when they are in the eye of political turmoil, than the more settled and mature fields of law? Today, financial law seems at least as restless and subjected to continuous change as consumer law.

Moreover, the image of a fresh and brisk consumer law also seems somewhat outdated. Consumer law was born in the early 70s' and came of age in the early 90s'.[8] Core subjects like the protection against unfair terms seem very well settled today, and certainly not restless. At the same time the consumer movement also starts to show definite signs of conservatism. The role of consumer protection groups today seems to be geared no longer only towards reform but as least as much towards the preservation of what has been achieved so far, in spite of the fact that 'the consumer acquis' in reality often represents the vested interests of the most privileged consumers in Europe which are not necessarily shared by the newcomers and outsiders from Europe's periphery.[9] A telling example was the recent debate concerning the European Commission's proposal for a Common European Sales Law, where consumer groups (and their advocates in the European Parliament) fought, tooth and nail, for the preservation of what they regarded as one of their main successes, i.e. Art 6 Para 3 of the Rome I regulation, while knowing very well that the main effect of this provision is that it forces consumers in the new Member States to subsidise the more extensive protection enjoyed by consumers living closer to Europe's political and economic centre.

2.4 BGB: Building Site or Austere Monument?

Micklitz' report focuses on the future of consumer law. So, we cannot blame him for not developing in any detail his views concerning the future of commercial law. However, if the explicit conclusion is that 'an outsourcing of the consumer law of the BGB is necessary and desirable',[10] then by implication non-consumer private law seems to be doomed to remain behind in the BGB—otherwise there would be no reason for consumer law to leave in the first place. In other words, while consumer law will move to its brand new premises commercial law will have to stay

[7] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law?', 359.

[8] The Paris Summit of 1972 or the Council's first consumer protection programme of 1975 are usually referred to as the cradle of consumer law in Europe. If we take John F Kennedy's, 'Special Message to the Congress' of 1962 as the starting point, then consumer law today is already beyond middle age.

[9] D Caruso, 'Qu'ils mangent des contrats: rethinking justice in EU contract law' in G de Burca, D Kochenov and A Williams (eds), *Europe's Justice Deficit?* (Oxford, Hart, 2014, forthcoming).

[10] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law?', 359.

in an old dysfunctional building.[11] Thus, we seem to be confronted with another contrasting pair of images, consumer law as the busy building site where modernity is shaped, and the BGB as an austere monument with the formalist architecture of classical private law, to which respectful visits are paid but which has lost most of its relevance for our daily lives. This will be all the more true given the fact that in Micklitz' proposal the consumer law that will be moving out, will take with it also the large and economically important group of transactions concluded between small businesses.[12]

While Micklitz's image of a dynamic consumer law seems overstated, the picture that he paints, largely by implication, of the civil code that will continue to apply to non-consumer transactions seems unduly dim. Consumer law is where the action is, general private law is static, if not lethargic, and without any realistic prospect for reanimation. The problem with Micklitz' proposal, therefore, is not that it goes too far, as some conservatives might be inclined to argue, but rather that it does not go far enough. Why should we accept that the general private law in the civil code be static to the point of becoming dysfunctional? Are not the parties to commercial contracts equally entitled to a private law that is fully up to date and in touch with the latest economic, technological and social developments? Micklitz writes: 'The BGB will continuously remain a building site, if the consumer law stays there.'[13] Well, maybe it should. To the extent that technological innovations and socio-economic developments, of national and (increasingly) transnational origin, call for an adequate response, would we not want to have a new architecture also for non-consumer private law?

2.5 Re-depoliticising Private Law

There is a persistent myth according to which a formal understanding of party autonomy, freedom of contract and corrective justice is of the essence of private law. The German version of the myth is called 'ordoliberalism' and its programme is entitled 'the private law society'. This is a myth because it is not even remotely descriptive of private law as it exists today in Germany or elsewhere in Europe. Indeed, in reality much of the socialisation of private law that took place in the

[11] Micklitz only discusses contract law and civil procedure. Thus, it remains unclear what should happen to the transfer of title aspects of consumer sales and, more generally, to the private property owned by consumers, to torts committed by consumers, to family quarrels among consumers, and to the application of succession law to consumers. Micklitz seems to imply that these subjects should continue to be taken care off by the BGB. That makes good sense. However, the question arises why *from his point of view* these subjects should not become part of consumer law as well.

[12] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law?', 351. Thus, the BGB would also become a rather empty house as well. Incidentally, it seems somewhat paradoxical that Micklitz wants to leave the BGB but then wishes to take most of its present inhabitants with him.

[13] Ibid, 284.

twentieth Century was based, especially in Germany, on general clauses in the civil code, like § 242 BGB on *Treu und Glauben* (good faith), and in the context of commercial contracts. The policing of unfair terms (especially limitation clauses) and doctrines like *Wegfall der Geschäftsgrundlage* (frustration of contract) were first developed in business-to-business (b2b), not in business-to-consumer (b2c) relationships. It is therefore misleading to conflate weaker party protection with consumer law, even if the definition of consumers is extended to small businesses. There exists no pure, politically neutral private law, to be contrasted with the intrinsically political consumer law. If anything, today the idea of a private law society constitutes a neoliberal programme for radical political reform. Curiously enough, however, the ordoliberal myth of private law is cultivated most diligently by its German academic critics from the left.

A direct implication of the formal understanding of private law and of contrasting general private law with the special private law that protects certain weaker parties, has always been that it makes general private law appear rather technical and apolitical.[14] One important consequence of the inclusion of weaker party protection law (consumers, patients, tenants, employees) into the German civil code in 2002 (and previously in the new Dutch civil code in 1992) was that it changed the political colour of the civil code.[15] A danger of outsourcing consumer law, as Micklitz proposes, is therefore that, as a result, the colour of the civil code will change again, after the departure of 'red' consumer law. Micklitz' proposal risks, in other words, to contribute to reviving the ordoliberal myth once again by re-depoliticising general private law.

2.6 Unfair Exploitation

In reality, there is no convincing substantive reason for limiting weaker party protection to consumers, even if this category is extended to small businesses, as Micklitz proposes. The example of unfair exploitation can illustrate this point. Article 51 of the proposed Common European Sales Law on unfair exploitation reads as follows:

'A party may avoid a contract if, at the time of the conclusion of the contract:

a. that party was dependent on, or had a relationship of trust with, the other party, was in economic distress or had urgent needs, was improvident, ignorant, or inexperienced; and
b. the other party knew or could be expected to have known this and, in the light of the circumstances and purpose of the contract, exploited the first party's situation by taking an excessive benefit or unfair advantage.'

[14] D Kennedy, 'The Political Stakes in "Merely Technical" Issues of Contract Law' (2002) 10 *European Review of Private Law* 7.

[15] With regard to European contract law, cf. S Grundmann, 'European Contract Law(s) of What Colour?' (2005) *European Review of Contract Law* 184. With regard to Dutch law, see EH Hondius, 'De zwakke partij in het contractenrecht; over de verandering van paradigmata van het privaatrecht' in T Hartlief and CJJM Stolker (eds), *Contractsvrijheid* (Deventer, Kluwer 1999) 387, who speaks of a paradigm shift. See also his contribution to the present volume.

As a provision of general contract law this Article is meant to apply in both b2c and b2b relationships.[16] It conveys a strong normative message that unfair exploitation is not tolerated in the internal market, not only in b2b, but also between businesses. This article is of great practical and symbolic value. It provides a long-awaited impulse to moralising the internal market. It does so in concert with the general duty to act in accordance with good faith and fair dealing (Art 2), which requires 'conduct characterised by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question', the obligation to co-operate (Art 3), and the many references in the text to 'reasonableness' (defined in Art 5). The internal market is not a jungle where might is right; the operators on the internal market are subject (within the scope of EU law) to the Charter of Fundamental Rights of the EU, which guarantees the fundamental rights to dignity, freedom, and equal treatment. Art 51 may be regarded as giving expression to those fundamental rights and, if enacted, it will have to be interpreted in their light.[17] EU private law rules provide guidance to individuals and businesses with regard to permissible conduct in the internal market. General private law, as rules of just conduct, may be regarded as a polity's civil constitution: the BGB expresses the German understanding of justice among private parties, a CESL could similarly constitute an expression of what we regard as contractual justice in the European Union.

2.7 Market Citizens

A troubling dimension of consumer law has always been that it addresses us as consumers rather than as the full persons that we are. Are we really merely consuming when we download the music that we love, book a well-deserved holiday, switch on the heater in the winter, or buy medicines? And is it desirable that we are encouraged to identify even more with our roles as consumers, as will happen, inevitably, if the part of private law most relevant to our daily lives will be relabelled as consumer law? Do we need further incentives for consumerism and commodification? As it is well known, the European commission tends to confuse citizens with consumers (e.g. when its citizens' agenda focuses on roaming rights),[18] the European Union

[16] It is true that the CESL-proposal limits the personal scope in b2b-contracts to cases where at least one of the parties is an SME (Art 7 para 1). However, the definition of SMEs is so broad (see Art 7 para 2) that apparently it covers 99% (!) of all businesses in the EU. See Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, [2003] OJ L 124/36. Moreover, under the proposed Regulation, the Member States are allowed to extend the personal scope of application to the largest businesses as well (Art 13 para 2).

[17] See recital 37 of the proposed regulation.

[18] JHH Weiler, 'To be a European Citizen: Eros and Civilization' in JHH Weiler (ed), *The Constitution of Europe; "Do the New Clothes Have an Emperor?" and Other Essays on European Integration* (Cambridge, CUP 1999) 324, 334; A Supiot, *Homo Juridicus; essai sur la fonction anthropologique du Droit* (Paris, Seuil 2005) 165; MW Hesselink, 'European Contract Law: A Matter of Consumer Protection, Citizenship, or Justice?' (2007) *European Review of Private Law* 323, 345.

with its single market, and justice with economic growth[19] (e.g. when it proposes a common European sales law underlining its potential for growth of the European economy).[20] Should we really follow the Commission's example?

Micklitz seems somewhat ambivalent with regard to the idea of the market-citizen. On the one hand, he is very critical of the fact that in the EU consumers are given the task to shop cross-border for the sake of the European economy. He is entirely right when he points out that in the EU 'it is incumbent upon [the consumer] to support, promote, and expand the single European market' and that this is 'a political task that goes beyond the simple purchase decision in individual cases.'[21] We must indeed reject this illegitimate confusion by public authorities of our roles as citizens and consumers.

On the other hand, however, Micklitz himself seems to endorse the idea that citizens should (sometimes) participate in the democratic debate qua consumers, e.g. when he claims that 'democratic participation means the inclusion of consumers in the legislative procedure'.[22] However, that seems equally wrong. Surely, we must participate in the democratic debate, even about consumer law, as citizens, not as consumers? When considering the merits of weaker party protection we should consider and weigh the interests of all potentially affected parties, including sellers and (potentially) third parties (i.e. in the case of negative externalities).[23] If we aspire to a meaningful political deliberation, we cannot enter the political debate as mere stakeholders—politics is for citizens, not for consumers.

2.8 Consumers and Their Lifeworld

It could be pointed out—and it seems implicit in Micklitz' analysis of consumer law—that our advanced societies are characterised by an ever further going functional differentiation, also in law, and that there is no way back. This is true as an empirical matter and there is also nothing per se worrying about this trend. For contract law, it means that social, economic, and technological developments require specifically appropriate rules for new types of contracts, for new contracting techniques, and for socially differently situated contracting parties. Clearly, it is not true that one size fits all, nor that it should. However, this does not mean that

[19] See Vice-President Reding's 'Justice for Growth Agenda'. Cf. 'Speech: Justice for Growth makes headway at today's Justice Council' (http://europa.eu/rapid/press-release_SPEECH-13-29_en.htm?locale=en).

[20] Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, Brussels, COM(2011) 635 final, recital (16); Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Common European Sales Law to facilitate cross-border transactions in the single market, COM(2011) 636 final, 12.

[21] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law?', 293.

[22] Ibid, 307.

[23] On such cases, see L Tjon Soei Len, *The Effects of Contracts Beyond Frontiers. A Capabilities Perspective on Externalities and Contract law in Europe* (Amsterdam, 2013).

the various differentiated contract types and contracting situations have nothing in common anymore that could be of any normative relevance. The idea of a closed, self-referential system of consumer law is both descriptively inadequate and normatively unattractive.[24] In addition to being a consumer, persons also have several very different roles and identities. It does not make sense, either descriptively or normatively, to reduce their agency when they are contracting, exclusively to their roles as consumers. Consumers are not locked-up in a self-referential system of consumer law; they still share together a common world of private law and contract law, and their rights and responsibilities qua wholly integrated persons cannot be outsourced.[25]

For private law, the ever growing functional differentiation in advanced societies like ours, means that we observe and need the development of differentiated rules for many different types of contracts, for different types of parties, for different contracting techniques et cetera. However, at the same time we also keep needing more general rules, on different levels of generality for the aspects (sometimes very few) that remain similar in differentiated contracts. This double requirement of differentiation and generality fits remarkably well with the structure of modern civil codes, which are both fully integrated and internally differentiated according to types of contracts, types of parties etc. The civil code comprehensively covers the entire world of private law (i.e. all the aspects of our lives that may be affected by private law), which remains merely one sector of the broader world of law (to the remainder of which it is fully connected in multiple ways). It means to treat cases similarly to the extent that they are indeed similar and differently to the extent that they differ.

It is the task of private law theorists and practitioners constantly to rethink the more general rules of private law in terms of the social, economic and technical developments: can and should certain rules that were adopted for a specific situation in fact be generalised? Do certain rules that were adopted as general rules actually require one or more exceptions? This need for rethinking applies to all parts of private law, including its most general rules and principles. It should not be accepted—and certainly not as a matter of dogma or resignation—that the general rules and principles of private law will remain behind in the nineteenth Century (or will be sent back to it) while consumer law moves fast forward, further into the twenty-first Century. The social acquis of the twentieth Century cannot be reduced to a consumer acquis. Weaker party protection cannot be outsourced to consumer law; it is an integral part of private law and remains a concern for all situations where unequal bargaining and unbalanced contracts occur, including b2b. 'Materialisation' (*Materialisierung*)—the abandonment of strict formal notions of freedom and equality in private law relationships—has nothing specifically to do with con-

[24] For systems theory applied to law, see N Luhmann, *Das Recht der Gesellschaft* (Frankfurt, Suhrkamp, 1993); N Luhmann, 'Law as social system' (1988–1989) 83 *Northwestern University Law Review* 136.

[25] For the critique of systems theories of law, and for the concept of lifeworld, see J Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (Cambridge, Polity Press, 1996).

sumption and consumerism. The concept rather represents a generally applicable normative understanding of core values and principles of our legal order—whose influence extends well beyond private law as well-, in particular the principles of freedom and equality. Obviously, just like the formal private law of the nineteenth Century also the material private law of the twentieth Century should not be reified. This notion also needs constant and thorough rethinking and reconsideration in light of new social, economic and technological developments, not only on the national level but also on the European and international levels. So the real question is (and will always be): do we need a new architecture for private law? There is no natural end to reconsidering the normative structure of private law.

The differentiation of contracting situations, contractual relationships and contract disputes takes place (and should take place), to some extent, along a variety of different axes, from rich to poor, from powerful to powerless, from expert to ignorant, from repeat player to one-off, from long-term to spot contract, from rational to fool, from relational to discrete, from sales to service, from private to public, and indeed from commercial to consumer. Obviously, there is a limit to the degree of nuance that a legal system can manage. The matrix may risk becoming too refined. It would be too costly to consider all contract cases individually in accordance with each of the relevant continua and try to find the proper legal response. And even if it could be found by the legislator at reasonable cost, it is likely that the outcomes would not be sufficiently foreseeable for the parties to plan their future conduct with confidence. So, there need to be some cut-offs: we develop sets of rules for certain types of 'nominate' contracts and weaker party protection has to be categorical at least to some extent. However, there is no logical or normative reason, nor is it somehow required by the empirical practice on the ground, to treat any of these axes for functional differentiation as absolute, and to leap—in its regard—from differentiation to full segregation.[26]

The challenge is to develop general principles of private law in terms of which we can consider the need for differentiations along different functional lines. Those principles, in order to be legitimate, will have to be developed in a fully inclusive democratic process. In this context, private law scholars and theorists, as specialists, have an opportunity (and maybe also a responsibility) to propose good reasons and convincing arguments, but no privileged normative authority.

2.9 Contractual Justice or Access Justice?

Thus, the question should not be what architecture is good for consumers. Consumers are not a section of society: we are all consumers. When the courts refuse to enforce a personal guaranty, they do so as a matter of constitutional protection

[26] Micklitz does propose to differentiate *within* consumer law, e.g. between responsible and vulnerable consumers. It is not clear why a broader spectrum of weaker party protection could not be considered.

of party autonomy (understood in a substantive sense) that any citizen should enjoy.[27] When we are protected against discrimination while contracting for goods and services (the horizontal effect of the non-discrimination principle), we are also addressed as citizens.[28] It is not clear why this should be any different when it comes to combating exploitative, abusive and unfair contracting practices. The state should never lend its support to such practices. That is why unfair terms and exploitative contracts should not be enforceable. It makes no difference whether we were consuming while being exploited or not. The state must show equal respect for the human dignity of all its citizens. Enforcing exploitative contracts is incompatible with that duty.

The principal aim should not be consumer protection, but contractual justice. A core aspect of contractual justice is the refusal by the state to enforce unfair terms and contracts resulting from unfair exploitation. Private law should refrain from enforcing exploitative terms and contracts as a matter of respect for the private autonomy, the equality, and the human dignity of all contracting parties in all types of contracts. What kind of architecture contractual justice exactly requires should be a matter of constant reconsideration and deliberation with a view to periodical reviews of private law. In this context, consumer protection may sometimes turn out to be the best way of achieving contractual justice. However, it is very doubtful that 'recasting consumer law as special law' would be the architectural choice most congenial to improving contractual justice.

Micklitz proposes to differentiate, within consumer law, between responsible consumers (a category which includes small businesses) and vulnerable consumers. The distinction is based on the idea that 'different orders of values can be assigned to the members of the groups'.[29] According to Micklitz responsible consumers require 'a legal model which does not primarily guarantee social justice through redistribution, but especially ensures access to the market, to enable him to benefit from the advantages of the plethora of products and services on offer in an expanded European or global environment'.[30] Micklitz calls this 'access justice' (*Zugangsgerechtigkeit*). He introduced this concept in an earlier paper to describe the EU model of justice.[31] As a descriptive concept, the idea of access justice is very convincing: much of EU law seems indeed to be concerned with access rights and antidiscrimination, the two elements which Micklitz indicates as constitutive of access justice. However, it his report Micklitz goes one step further and claims that responsible consumers should not receive more than access justice. This raises the question whether it is really enough for responsible consumers that they have access to the market and are able to choose from a broad variety of products and

[27] BVerfG, 19/10/1993, 89 *Entscheidungen des Bundesverfassungsgerichts* 214 (*Bürgschaft case*).

[28] Dir 2004/113/EC implementing the principle of equal treatment between men and women in the access to and supply of goods and services.

[29] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law?', 363 f.

[30] Ibid.

[31] H-W Micklitz, 'Social Justice and Access Justice in Private Law' (2011) *EUI Working Papers LAW* No. 2011/02.

services. What if that market is in fact a jungle, without any guarantees of at least minimal contractual justice, e.g. protection against unfair exploitation? If someone who concluded a very unbalanced contract will be defined ipso facto as a vulnerable consumer then, of course, there is no reason to worry. Otherwise, the limitation to mere access justice may well lead, in effect, to contractual injustice in certain cases. Therefore, much will depend on how exactly responsible consumers will be defined (ex ante or ex post, categorically or contextually).

As it often happens in friendships, Hans and I seem to be constantly divided, in our discussions, by strongly felt common ideals, in our case social justice and Europe. It has always been a pleasure to discuss these with Hans, at the very stimulating workshops organised by him at the EUI in Florence, at our research centre in Amsterdam where Hans has been a frequent and most welcome guest, and in many other places in Europe. Hopefully, there are still many more such occasions to come.

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Chapter 3
Non-State Law in the Hague Principles on Choice of Law in International Commercial Contracts

Ralf Michaels

Abstract Article 3 of the Hague Principles on Choice of Law in International Commercial Contracts is the first quasi-legislative text to allow explicitly for the choice of non-state law also before state courts. This article puts the provision into a broader context, discusses their drafting history and particular issues involved in their interpretation. It also provides a critical evaluation. Article 3 does not respond to an existing need, and its formulation, the fruit of a compromise between supporters and opponents of choosing non-state law, makes the provision unsuccessful for state courts and arbitrators alike.

3.1 Introduction

Are we witnessing a revolution in choice of law for contracts? The Hague Conference on Private International Law is about to finalize work on so-called 'Principles on Choice of Law in International Commercial Contracts' (hereinafter called Hague Principles).[1] Formally, the novelty of the Hague Principles lies in their character as nonbinding soft law instead of, as has traditionally been the case at the Hague Conference, a Convention. Their substantive novelty is somewhat hidden, but—perhaps—just as important. After laying down rather uncontroversially, in Article 2(1), that '[a] contract is governed by the law chosen by the parties', Article 3 introduces a definition of law that is novel, at least for state courts:

Arthur Larson Professor of Law, Duke University. Thanks for invaluable advice to Mary Keyes, Yuko Nishitani, Geneviève Saumier and Matthias Scherer. Views and errors are mine.

[1] For the text, preparatory materials, and a bibliography, see http://www.hcch.net/index_en.php?act=text.display&tid=49.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_3,

> **Article 3—Rules of Law** Under these Principles, the law chosen by the parties may be rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.[2]

'Rules of law', as opposed to 'law', has traditionally been understood to include non-state law, and this is intended here, too. What the Hague Conference thereby introduces is the ability for parties to choose non-state law as the law applicable to their contract. Notably, such a choice is supposed to designate the applicable law in the sense of choice of law, not as mere incorporation into the contract.[3] This is an important difference. If a body of rules is merely incorporated, the whole contract (including the incorporated rules) remains governed by a state's law, including its mandatory rules. Where, by contrast, a body of rules is chosen in the sense of choice of law, that body becomes the applicable contract law and, at least in principle, no other contract law governs.[4]

In international commercial arbitration, the choice of non-state law has long been possible (though it has not been used as much as some proponents make us believe.)[5] For state courts, by contrast, allowing for the choice of non-state law represents a novelty. Choice of non-state law is excluded in practically every national system of choice of law.[6] Before courts, the choice of non-state law has played virtually no role, apart from limited exceptions concerning religious law, and isolated decisions rejecting the validity of the choice of non-state law like sports rules,[7] ICC

[2] For this formulation, see *Draft Commentary on the Draft Hague Principles on Choice of Law in International Commercial Contracts* (March 2014) 13, available at www.hcch.net/upload/wop/gap2014pd06_en.pdf. The text, together with the Draft Commentary, will be proposed to the Council on General Affairs and Policy in April 2014. The previous version of Article 3 had a slightly different wording: 'In these Principles, a reference to law includes rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.'

[3] G Saumier and L Gama Jr, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts' in DP Fernández Arroyo and JJ Obando Peralta (eds), *El derecho internacional privado en los procesos de integración regional* (San José, Editorial Juridica Continental, 2011) 41, 44; JL Neels and EA Fredericks, 'Tacit Choice of Law in the Hague Principles on Choice of Law in International Contracts' (2011) 44 *De Jure* 101, 109.

[4] In practice, even if parties choose a law, the law that would have applied without the choice still plays an important role. See R Michaels, 'Die Struktur der kollisionsrechtlichen Durchsetzung einfach zwingender Normen' in R Michaels and D Solomon (eds), *Liber Amicorum Klaus Schurig* (Munich, Sellier, 2012) 191.

[5] See F Dasser, 'Mouse or Monster? Some Facts and Figures on the lex mercatoria' in R Zimmermann (ed), *Globalisierung und Entstaatlichung des Rechts* (Tübingen, Mohr Siebeck, 2008) 129.

[6] R Michaels, 'Preamble I' in S Vogenauer and J Kleinheisterkamp (eds), *Commentary on the UNIDROIT Principles of International Commercial Contracts* (Oxford, Oxford University Press, 2009) 21, nos 49–63. The only state that allows for the choice of non-state law that I am aware of is Oregon; see ibid at no 58. On the Inter-American Convention, see infra section 3.2.3.

[7] Swiss Federal Court, DFT 20/12/2005, 132/2005 III 285, (2006) *Archiv für Juristische Praxis* 615.

rules,[8] or the Unidroit Principles.[9] Where it is discussed it is rejected. Attempts to allow for such a choice—first in the Interamerican Conference, then in the reform of the European Rome I Regulation—have, so far, been unsuccessful. And indeed, it is not clear why we should expect there to be more interest before state courts—why should parties want to opt out of state-made law, but not out of state-made adjudication?

In this article, I aim to do three things. The first is to lay out, in relative detail, the context for the provision, as well as its drafting history. Article 3 of the Hague Principles is the latest intervention in the debate on the choice of non-state law; it can be better understood against this history. My second goal is doctrinal: I attempt to give guidance as to some of the issues of detail that are left open by the Principles, while at the same time maintaining a critical stance towards them. The third goal is a critical evaluation. I argue that Article 3 is emblematic of a dangerous tendency of making law to educate parties as to what would be good for them.

3.2 Choice of Non-State Law in Transnational Codifications—Predecessors of the Hague Principles

The question whether non-state law can be chosen as the applicable law is, in the history of choice of law, a relatively recent one. That is not surprising, given that even party autonomy at large—the ability of the parties to choose the applicable law—is a very recent introduction. Party autonomy in the modern sense really arose only in the nineteenth century and became paradigmatic relatively late in the twentieth century.[10] Still today, some legal systems, especially in Latin America, reject party autonomy altogether, at least in principle.[11]

For a long time, discussions on party autonomy were thus, as a matter of course, restricted to state laws. The idea that secular non-state law could be chosen (and thus all state law deselected) seems to have come up in the context of discussions, especially among French law professors and practitioners, on a new lex mercatoria, which was supposed to enable either a contrat sans loi (that is a self-sufficient contract that requires no recourse to any other body of law than the contract itself),[12]

[8] Tribunale di Padova, Sezione di Este 11/1/2005, available at www.unilex.info; for discussion, see M Luby and S Poillot-Peruzzetto, 'Chronique: Droit international et européen' (2006) *Jurisclasseur Périodique (La semaine juridique)* 157.

[9] Tribunale di Padova, ibid. On the Unidroit Principles, see infra section 3.2.2.

[10] See the extensive analysis in Y Nishitani, *Mancini und die Parteiautonomie im internationalen Privatrecht* (Heidelberg, Winter, 2000).

[11] See MM Albornoz, 'Choice of Law in International Contracts in Latin American Legal Systems' (2010) 6 *Journal of Private International Law* 23; MS Rodríguez, 'El principio de la autonomía de la voluntad y el Derecho Internacional Privado: asimetrías en su reconocimiento y necesidad de armonización legislativa en el Mercosur' (2011) 15 *Revista Científica de UCES* 112.

[12] L Gannagé, 'Le contrat sans loi en droit international privé' (2007) 11.3 *Electronic Journal of Comparative Law*, www.ejcl.org/113/article113-10.pdf.

or the choice of an alleged transnational customary contract law, the so-called lex mercatoria.

The origins are of course complex, but it seems that we can recognize two interests underlying this support for non-state law. One was a professorial desire, emerging from a long academic tradition particularly in Europe, to 'privatize' private law, by removing its source from the state and making it independent.[13] Detachment from the state seems to enhance the private character of private law. In connection with this, it could maximize party autonomy, which is sometimes viewed as an unqualified good. A universal transnational private law would represent the return of an old dream, that of the ius commune. Diversity of laws is often viewed as undesirable—even by private international lawyers, who often view private international law as a second best solution that would be made unnecessary through the adoption of some universal law.

The other was a practitioners' interest in liberating transnational contracts from interference by states with their mandatory laws, a market-oriented project linked to the rise of international arbitration as an adjudicatory system liberated from the state. Some practitioners support the idea of a law that is, to the farthest extent possible, detached from the state, and thus guarantees maximum freedom to parties, and maximum business to their lawyers. This latter interest in a privatized substantive law was always closely linked to an interest in privatized adjudication (arbitration).

3.2.1 UNCITRAL Arbitration Rules and Other Arbitration Texts

It is indeed in international arbitration that these ideas for the choice of non-state law had some success. Article 28 of the UNCITRAL Model Law on International Commercial Arbitration allows for the choice of 'rules of law', which is meant to comprise law other than state law.[14] 'Rules of law' in the same sense can be chosen also under many other national and non-national arbitration regimes.[15] Indeed, in arbitration, lex mercatoria and other non-state law have occasionally been selected, though not frequently.[16]

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[13] See N Jansen and R Michaels, 'Private Law and the State. Comparative Perceptions, Historical Observations, and Basic Problems' in N Jansen and R Michaels (eds), *Beyond the State? Rethinking Private Law* (Tübingen, Mohr, 2009) 15; also in (2007) 71 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 345.

[14] *UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration* (2012) 121; for discussion, see Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 46 ff.

[15] Saumier and Gama, ibid.

[16] See G Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution' (2012) 17 *Uniform Law Review* 533, 539.

Before state courts, by contrast, the choice of lex mercatoria as applicable law has never been allowed.[17] Certainly, one argument was that conflict of laws had traditionally (at least in the West and at least since the rise of the nation state) designated only state laws as applicable.[18] However, there were also practical concerns having to do with the function of courts. State court decisions are published and may serve as precedent. This places greater requirements on doctrinal accuracy. And one problem with non-state law like the lex mercatoria has always been that its content could not be established with sufficient certainty.[19]

3.2.2 UNIDROIT Principles of International Commercial Contracts (1994) and Principles of European Contract Law (1995)

Such uncertainty is not a problem where the non-state law in question comes in the form of legal rules. This was, from the beginning, a great selling point for the UNIDROIT Principles of International Commercial Contracts (UPICC), which appeared, in a first edition, in 1994. Mostly, the UPICC are a text of substantive law; they only present themselves as a modern Restatement of the lex mercatoria, or of transnational commercial law.[20] They also include, however, in their Preamble, rules on when the Principles should be applicable, including a rule that '[t]hey shall be applied when the parties have agreed that their contract be governed by them.' The Principles of European Contract Law, whose first edition appeared in 1995, have a conflicts rule quite similar to the Preamble of the UPICC in their Article 1:101.[21]

These are, perhaps, the earliest examples of provisions in transnational legislative texts that explicitly endorse the choice of non-state law without restriction to arbitration. Their rules on applicability have created disproportionate interest in scholarship—quite likely, more ink has been spilled on the single question of whether the Principles can be chosen as applicable law than on all of their substantive provisions

[17] It is sometimes claimed that state courts recognize lex mercatoria when they enforce arbitral awards that have been rendered on the basis of lex mercatoria. But this proves little, given that arbitral awards are regularly enforced without revision of the applicable law.

[18] See R Michaels, 'The Re-State-Ment of Non-State Law: The State, Choice of Law, and the Challenge from Global Legal Pluralism' (2005) 51 *Wayne Law Review* 1209, 1244 ff.

[19] For a similar argument as regards religious law, see *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ 19, nos 51–52; see A Briggs, *Agreements on Jurisdiction and Choice of Law* (Oxford, Oxford University Press, 2008) 386, 387 f.

[20] MJ Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, 3rd ed (Ardsley, Transnational Publishers, 2005), esp. 9 ff.

[21] Article 1:101—Application of the Principles

'(2) These Principles will apply when the parties have agreed to incorporate them into their contract or that their contract is to be governed by them.'

combined.[22] For the PECL, the question has lost some interest, as they merged subsequently into predecessors of an EU instrument of contract law.[23] By contrast, for the UPICC the question remains relevant.

The UPICC are not binding law. Their Preamble is, therefore, a rather curious rule, because it attempts something logically impossible: the UPICC attempt to make themselves applicable, just like a bootstrap.[24] Nonetheless, the UPICC have had some success worldwide: they have occasionally been chosen as the applicable law (although, as far as can be seen, less frequently than their promoters suggest), and they are quite frequently referred to in judicial opinions.[25] Their choice has not been held valid before any state court, however. This is so although many commentators have argued that the UPICC are 'law' in every relevant regard, and must therefore be a possible object of choice. But this has always been a non sequitur: even if the UPICC are indeed law in the sense of legal theory, this is not binding for the sense of the term 'law' in a choice-of-law rule. Here, the matter is one of statutory interpretation, and confinement to state law is usually in accordance with legislative intent.

3.2.3 Inter-American Convention on the Law Applicable to International Contracts (1994)

The first treaty that allows, according to some, for the choice of non-state law as the applicable law before state courts was the Inter-American Convention on the Law Applicable to International Contracts, also called the Mexico Convention. Non-state law was actively pushed by some participants in the negotiations, in particular Fritz Juenger. It does indeed appear in the Convention, though not in direct connection to party choice. Thus, Article 9(2)(2) requires the judge to look also to "general principles of law" when the parties have *not* chosen a law, but this hardly suggests that parties should be able to choose such general principles. In addition, Article 10 gives a role to guidelines, customs, principles of international commercial law and commercial usage and practice, but that role is merely supplementary.[26]

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[22] A comprehensive bibliography would be impossible. For a great number of publications, see the bibliography for the Preamble of the UPICC at www.unilex.info, and the bibliography in Vogenauer and Kleinheisterkamp (eds), *Commentary on the UNIDROIT Principles of International Commercial Contracts*, 1201, 2nd ed forthcoming.

[23] See E Clive,'The Lasting Influence of the Lando Principles' in MJ Bonell et al (eds), *Liber Amicorum Ole Lando* (Copenhagen, DJØF, 2012) 69, 71. For a (critical) perspective on the trajectory from PECL to European Sales Law, see H Eidenmüller et al. 'The Proposal for a Regulation on a Common European Sales Law: Deficits of the Most Recent Textual Layer of European Contract Law' (2012) 16 *Edinburgh Law Review* 301.

[24] See R Michaels, 'Privatautonomie und Privatkodifikation – Zu Anwendbarkeit und Geltung allgemeiner Vertragsrechtsprinzipien' (1998) 62 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 580, 613.

[25] See Michaels, 'Preamble I', nos 88-117.

[26] Similarly now Articles 13(4) and 51 of the new Uruguayan Code for Private International Law. See D Opertti Badán and C Fresnedo de Aguirre, 'The Latest Trends in Latin American Private

Where the Convention talks about party autonomy, by contrast, non-state law does not seem to be available. Article 7(1)(1) reads simply: 'The contract shall be governed by the law chosen by the parties.' Allowing parties to choose the applicable law was already a novelty for many countries in Latin America, where party autonomy is still viewed by many with suspicion.[27] Nonetheless, some commentators suggest that the provision is even more far-reaching: for them, 'Law' has been read to include non-state law.[28] This would be rather unusual; in most other choice-of-law statutes, 'law' is restricted to the law of states, and Article 17 defines law as 'the law current in a State, excluding rules concerning conflict of laws.' The Spanish version has 'derecho' instead of 'ley', which could suggest a different meaning, but this seems by no means conclusive. In practice, this may matter little, since the Convention has been ratified only by Mexico and Venezuela.[29]

3.2.4 Rome I Regulation (2008)

For some time, it looked as though the choice of non-state law would become available in a major transnational text. In a Green Paper of 2003, the European Commission considered enabling parties to choose 'general principles of law' as applicable law.[30] The background to the rather surprising proposal lay in other areas

International Law: The Uruguayan 2009 General Law on Private International Law' (2009) 11 *Yearbook of Private International Law* 305; eid, 'El derecho internacional en el Proyecto de Ley general de derecho internacional privado del Uruguay—Una prima aproximación' in J Basedow, DP Fernández Arroyo and JA Moreno Rodríguez (eds), *Cómo se codifica hoy el derecho comercial internacional?* (Asunción, CEDEP, 2010) 385, 390 f, 410 et passim. According to C Fresnedo de Aguirre, 'Party Autonomy—A Blanc Cheque?' (2012) *Uniform Law Review* 655, 665, Article 13(4) reaches 'the same conclusion' as Article 3 of the Hague Principles, which seems far-fetched, given that Article 13(4) does not deal with party choice.

[27] Supra n 11.

[28] FK Juenger, 'The Inter-American Convention on the Law Applicable to International Contracts; Some Highlights and Comparisons' (1994) 42 *American Journal of Comparative Law* 381, 392; id, 'Contract Choice of Law in the Americas' (1997) 45 *American Journal of Comparative Law* 195, 204; G Parra-Aranguren, 'The Fifth Inter-American Specialized Conference on Private International Law, Mexico City, 14–18 March, 1994' in A Borrás et al (eds), *E Pluribus Unum: Liber Amicorum Georges AL Droz* (The Hague et al. Kluwer Law International, 1996) 299, 308; JL Siqueiros, 'Los Principios de UNIDROIT y la Convención Interamericana sobre el derecho aplicable a los contratos internacionales' in Instituto de Investigaciones Jurídicas (ed), *Contratación internacional: Comentarios a Los Principios sobre los Contratos Comerciales Internacionales del UNIDROIT* (Mexico, Universidad Nacional Autónoma de México, 1998) 217, 227; for a constitutional argument, see L Gama, *Contratos Internacionais à luz dos Princìpios do UNIDROIT 2004: Soft Law, Arbitragem e Jurisdicao* (Rio de Janeiro, Renovar, 2006) 434-8; for extensive discussion, see S Schilf, *Allgemeine Vertragsgrundregeln als Vertragsstatut* (Tübingen, Mohr Siebeck, 2005) 347–359; JA Moreno Rodriguez and MM Albornoz, 'Reflections on the Mexico Convention in the Context of the Preparation of the Future Hague Instrument on International Contracts' (2011) *Journal of Private International Law* 491, 502–7.

[29] www.oas.org/juridico/english/sigs/b-56.html.

[30] COM(2002) 654 final, 23–24.

of European law: At the time, there were discussions about an optional Community instrument, which, to be effective, had to be electable. It was felt that a private international law text should formulate this possibility in a more abstract manner. Reactions to the proposal were mixed: While many academics were positive, professional associations and practitioners remained, by and large, more hesitant.[31] Nonetheless, a 2005 proposal for a new Regulation provided, in the first sentence of its Art 3(2), that '[t]he parties may also choose as the applicable law the principles and rules of the substantive law of contract recognized internationally or in the Community'.[32] It was not, however, adopted in the final version of the Regulation.[33] Recital (13) merely states that such general principles can be incorporated into the contract by means of freedom of contract under the applicable (state) law. A reason for the change of heart may well have been that the question had lost much relevance, once it was clear that a Europeanized contract law could be made applicable by other means.[34]

3.3 The Genesis of Article 3 of the Hague Principles

In result, then, attempts so far to introduce a choice of non-state law have been unsuccessful, at least as regards courts. The UNCITRAL Model Law on International Commercial Arbitration and similar texts apply only in arbitration. The Mexico Convention contains no clear endorsement of the choice of non-state law and in any event has been largely unsuccessful so far. The Preamble of the UPICC has garnered much academic support but no followers among legislators or courts. The Rome I Proposal in the relevant parts did not become law.

The Hague Principles start very much where the unsuccessful attempts for the Rome I Regulation left off. They represent another attempt to introduce the choice of non-state law in an international instrument. In order to understand the role that non-state law plays in them, it may be helpful to look in some more detail at the genesis of their Article 3, in the context of the general nature of the Hague Principles.

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[31] All reactions are available at http://ec.europa.eu/justice_home/news/consulting_public/rome_i/news_ summary_rome1_en.htm.

[32] Proposal for a Regulation on the Law applicable to contractual obligations (Rome I), COM (2005) 650 final (15 December 2005) 5. See ZS Tang, 'Non-state law in party autonomy—a European perspective' (2012) 5 *International Journal of Private Law* 22, 26.

[33] See Rome I Regulation, Art 3(1) and recital 13; Tang, 'Non-state law in party autonomy', 27.

[34] See now SA Sánchez-Loreno, 'Common European Sales Law and Private International Law: Some Critical Remarks' (2013) 9 *Journal of Private International Law* 191; G Dannemann, 'Choice of CESL and Conflict of Laws' in G Dannemann and S Vogenauer (eds), *The Common European Sales Law in Context—Interactions with English and German Law* (Oxford, Oxford University Press 2013) 21.

3.3.1 Challenges for the Hague Conference

The Hague Conference on Private International Law, founded in 1893, is the most venerated institution for the international unification of private international law. In one way, it is a very successful organization—it counts 75 members from all five continents (74 states and the European Union), and many of its Conventions have been very successful. In another way, however, the Conference and its preferred instrument, the Convention, are in a crisis.

This crisis has several aspects. One is the fact that membership in the Conference has greatly increased; it now comprehends states with vastly different legal and economic conditions. A related problem is that member states are increasingly hesitant to ratify Conventions. In addition, the Hague Conference is no longer the unquestioned leader of private international law developments, now that the European Union has become very active in the field. [35]

And although the Hague Conference has had success in the area of administrative coordination especially in family law, it has never been very successful with choice-of-law regimes. Choice of law for contracts is a prime example. The Hague Principles are not the first project of the Hague Conference devoted to choice of law in contracts. Conventions of 1955 and 1986 already addressed the law applicable to contracts for the international sale of goods.[36] The 1955 Convention went into force in 1964, the 1986 Convention never did. Neither of them addressed the choice of non-state law. Chances for ratification of a general choice of law convention, considered in the 1980s, were considered slim (not least because the EC member states had just concluded the Rome Convention and saw little need for a global treaty); the project was abandoned.[37] At the same time that the European Union has a comprehensive code on choice of law for contracts in the Rome I Regulation (albeit one in which, as discussed, non-state law cannot be chosen), international unification through hard law seems nearly impossible. Even the Exclusive Choice-of-Court Convention, which is, in its content, fairly uncontroversial has so far proven very hard to even ratify, let alone implement.[38]

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[35] See J Basedow, 'Was wird aus der Haager Konferenz für Internationales Privatrecht?' in T Rauscher and H-P Mansel (eds), *Festschrift für Werner Lorenz zum 80. Geburtstag* (Munich, Sellier, 2001) 463; M Traest, 'Development of a European Private International Law and the Hague Conference' (2003) 5 *Yearbook of Private International Law* 223.

[36] See O Lando, 'The 1955 and 1985 Hague Conventions on the Law Applicable to the International Sale of Goods' (1993) 57 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 155.

[37] H van Loon, 'Feasibility study on the law applicable to contractual obligations, Preliminary Document E of December 1983' in *Hague Conference of Private International Law: Proceedings of the Fifteenth Session,* vol I (1983) 98.

[38] See M Pertegás and LE Teitz, 'Prospects for the Convention of 30 June 2005 on Choice of Court Agreements' in Permanent Bureau of the Hague Conference on Private International Law (ed), *A Commitment to Private International Law—Essays in Honour of Hans van Loon* (Cambridge et al. Intersentia, 2013) 465.

3.3.2 Principles As a Response

The combination of these challenges is what led the Hague Conference to adopt a new form for their contracts project: soft instead of hard law, principles instead of a convention. The UPICC provided a model in this regard.[39] Several years ago, Herbert Kronke, then director of UNIDROIT, floated the idea of principles of choice of law, though what he had in mind at the time was a more comprehensive project.[40] The Hague Conference has now taken up this idea.[41] On recommendation by the Council,[42] its new text on choice of law in contracts comes as a non-binding text, notably as Principles, rather than as a Draft Convention. Their Preamble, which is modeled closely on that of the UPICC, suggests that they can be used as a model for legislation, or, by courts or arbitrators, as a supplementary source for interpretation. This suggests that the Hague Preamble does not aim to fulfil the third of the functions of the UPICC, namely its Restatement function—to serve, as an accurate description of the current state of the law.[43] Their main function is rather to serve as a model for lawmaker (predominantly perhaps in Latin America).[44] In addition, they are supposed to play a supplementary role in the interpretation of existing regimes. Unlike the UPICC, the Hague Principles do not suggest that they themselves can be chosen by the parties (in line with the general opposition to allowing parties to choose the applicable choice-of-law rules).

The advantages should be obvious: Principles do not have to go through a difficult ratification process; instead, it can be hoped that they can influence legislators and courts in a more informal way. Their reception need not happen wholesale; lawmakers may pick and choose the provisions they like. In theory, their content can be changed more easily (although experience with the UPICC suggest that such changes will be rare).

However, these advantages come with disadvantages. The most obvious disadvantage arises from their nonbinding character: unlike a Convention, the Hague Principles have no binding force; they must convince before they can become rele-

[39] Permanent Bureau of the Hague Conference, *Consolidated Version of Preparatory Work Leading to the Draft Hague Principles on the Choice of Law in International Contracts* (Prel Doc No 1, Oct 2012) no 7; Neels and Fredericks, 'Tacit Choice of Law', 102.

[40] H Kronke, 'Most Significant Relationship, Governmental Interests, Cultural Identity, Integration: "Rules" at Will and the Case for Principles of Conflict of Laws' (2004) 9 *Uniform Law Review* 467.

[41] They are not the only such project. For another project, see SV Bazinas, 'Towards Global Harmonization of Conflict-of-Laws Rules in the Area of Secured Financing: The Conflict-of-Laws Recommendations of the UNCITRAL Legislative Guide on Secured Transactions' in Permanent Bureau of the Hague Conference on Private International Law (ed), *Essays in Honour of Hans van Loon*, 1.

[42] Conclusions and Recommendations adopted by the Council on General Affairs and Policy of the Conference (31 March—2 April 2009), and in particular 'Choice of law in international contracts', 1.

[43] For this function of the UPICC (and its limitations), see Michaels, 'Preamble I', nos 3–4.

[44] Permanent Bureau of the Hague Conference, *Consolidated Version*, no 8.

vant. Of course, this is true also for Conventions. But Conventions at least carry the weight that they have been negotiated by delegates of the ratifying country. It is not clear that a state would be more likely to adopt a text if it does not come as a Treaty.

A more pressing potential disadvantage concerns the negotiating process: Whereas negotiators drafting a Convention with a view towards ratification will, to a large extent, have the positions of potential ratifiers in mind, negotiators of a nonbinding instrument may feel less constricted. They are not subject to instructions or expectations to the same degree. As a consequence, they may hope that the quality of the text they agree on will alone suffice to make them attractive. This may occasionally be the case. Sometimes, legal rules are successful precisely because they are developed without direct political pressure from constituents. But the danger exists, instead, that negotiators will veer too far from the mainstream to produce a text that is accepted.

The difference in processes should not be exaggerated in this case. For work on the Hague Principles, the Hague Conference followed a semi-official procedure and organized the Special Commission as a diplomatic conference. Representatives from several governments were given relatively detailed instructions, and the EU representative in particular opposed Article 3 with vehemence. Still one may speculate that a government should be more interested in the content of a treaty it plans to enter into than of Principles that have no binding character.

3.3.3 Drafting History of Article 3

All of this seems especially relevant as concerns the drafting of Article 3. The question whether non-state law could be chosen must have been on the mind of negotiators from the beginning, in light of experiences with the Rome I Regulation drafting process.[45] Nonetheless, it was not in the forefront from the beginning.

The question of non-state law first appears in official materials of the Hague Conference in a feasibility study drafted in 2007.[46] The study suggests the question should be taken on because the choice of non-state law 'has for long played an important role in arbitration but is also of growing importance in court proceedings'.[47] No evidence is provided for this finding. Indeed, although the Hague Conference had sent out questionnaires earlier in 2007 to member states and stakeholders

[45] Cf Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 53 f.

[46] *Feasibility Study on the Choice of Law in International Contracts—Report on Work Carried out and Conclusions (Follow-Up Note)* (Prel Doc No 5, Feb 2008), www.hcch.net/upload/wop/genaff_pd05e2008.pdf.

[47] Ibid no 28: 'The instrument might also need to clarify whether it is permissible for parties to choose not only national laws but also transnational or a-national rules or principles to govern the dispute. This has for long played an important role in arbitration but is also of growing importance in court proceedings.' See also no 31 (applicability of a-national law in the absence of party choice in arbitration).

whether and in what way uniform rules on choice of law in international contracts should be made, the questionnaires did not contain a question as to whether there was any need to choose non-state law.[48] Consequently, the question was not addressed in responses.

A later study suggests, appropriately, the Working Group should 'take into consideration both the rules applied by State courts and specific international arbitration rules.'[49] That would suggest making a distinction between arbitration (where 'rules of law' can be chosen) and courts (where only 'law' can be selected).[50] The Working Group, however, took a different path. After an extensive discussion in its first meeting in January 2010, it established a subgroup to address the question, consisting of Lauro Gama (author of a very comprehensive book on the UPICC and subsequently a member of the UPICC working group)[51], Geneviève Saumier (a leading private international law expert at McGill), and, at different times, Emmanuel Darankoum from Montréal and José Moreno Rodriguez from Paraguay.[52] The subgroup produced two reports which remain unpublished but form the basis of two articles.[53] It found that non-state law could be chosen, at the moment, only in commercial arbitration.[54] Nonetheless, the subgroup advocated neither this solution nor another, namely to say nothing and leave the definition of 'law' to further development. Instead, it supported a third option that was approved by the Working Group and ultimately made its way into the Hague Principles—to allow the choice of non-state law regardless of the mode of adjudication.[55] The main reasons given were that no meaningful difference exists between courts and arbitrators or between the choice of state law and that of non-state law, and that allowing for the choice of non-state law enhances party autonomy.[56]

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[48] *Questionnaire Addressed to Member States to Examine the Practical Need for the Development of an Instrument Concerning Choice of Law in International Contracts*, http://www.hcch.net/upload/quest_jan2007members.pdf; *Questionnaire Addressed to Stakeholders in the Field of International Commercial Arbitration to Examine the Practical Need for the Development of an Instrument Concerning Choice of Law in International Contracts*, www.hcch.net/upload/quest_jan2007stake.pdf.

[49] *Feasibility Study on the Choice of Law in International Contracts. Report on Work Carried Out and Suggested Work Programme for the Development of a Future Instrument*, Prel Doc No 7 (March 2009), www.hcch.net/upload/wop/genaff2009pd07e.pdf no 41.

[50] Cf. Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 49.

[51] Gama, *Contratos Internacionais*.

[52] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 44 fn 6.

[53] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', especially 44; Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution', 540 ff (especially 541 note 32).

[54] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 45.

[55] Ibid, 50.

[56] Ibid, 50–52. I discuss these arguments in section 3.5.2.

This suggestion was successful. Although parties in practice rarely choose non-state law—or, rather, precisely in order to overcome this situation[57]—the Working Group decided, after further discussions, to allow parties to choose 'the law or rules of law governing their contract'.[58] The formulation mirrored the UNCITRAL Model Law and thus allowed for the choice of non-state law, but was meant to be available also to state courts. The ability to choose non-state law was justified with the need of the parties for specific rules and for stabilization of the parties' expectations. The aim was to make the choice as broad as possible. The report also suggests that 'the draft Hague Principles not include any express definition or limitation of the term "rules of law", as this provides the greater support for party autonomy.'[59] Moreover, unlike the Draft Rome I Regulation, the Working Group explicitly rejected an additional criterion of legitimacy or international or regional recognition. The only restriction was that the chosen law had to be a body of rules.[60]

The draft thus provided, for the first time, for the choice of non-state law without significant restrictions. This apparently went too far for members of the Hague Conference. According to one participant, non-state law was 'the most controversial issue at the session of the Special Commission'[61] (which is not surprising, given that the other provisions are mostly well within the mainstream) and was discussed 'for the better part of the week.'[62] In the end, a compromise was reached: the choice of 'rules of law' remained possible but was subjected to a number of qualifiers: these rules must be 'generally accepted on an international, supranational or regional level as a neutral and balanced set of rules'. The Special Commission apparently demanded these qualifiers 'to afford greater certainty as to what parties can designate as rules of law governing their contractual relationship', though in reality the qualifiers seem to act more as substantive restrictions than as clarifiers, as I discuss in the next section. In addition, Article 3 now suggests that rules of law can be chosen only 'unless the law of the forum provides otherwise.' This seems a rather unnecessary clarification, given that the Hague Principles are not binding anyway.[63]

After the session, the Working Group redrafted the provision and also drafted commentary, in which the drafting responsibilities for Article 3 were taken by Lauro Gama and Geneviève Saumier.[64] Because the final version differs significantly from the draft version of the Working Group, the draft commentary differs significantly from the 2011 policy document. The draft commentary is to be discussed and finalized in 2014.

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[57] Ibid, 64 f.

[58] http://www.hcch.net/upload/wop/contracts_rpt_nov2010e.pdf, 1 (Preamble), 2 (Formulation of the Principle of Party Autonomy in General).

[59] Ibid.

[60] http://www.hcch.net/upload/wop/contracts_rpt_june2011e.pdf, 3.

[61] SC Symeonides, 'The Hague Principles on Choice of Law for International Contracts: Some Preliminary Comments' (2013) 61 *American Journal of Comparative Law* 873, 892.

[62] Ibid, 893.

[63] Symeonides, ibid, 894 finds the caveat useful in that it signals to courts that nothing changes even if their states acquiesce to the compromise. This seems a rather theoretical risk.

[64] http://www.hcch.net/upload/wop/princ_com.pdf.

3.4 Particular Issues

With the changes introduced by the Special Commission, Article 3 has become significantly more complex than it was in its earlier formulation by the Working Group. This makes a closer look at individual requirements of the rule appropriate.

3.4.1 'Rules of law'

What is actually meant by 'rules of law'? Obviously, law does not mean state law here, as a positivistic understanding would have it.[65] Rules of law are, presumably, legal norms formulated by so-called 'formulating agencies',[66] be those intergovernmental (like UNIDROIT or UNCITRAL) or academic (like the Lando group that formulated the PECL) or representative of certain industries (like the International Chamber of Commerce).

Although 'rules of law' is meant to designate non-state law, not all non-state law can qualify as 'rules of law'. Mere principles of law are not rules. (UPICC and PECL however, although they carry the title of Principles, actually consist of rules.) Lex mercatoria for example, as an amalgam of rules and principles and maxims, does not qualify. However, it seems appropriate that a choice of lex mercatoria can often be reinterpreted as a choice of the UPICC according to their Preamble.[67]

Another type of law that creates problems are most religious or customary laws, because they do not come in the form of rules.[68] Western courts have indeed expressed discomfort with a duty to interpret religious law like Islamic law, the content of which is often unclear.[69] At the same time, it would be quite unfortunate if religious law could not be chosen, especially given that this may be the only kind of non-state law that could actually matter before state courts. Religious actors choose religious law not infrequently for their business transactions;[70] for them, access to

[65] Symeonides, 'The Hague Principles on Choice of Law', 892 suggests that *real* rules of law must be state law. Debates on legal pluralism suggest that such a state-based concept of law is not necessary. See R Michaels, 'Was ist Recht jenseits des Staates? Eine Einführung' in G-P Calliess (ed), *Transnationales Recht—Stand und Perspektiven* (Tübingen, Mohr Siebeck, 2014).

[66] On the idea of formulating agencies, see KP Berger, *The Creeping Codification of the New Lex Mercatoria* (The Hague et al. Kluwer Law International, 2010) 88; see also R Michaels, 'Rollen und Rollenverständnis im transnationalen Privatrecht' in B Fassbender et al., *Paradigmen im internationalen Recht—Implikationen der Weltfinanzkrise für das internationale Recht* (Berichte der Deutschen Gesellschaft für Völkerrecht 45) 175, 208–10.

[67] Michaels, 'Preamble I', no 67.

[68] For inclusion of such rules under Article 3, see Neels and Fredericks, 'Tacit Choice of Law', 109 note 51.

[69] See references in n 19.

[70] See eg *Soleimany v Soleimany* [1998] EWCA Civ 285; *Halpern v Halpern* [2007] EWCA Civ 291; *Musawi v RE International (UK) Ltd* [2007] EWHC 2981 (Ch).

courts might be attractive if they could maintain the choice of religious law. In this regard, a broad interpretation of the term appears advisable.

3.4.2 'Set of Rules'

In addition, Article 3 requires that the rules of law come as a 'set of rules.' This has been explained as requiring that they are 'fairly complete and comprehensive'.[71] What does that mean? Is the CISG fairly complete and comprehensive? It covers only sales law, and even here it has gaps. Are the UPICC fairly complete and comprehensive? [72] They have gaps, too. Even more problematic are rules like the Hague-Visby Rules, which cover only certain sub-themes of contract law. The Draft Commentary asks that sets of rules 'allow for the resolution of common contract problems in the international context.'[73] But are not uncommon contract problems at least as important? Should a chosen law not resolve, potentially at least, all problems?

Notably, a similar restriction does not exist in arbitration, where the 'rules of law' to be chosen can, in theory, be individual rules. The idea behind requiring a 'set of rules' for the Hague Principles may have been that non-state law should be chosen only where it bears some similarity to state law (which is comprehensive), and that parties should not be allowed to pick and choose individual rules. But both concerns appear unwarranted. The idea behind sectoral codifications is not to achieve comprehensiveness beyond the respective sector, and not even necessarily within it. Such non-state laws will always govern in combination with another law (frequently the law of a state, designated through a choice-of-law rule). But that is not at all unusual in contract law. Notably, parties can even choose different laws for different parts of their contract in a process called dépeçage; the Hague Principles, which allow for this in their Article 2(2),[74] only adopt a possibility that is already widely available. A clever use of dépeçage already allows parties to pick and choose individual rules from different legal systems. Restricting choice of non-state law to 'sets of rules' thus seems, in the face of Article 2(2), not to be a significant restriction.

3.4.3 'Neutral and Balanced'

More important is another restriction: chosen sets of rules of law must be 'neutral and balanced'. A similar criterion had been discussed for the Rome I Regulation. But what does this mean? Does it mean a substantive standard? The Draft Com-

[71] Symeonides, 'The Hague Principles on Choice of Law', 894.

[72] Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution', 545 f.

[73] Draft Commentary, no. 3.10.

[74] Art 2(2) reads: 'The parties may choose (i) the law applicable to the whole contract or to only part of it and (ii) different laws for different parts of the contract.'

mentary suggests as much: the designated rules 'should not advantage one party's interests over the other'.[75] That would be more than awkward: according to what standard should an adjudicator make this assessment? For example, the Convention on Contracts for the International Sale of Goods (CISG) has been criticized by some as being either too seller-friendly or too buyer-friendly, and thus not balanced.[76] For its legal treatment under existing law, this matters little: as an international law Convention, the CISG applies automatically within its scope unless the parties explicitly exclude it. A perceived lack of balance matters only in practice insofar as it may bring parties to opt out of the CISG. If, however, balance becomes a criterion for electability, one can expect contestations. Even the UPICC, perhaps the clearest example of a non-state text that the drafters have in mind, are not obviously balanced; they share this with the CISG.

More fundamentally, it is not clear at all why the parties, whose autonomy is otherwise emphasized, must be restricted to the choice of a balanced law at all. For the substantive terms of contracts, no such restriction exists; what we find instead, typically, is a far less demanding requirement of 'good faith and fair dealing' (eg Art 1.7 UPICC). When parties choose the law of a state, that state law need not be neutral and balanced either, up to the limits of internationally mandatory rules and ordre public. It would be understandable to demand that non-state law, to be chosen, be as balanced as state law; it is not clear at all why higher requirements make any sense.

All of this suggests that the 'neutral and balanced' requirement must be understood in a formal, not a substantive way. That means: non-state law can be chosen only when it has been formulated by an agency that is, with regard to the parties, neutral.[77] Even this restriction finds no similarity in the choice of state law, where parties can and frequently do choose one party's home law. And it is hard to operationalize. The Draft Commentary requires that the body 'represents diverse legal, political and economic perspectives'.[78] This confuses diversity with neutrality. Does the ICC represent diverse perspectives? (Or, more practically—will there not be dispute over whether any body really fulfils this requirement?)

Even more strangely, the Special Commission asks that the body of laws should 'not [be] imposed by market power.'[79] But is not every contract term, including every chosen law, a function of market power (or, more precisely: bargaining power)? Are not the drafters of nonstate law also competitors in the market for laws, and are not their products more or less successful as a function of their market power?

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[75] Draft Commentary 3.12 in its newest version no longer contains this quote.

[76] See the brief discussion in I Schwenzer and P Hachem, 'The CISG—Successes and Pitfalls (2009) 57 *American Journal of Comparative Law* 457, 474 f. Their conclusion that both arguments neutralize each other appears to be wishful thinking.

[77] See Draft Commentary, no. 3.11, 3.12.

[78] Draft Commentary, no. 3.11.

[79] *Choice of Law in International Contracts: Draft Hague Principles and Future Planning* (Prel Doc No 6, February 2013), Annex I (p iv). See also Draft Commentary 3.12: 'The assumption underlying party autonomy in commercial contracts according to which parties have relatively equal bargaining power'.

(UNIDROIT has greater power than the Académie des Privatistes Européens, to name just one example.) This criterion appears unworkable.

A more appropriate criterion of neutrality would be to ask that an agency could claim to represent either all parties (like the ICC with regard to commercial actors) or none (like UNIDROIT). This leads to a relative concept of neutrality: Islamic law becomes neutral and balanced as between Muslims[80] but loses that character as between a Muslim and a non-Muslim.

3.4.4 'Generally Accepted'

Another requirement is included, again one known from the European discussions: the chosen law must be 'generally accepted'. This is a vague standard. Whose recognition matters for this? And how much recognition is required? The criterion is met most easily by laws that are already binding, like the CISG,[81] which have been accepted by the treaty partners and by numerous courts, even though even the CISG is not 'generally accepted' in one sense: parties still regularly opt out of its use. Beyond the CISG, the UPICC are usually named as the most obvious candidate.[82] But in what way are they "generally accepted"? They are certainly not accepted by courts, which never apply them, except by comparative reference. We find more acceptance among arbitrators, but acceptance only by one type of adjudication can certainly not be 'general'.

More importantly, again, it is not at all clear what general acceptance should actually accomplish. Why is acceptance by the parties not enough, coupled with a supervisory control by the adjudicator? The problem is one of chicken and egg: as long as non-state law cannot be chosen it cannot be generally accepted, and as long as it is not generally accepted it cannot, under the new standard, be chosen. This may not be a problem for the UPICC, given the extensive debate that has occurred, but it is a problem for other, newer texts.

3.4.5 'International, Supranational or Regional Level'

Even stranger is the requirement that general acceptance must occur on a international, supranational or regional level. Maybe, the Hague Conference had in mind that international contracts require a law that somehow transcends locality. But ordinary party autonomy regularly goes to state laws that are, by definition, not accepted on a general or regional level. Why must non-state law then be transnational? Why should parties be allowed to choose the UPICC but not one of their models, the Uniform Commercial Code (UCC)? What does supranational or regional ac-

[80] A separate question is whether Islamic law itself discriminates between men and women.

[81] Draft Commentary, no. 3.5.

[82] Draft Commentary, no. 3.6.

ceptance guarantee that is not already inherent in general acceptance? The Code of European Contract Law by the Académie des Privatistes Européens[83] was drafted closely on a project for an English Code, the so-called McGregor Code[84]—does it make sense to draw a distinction between them? Perhaps, the requirement should be read to simply mean wide acceptance—which could then include also local law as long as such law is widely recognized, like the UCC.

3.4.6 Filling Gaps

So far, these have all been interpretative problem. A more fundamental problem arises from the fact that all non-state sets of rules, other than state laws, are incomplete—they cover certain areas of the law, but not all. The CISG, for example, deals only with sale of goods contracts. The UPICC deal only with contract law and do not even extend to every aspect of it. Choice of non-state law is thus, almost necessarily, incomplete.

What follows? The draft commentary suggests, pragmatically, that parties should choose an additional law to fill the ensuing gaps.[85] This is of course possible, although it seems to reduce, significantly, the value of choosing non-state law. But it points to a more fundamental problem with the choice of non-state law: such choice is always, literally, choice of 'rules of law', not of a governing 'law'. This may make sense in international arbitration, where the decision-making process, aimed at justice in the individual case, is often based on individual rules, and where mandatory rules can still often be entirely avoided. Before state courts it appears fairly unattractive. State courts already refer to individual rules of the UPICC frequently, though for comparative purposes rather than as actually applicable law.[86] It is not clear why the choice of a non-state law like the UPICC should be attractive if it requires the choice or determination of another contract law.

[83] Académie des Privatistes Européens, *Code européen des contrats, Avant-projet, Coordinateur Giuseppe Gandolfi, Livre premier, Edition de poche revue et corrigée par Lucilla Gatt, Professeur à l'Université de Naples 2* (Milan, Giuffré, 2004).

[84] Published long after its first promulgation as H McGregor*, A Contract Code: Drawn up on Behalf of the English Law Commission* (Milan, Giuffré, 1993).

[85] Draft Commentary, no. 3.15.

[86] See R Michaels, 'Umdenken für die UNIDROIT-Prinzipien: Vom Rechtswahlstatut zum Allgemeinen Teil des transnationalen Vertragsrechts' (2009) 73 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 866.

3.5 Evaluation

3.5.1 The Rule

All in all, Article 3 appears as a rather problematic provision in what should otherwise be a rather uncontroversial legal document. A provision allowing for the choice of non-state law is a bold novelty. Whether such a provision is a good idea is another matter. Given the relatively low interest that parties have shown, so far, in the choice of non-state law (with the exception of religious law), it is not clear that it was worth including such a provision. Other than for the Rome II Regulation (which had to address, at the time, the potential of an optional contract code), there seems to have been no real need for such a provision. This is so especially for a rule that allows for the choice only of 'rules of law' and thereby excludes, in all likelihood, those areas of non-state law that would potentially be most relevant, especially Jewish and Islamic law.

Still, a provision like the one originally proposed by the Working Group, that laid out no additional requirements for what could be chosen as rules of law would at least have made analytical sense. But the additional requirements, added at the request of the Special Commission, have made a problematic rule far worse. They may have been aimed at achieving more certainty, but, in the apt words of one (not so subtle) early commentator, 'almost every word drips with uncertainty'.[87] They surpass what is required from state law (which need not be neutral and balanced) and thus reinforce, albeit in an ad hoc way, what was to be overcome—the arbitrary distinction between state and non-state law. Their introduction means that Article 3 is now too narrow for international arbitration (which mostly does not have similar requirements). At the same time it is likely too broad and also too imprecise for courts (which so far do not allow for the choice of non-state law at all). All in all, the requirements express an understandable uneasiness with the choice of non-state law. But instead of either opposing the choice of non-state law altogether, or suppressing the concerns and trusting adjudicators to find appropriate criteria, the Special Commission found a compromise that cannot satisfy either side of the discussion.

The Hague Conference, by including Article 3 in the Hague Principles, takes a gamble. The hope is that the authority of the Hague Conference can finally bring about what earlier attempts failed at—to bring state courts to allow parties to choose non-state law. However, the gamble is not without risk. The novelty of the provision may well mean that Article 3 garners disproportionate attention in discussions, at the expense of the other provisions, which might well yield general assent. (Experience with the UPICC where the Preamble has been discussed more than all other provisions combined, might suggest as much.) Moreover, Article 3 might well

[87] A Dickinson, 'A principled approach to choice of law in contract?' (2013) 18 *Butterworths Journal of International Banking and Financial Law* 151, 152.

cause lawmakers to trust the entire Hague Principles less; they might consider them more uncontroversial than they otherwise are.

3.5.2 The Arguments

With Article 3, then, the Working Group added a provision that is deeply problematic for the law and creates a great risk for the acceptance of the Hague Principles, while at the same time not responding to an actual practical need. This makes it worthwhile to look at the arguments brought forward.

One argument for the new rule can be found in a certain ideological commitment. The Principles, following the explicit mandate from the Council on General Affairs and Policy,[88] formulate the maximization of party autonomy as an explicit goal. And indeed, allowing the choice of non-state law obviously extends party autonomy. But it is not clear why the task of a legal text on party autonomy should be to promote party autonomy.[89] Robert Wai has pointed out, quite elegantly, that the task of private international law is not to promote enforcement of the will of the parties, but instead to lay down both the scope and the limits of such enforcement.[90] One may well think that the balance needs to be struck in a different way, but that a balance is necessary seems to be out of question, and thus the mere finding that allowing choice of non-state law enhances party autonomy is simply not enough.

A second argument concerns the alleged similarity between state law and non-state law. Much has been made of this alleged similarity in scholarly discussions.[91] Expanding the notion of law to non-state law is fashionable; it is often called the more 'modern' position,[92] which alone seems to make it superior. Frequently, scholars point out that at least some non-state laws have great parallels with state law. Both arguments are debatable. But even regardless of these theoretical arguments, it should be quite obvious that non-state law and state law are not similar from a practical position. Members of the Hague group suggest that the process of choosing non-state law would not be very different from the widely accepted process of

[88] See Permanent Bureau of the Hague Conference on Private International Law, 'Choice of Law in International Commercial Contracts: Hague Principles?' (2010) 15 *Uniform Law Review* 883, 885.

[89] See also Symeonides, 'The Hague Principles on Choice of Law', 878 f.

[90] R Wai, 'Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization' (2002) 40 *Columbia Journal of Transnational Law* 209. The Hague Principles do lay down such limits in their provision on mandatory rules and public policy, Article 11. Cf Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution', 543.

[91] See, eg, M Lehmann, 'Liberating the Individual from Battles between States: Justifying Party Autonomy in Conflict of Laws' 41 *Vanderbilt Journal of Transnational Law* 381, 426 ('there is simply no reason why one should allow the parties to use the contract rules of Burma and not the rules of a business organization like the International Chamber of Commerce.').

[92] Eg L Gama jr, 'Prospects for the UNIDROIT Principles in Brazil' (2011) 16 *Uniform Law Review* 613, 638.

choosing state law.[93] But there exists an obvious difference. The term 'rules of law' is sometimes viewed as mere code for non-state law, but the term makes sense quite literally: rules of law, like the UPICC, are different from systems of law, like state law. Where state law is chosen, the result is a relatively comprehensive set of rules and principles and a relatively high degree of internal consistency (created by highest courts). Where rules of law are chosen, the result is, necessarily, an incomplete body of law. Practically, the choice of rules of law always makes it necessary to apply other rules, too. It may be possible to devise ways for how to do this. But the universal need to do so represents a fundamental difference to state law that is hard to overlook.

This argument does not seem crucial in arbitration, and therefore a third argument brought forward in favor of Article 3 lies in the equation of courts and arbitrators. It is suggested that 'in most legal systems arbitration now carries the same legitimacy and effectiveness as the judicial dispute resolution system'.[94] This is a bold statement,[95] but legitimacy is not the most pressing issue. Even if it is true that courts and arbitrators are similarly legitimate, it by no means follows that courts and arbitrators should use the same rules. Notably, the use of 'rules of law' in arbitration is, comparatively, less dramatic than before courts.[96] Even where the arbitrator is required to apply the law, and cannot determine relevant issues on the sole strength of the contract terms, the legal argument on which arbitrators and counsel rely is often quite different from what one sees in state courts: counsel and arbitrators frequently argue on the basis of individual rules, sometimes drawn from different legal systems, and from uniform rules such as UPICC, which strictly speaking may not be applicable at all, but can be key to bolstering a legal argument based on the applicable law, or, to the contrary, to persuading the arbitral tribunal that the opponent's argument based on the applicable law leads to a result that is incompatible with other laws or instruments. The force of such indirect legal arguments is naturally greater before an international arbitral tribunal than in a court of law. In many cases, one or more arbitrators will not be qualified in the applicable law. If the solution found in the applicable law does not meet the expectations of said arbitrators they will be inclined to find a solution they find more appropriate, interpreting the law in a manner that may be driven more by pragmatism than by doctrinal rigor.

Finally, the expanded role for non-state law has been justified, somewhat ironically, with an interest in strengthening state courts and their role in international commercial litigation.[97] The hope is that state courts become more attractive vis-

[93] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 51.

[94] Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution', 542; but see Symeonides, 'The Hague Principles on Choice of Law', 894.

[95] See now the contributions in W Mattli and T Dietz (eds), *International Arbitration and Global Governance: Contending Theories and Evidence* (Oxford, Oxford University Press, 2014).

[96] What follows is a quote from an email by Matthias Scherer; I am much obliged for his expert advice. See also G Kaufmann-Kohler,'The transnationalization of national contract law by the international Arbitrator' in *Mēlanges en l'honneur du Professeur Jean-Michel Jacquet* (2013) 107.

[97] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 52 f.

à-vis arbitration if they allow, as does arbitration, the choice of non-state law. Indeed, there would be many advantages to a situation in which state courts played a greater role, both in terms of development of commercial law through precedent, and in terms of legitimacy of adjudication. At present, state courts seem all too willing to defer commercial law to arbitration; a real competition does not seem to take place.[98] It seems doubtful whether parties will flock to state courts if they can choose non-state law. Moreover, it seems questionable whether state courts should really become more like arbitrators in order to compete better.

3.5.3 The Process

Argumentative positions are one thing; attention to needs and practice is another. This signifies the most puzzling element about the Hague Principles. From all one can see, the decision to allow for the choice of non-state law was taken not in response to requests from outside, but on the basis of the assessment by members of the Working Group on what would, in their view be the best law. Such a process of lawmaking, be it in soft law or in hard law, is always problematic, simply because the drafters' convictions are not tested. It is a danger already in negotiations for treaties, because negotiators are often more willing than their constituents to move the law forward. The danger is enhanced where law is made in a soft law process, with no check on the negotiators from their governments at all. As a consequence, drafters end up with what is in effect a subjective view on how the law should be, but formulated and promulgated in the form of law.

Strikingly, Article 3 was not drafted in ignorance of existing laws or legal practice. The drafters were by no means unaware of the fact that state courts do not allow for the choice of non-state law, and parties very rarely show an interest in the choice of non-state law even in arbitration. Instead of concluding that allowing such a choice would be unnecessary, the Working Group came to the exact opposite conclusion: if parties and states do not yet opt for such choice, they must be educated to do so. For example, one member of the Drafting group explicitly suggests that the only plausible reasons why the Inter-American Convention has not been adopted by more countries are lack of information and inherent conservatism.[99] He expresses the hope that the new Hague Principles can overcome both of these, without explaining why or how.[100] Similarly, another member of the Draft-

[98] See R Michaels, 'Roles and Role Perceptions of International Arbitrators' in Mattli and Dietz (eds), *International Arbitration and Global Governance*, sub 2)c).

[99] JA Moreno Rodríguez, 'Contracts and Non-State Law in Latin America' (2011) 16 *Uniform Law Review* 877, 881 f, 888.

[100] José Antonio Moreno Rodriguez, the Paraguayan member of the Working Group and sometime member of the subgroup dealing with Article 3, has drafted a legislative proposal for choice of law legislation in Paraguay that has been put forward, in May 2013, by a senator; see the document available at www.hcch.net/upload/wop/contracts_legisl_py.pdf. Its Art 5 is modeled after Art 3 of the Hague Principles.

ing group hopes that the Hague Principles can overcome the uncertainty which she believes alone keeps practitioners from selecting the UPICC and can therefore 'provide the impetus needed for the successful deployment of the UPICC.'[101] Elsewhere, she and another member are even more explicit. They believe the reason non-state law is not chosen is that parties avoid the risk of uncertainty about its content, and without allowing for the choice before state courts, no system of precedent will build that can enhance certainty.[102] But what they call a vicious cycle is not broken by making non-state law available (as experience with the CISG shows) but only by providing incentives to choose it. All in all, the lack of interest by states and parties is explained away as the consequence of ignorance and conservatism. Whether parties or states will want to be educated by legal codes appears rather doubtful.

3.6 Conclusion

Debates on whether non-state law can be chosen frequently focus on matters of legal theory (the definition of 'law'), autonomy (the extent to which parties should be able to determine their respective rights and obligations) and legitimacy (whether law made by a Working Group can be as legitimate as law that has gone through a democratic process). In this article, I have deliberately refrained from joining the discussion with arguments on these issues. Instead I have tried to show that allowing the choice of non-state law responds to few existing needs, while necessarily running into a number of practical problems.

It is not certain that Article 3 will fail for these reasons. Perhaps, official reaction will be more positive than it has been with regard to earlier attempts to allow the choice of non-state law. The Principles have little to teach for systems that already accept party autonomy, and systems that have refused to allow for the choice of non-state law like EU law are unlikely to change in view of a new attempt to integrate them.[103] Arbitrators are unlikely to find the restrictive criteria in Article 3 attractive. However, Latin American countries may view the Hague Principles as a model for the introduction of party autonomy.[104] They would then move immediately from a situation in which party choice is barred altogether to one in which it can cover even to non-state law. If indeed that is the modern solution, then those countries now have their chance to be really modern.

[101] Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution', 535.

[102] Saumier and Gama, 'Non-State Law in the (Proposed) Hague Principles on Choice of Law in International Contracts', 64 f.

[103] See also O Lando, 'The Draft Hague Principles of the Choice of Law in international contracts and Rome I' in Permanent Bureau of Hague Conference on Private International Law (ed), *A Commitment to Private International Law—Essay in Honour of Hans Van Loon* (2013) 299.

[104] On the Paraguayan legislative initiative, see n 99. See also, more generally, JA Moreno Rodríguez, 'Los contratos y La Haya: ¿Ancla al pasado o puente al futuro? (2010) 15 *Revista Brasileira de Direito Constitucional* 125.

But such success does not seem likely. Article 3 responds to a need that is not really there. Procedurally, it was drafted from an academic perspective of education: because there is not yet interest in allowing the choice of non-state law, such interest must be created. Substantively, the rule does this in a manner that is, due to interference by the Special Commission, half-hearted, internally incoherent and hard to manage. All of these are reasons that not only make Article 3 unattractive; they also make it more than likely that Article 3 will have little impact. The Hague Principles will likely expand the list of projects attempting, and failing, to push the choice of non-state law forward. Those who wait for a revolution in choice of law for contracts must, in all likelihood, wait longer.

Should one deplore this? Would the world be a better place if parties could choose non-state law before state courts? Would it be good for courts in their competition with arbitrators? I doubt this, but here I voice no strong opinion either way. Ultimately, it seems that whether non-state law can or cannot be chosen will have fairly little impact on transnational contracts. What matters is that parties can choose a state law as a comprehensive framework to give their transaction predictability. What matters also is the scope of mandatory rules that limit such freedom. All of these are issues that the Hague Principles take up in other provisions. Non-state law has a significant role to play in this context—usages influence contract interpretation, transnational notions of law may provide a transnational background law. Whether non-state law can be chosen as applicable law or not is, however, in comparison quite irrelevant.[105]

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[105] For a more positive assessment from an outside observer, see L Radicati di Brozolo, 'Non-national rules and conflicts of laws: Reflections in light of the UNIDROIT and Hague Principles' (2012) 48 *Rivista di diritto internazionale privato e processuale* 841. See als B Fauvarque-Cosson and P Deumier, 'Un nouvel instrument du droit souple international: Le "projet de Principes de la Haye sur le choix de la loi applicable en matière de contrats internationaux"' (2013) 189 *Recueil Dalloz Sirey* 2185.

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Chapter 4
Optional Regulation of Standard Contract Terms

Florian Möslein

Abstract Optional regulation of standard contract terms gives rise to several functional peculiarities and to a number of difficult systematic questions. More specifically, the present chapter deals with the draft rules on standard contract terms in the proposed Common European Sales Law (CESL). Rather than commenting on these rules in substantially, however, its focus is precisely on these functional questions. We proceed in three steps, starting with an overview of the existing European rules on standard contract terms, including the draft provisions of the CESL. In a second step, we examine whether the CESL rules themselves could potentially become the subject of control under (national) standard contract terms legislation, given that these rules are provided in a standard format, and that they are adopted by the contracting parties on an opt-in basis. Thirdly and finally, we briefly analyse the mode of function of the CESL's own rules on standard contract terms. These three steps will show that according to the European legislator's design of the opt-in mechanism, two different optional contract law regimes operate within the very same national legal system. This two-foldness implies ambiguities, because the control of standard terms strongly interacts with substantial rules of contract law. This interaction is a necessary, unavoidable consequence of the embeddedness of the optional regime in national contract law.

4.1 Introduction

Instruments of consumer protection—such as the fairness control of standard contract terms—have always been a focal area of interest for *Hans-W. Micklitz*.[1] The same is true for the evolution of European Private Law, in particular for its

[1] See especially H-W Micklitz, 'Reforming European Union Unfair Terms Legislation in Consumer Contracts' (2010) 6 *European Review of Contract Law* 347; H-W Micklitz, 'Some Considerations on Cassis de Dijon and the Control of Unfair Contract Terms in Consumer Contracts' in K Boele-Woelki and W Grosheide (eds), *The Future of European Contract Law* (Aalphen ad Rijn,

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_4,

conceptual and methodological questions.[2] The present chapter, which is offered to him with admiration and appreciation for his support and friendship, will try to combine these two pathways. It deals with the draft rules on standard contract terms in the proposed Common European Sales Law (CESL).

Rather than commenting on these rules substantially,[3] however, the focus will be on functional questions arising from their optional character. While the optionality of the CESL is being much discussed,[4] its implications for the control of standard contract terms require further considerations. We will proceed in three steps, starting with an overview of the existing European rules on standard contract terms, including the draft provisions of the CESL. In a second step, we will examine whether the CESL rules themselves could potentially become the subject of control under (national) standard contract terms legislation, given that these rules are provided in a standard format, and that they are adopted by the contracting parties' opt-in. Thirdly and finally, we will analyse the mode of function of the CESL's own rules on standard contract terms. More precisely, we will consider the impact of their optional character on their functionality.

4.2 Control of Standard Terms in European Law

Rules on relating to standard contract terms have a long tradition. At the European level, such rules have been in existence for over 20 years, although the political and academic discussion had started decades earlier.[5] In addition to the Directive on Unfair Terms from 1993, respective rules are also contained in the Acquis Principles,

Kluwer, 2007) 387; H-W Micklitz, 'AGB-Gesetz und die Richtlinie über mißbräuchliche Vertragsklauseln in Verbraucherverträgen – Eine Skizze' (1993) *Zeitschrift für Europäisches Privatrecht* 522.

[2] See, eg, H-W Micklitz and F Cafaggi (eds), *The European Private Law after the Common Frame of Reference* (Cheltenham, Elgar, 2010); R Brownsword, H-W Micklitz, L Niglia and S Weatherill (eds), *Foundations of European Private Law* (Oxford, Hart Publishing, 2011); H-W Micklitz (ed), *The Many Concepts of Social Justice in European Private Law* (Cheltenham, Elgar, 2011).

[3] On their substance, see references n. 28.

[4] JJ Ganuza and F Gomez, 'Optional law for firms and consumers: An economic analysis of opting into the Common European Sales Law' (2013) 50 *Common Market Law Review* 29; J Smits, 'Party choice and the Common European Sales Law, or: How to prevent the CESL from becoming a lemon on the law market' (2013) 50 *Common Market Law Review* 51; H Eidenmüller, 'What Can Be Wrong with an Option? An Optional Common European Sales Law as a Regulatory Tool' (2013) 50 *Common Market Law Review* 69; S Grundmann, 'Costs and Benefits of an Optional European Sales Law' (2013) 50 *Common Market Law Review* 225; MW Hesselink, 'An Optional Instrument on EU Contract Law: Could it Increase Legal Certainty and Foster Cross-Border Trade?' in MW Hesselink, A van Hoek, MBM Loos and AF Salomons (eds), *Het Groenboek Europees contractenrecht: naar een optioneel instrument?* (Den Haag, Boom Juridische uitgevers, 2011) 9.

[5] Legislative preparatory work for the Directive lasted nearly 20 years; for a detailed account see N Reich and H-W Micklitz (eds), *Europäisches Verbraucherrecht*, 4th ed (Baden-Baden, Nomos, 2003) 495–498.

the Principles of European Contract Law, the Draft Common Frame of Reference, and now in the Draft Common European Sales Law. In substance, all these rules on standard contract terms are quite similar. Indeed, one can observe a continuous line of development from the Unfair Contract Terms Directive to the CESL.[6] The different sets of rules differ, however, quite substantially with regard to their binding force, their purpose, and their regulatory density. All these differences may have an impact on the functionality of the substantive rules.

4.2.1 Directive on Unfair Terms in Consumer Contracts

The Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts forms the basis of all European rules on standard contract terms.[7] We do not need to analyse its regulatory content in detail here, but can confine ourselves to a very brief overview. The aim of the Directive is to prohibit the use of unfair terms in consumer contracts which have not been individually negotiated. Accordingly, its scope of application is limited to contracts between a consumer and a seller or supplier of goods or services (Art. 1, with both terms being defined in Art. 2). The substantive rules only apply to terms which have not been individually negotiated, in particular to terms that have been drafted in advance without any possibility for the consumer to influence the substance of that term, for example in the context of a pre-formulated standard contract (Art. 3). On the other hand, the fact that one particular term or some aspect of a term has been individually negotiated does not prevent the application of these rules if an overall assessment of the contract demonstrates that it is in reality a pre-formulated standard contract.

According to the Directive a term is qualified as unfair 'if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer' (Art. 3 (1)). Even though it is not entirely clear whether 'good faith' and 'significant imbalance' are cumulative criteria or merely alternative means to describe the same substantive test,[8] the somewhat vague notion of 'good faith' is central to the Directive.

[6] Similar T Pfeiffer, 'Unfaire Vertragsbestimmungen' (2011) 10 *European Review of Private Law,* 835, 837 ('durchgehender Entwicklungsstrang von der Klausel-RL über die Acquis-Principles und die Principles of European Contract Law sowie den DCFR zur Feasibility Study').

[7] [1993] OJ L 95/29. Similar H Collins, 'The Directive on Unfair Contract Terms: Implementation, Effectiveness and Harmonization' in H Collins (ed), *Standard Contract Terms in Europe: A Basis for and a Challenge to European* Contract *Law* (Aalphen ad Rijn, Kluwer, 2008) 1 ('a watershed in the evolution of European Law').

[8] See, for instance C Twigg-Flesner, *The Europeanisation of Contract Law* (London, Routledge, 2013) 81; several possible interpretations of this test have been suggested by R Brownsword, G Howells and T Wilhelmsson, 'Between Market and Welfare: Some Reflections on Article 3 of the EC Directive on Unfair Terms in Consumer Contracts' in C Willett (ed), *Aspects of Fairness in Contract* (Cambridge, Blackstone, 1996) 25, 31.

Many (but not all) national laws are familiar with the concept of good faith.[9] EU law, however, needs to be interpreted autonomously, and so does the notion of good faith.[10] The Directive gives some limited guidance for this interpretation. On the one hand, Article 4 (1) provides that the unfairness of a contractual term shall be assessed "taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent". On the other hand, the Annex gives further guidance by providing an "indicative and non-exhaustive" (Art. 3 (3)) list of 17 terms which are presumed to be unfair if they have certain objects or effects ('grey list'): "The list thus offers the courts and other competent bodies, affected groups and individual consumers, sellers and suppliers—including those from another Member State—a criterion for interpreting the expression 'unfair terms'".[11] Nonetheless the general clause of 'good faith', while being such a key element of the control of standard contract terms, raises serious interpretation problems. Indeed, the clause is much more difficult to interpret than comparable national rules. The main reason for these additional difficulties is the lack of a comprehensive contract law at EU level, because such a legal framework otherwise serves as yardstick and reference order for the unfairness test.[12]

The application of these substantive rules, however, is crucially determined by their regulatory character which, in turn, mainly depends on the legal instrument providing those rules. Forming part of a European directive, the provisions "must be implemented in due form and applied consistently by Member States and their courts of law in respecting its protective ambit, as interpreted by the ECJ".[13] The Member States' obligation to transpose the directive's rules into their own, national law leads to a functional interaction between the transposed rules and the residual national law. National courts therefore tend to interpret transposed general clauses like the expression 'unfair terms' by referring to their respective national law, but such an approach is limited by the principle of the uniform interpretation of di-

[9] One important exception is English law, see in detail M Dean, 'Unfair Contract Terms: The European Approach' (1993) 56 *Modern Law Review* 581, 584 ff. For a general overview, see M Ebers 'Unfair Contract Terms Directive (93/13)' in H Schulte-Nölke, C Twigg-Flessner and M Ebers (eds), *EC Consumer Law Compendium* (Munich, Sellier, 2008) 197, 232.

[10] Implicitly ECJ Joined Cases C-240/98 to C-244/98 *Océano Grupo* [2000] ECR I-4941 para 22; for a thorough discussion with further references see K Riesenhuber, *Europäisches Vertragsrecht*, 2nd ed (Berlin, de Gruyter, 2006) paras 627–633.

[11] Opinion of AG Geelhoed, Case C-478/99 *Commission* v *Sweden* [2002] ECR I-4149, para 29.

[12] See generally A Röthel, 'Die Konkretisierung von Generalklauseln' in K Riesenhuber (ed), *Europäische Methodenlehre*, 2nd ed (Berlin, de Gruyter, 2010) § 12 paras 31–36; see also S Grundmann, 'The General Clause or Standard in EC Contract Law Directives – A Survey on Some Important Legal Measures and Aspects in EC Law' in S Grundmann and D Mazeaud (eds), *General Clauses and Standards In European Contract Law* (Aalphen ad Rijn, Kluwer, 2005) 141, 155 ff. For a recent example, see ECJ Case C-415/11 *Mohamed Aziz v Catalunycaixa* [2013] ECR I-0000 (not yet reported), para 69.

[13] H-W Micklitz and N Reich, 'Unfair Terms in the Draft Common Frame of Reference' (2008) *Juridica International, Law Review University of Tartu* 58.

rectives. However, the ECJ stated in its *Freiburger Kommunalbauten*-ruling "that in the context of its jurisdiction under Article 234 EC [now Article 267 TFEU] to interpret Community law, the Court may interpret general criteria used by the Community legislature in order to define the concept of unfair terms. However, it should not rule on the application of these general criteria to a particular term, which must be considered in the light of the particular circumstances of the case in question".[14] The same contract term may therefore be considered unfair in one Member State and fair in another.[15] As a consequence, the Directive, although it introduces a "mandatory, minimum, internationally applicable instrument of 'horizontal' consumer protection",[16] does not necessarily provide a fully consistent fairness standard throughout the European Union. A *fortiori*, the 'grey list' could help to substantiate this standard, but it forms part of the Annex, not of the directive as such. The ECJ has therefore decided that this list does not need to form "an integral part of the provisions implementing the Directive". It can therefore simply be reproduced "in the preparatory work for the law implementing the Directive".[17] This alleviation further reduces the consistency of the fairness standard's application throughout the Union. More fundamentally, full harmonisation of rules on standard contract terms has proven to be impossible in a system of different contract laws. At least, this would seem to be the lesson of the failed inclusion of the Unfair Contract Terms Directive in the new Directive on Consumer Rights.[18]

4.2.2 Acquis Principles, PECL and DCFR

Acquis Principles, Principles of European Contract Law (PECL) and the Draft Common Frame of Reference (DCFR) all contain rules on standard contract terms as well. The substance of these rules, however, differs quite considerably. Roughly speaking, the substantial differences centre on three aspects. In the first place, these other sets of rules do not restrict the scope of application to consumer contracts, so that the control of standard contract terms also applies to B-to-B transactions,

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[14] ECJ Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG* v *Ludger Hofstetter and Ulrike Hofstetter* [2004] ECR I-3403, para 22; on this case, see e.g. P Rott, 'What is the Role of the ECJ in European Private Law?' (2005) *1 Hanse Law Review* 6; MW Hesselink, 'Case note on ECJ Case C-237/02 [2004] ECR 1-3403 (01-04-2004), (Freiburger Kommunalbauten v Hofstetter)' (2006) 3 *European Review of Contract Law* 366.

[15] MBM Loos, 'Full Harmonisation as a Regulatory Concept and its Consequences for the National Legal Orders: The Example of the Consumer Rights Directive' in M Stürner (ed), *Vollharmonisierung im Europäischen Verbraucherrecht* (Munich, Sellier, 2010) 47, 92, with further references.

[16] H-W Micklitz and N Reich, 'Unfair Terms in the Draft Common Frame of Reference', 58.

[17] ECJ Case C-478/99 *Commission v Sweden* [2002] ECR I-4147 paras 21 and 23.

[18] E-M Kieninger, 'Die Vollharmonisierung des Rechts Allgemeiner Geschäftsbedingungen - eine Utopie?' (2009) 73 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 793; A Mittwoch, *Vollharmonisierung und Europäisches Privatrecht* (Berlin, de Gruyter, 2013) 236 ff.

albeit with some modifications.[19] The criterion of 'non-negotiation' is also defined somewhat differently, but these reformulations seem to have limited impact.[20] A second difference concerns the inclusion of terms in the contract. As opposed to the Directive, the other sets of rules contain specific provisions in this respect, namely with regard to transparency and the acquaintance of the client with the terms. For instance, the DCFR provides for a test of effective incorporation which requires the user to undertake reasonable steps aimed at drawing the other party's attention to them, before or when the contract is concluded.[21] A similar 'attention-drawing' principle is contained in the Acquis Principles.[22] Thirdly, the fairness test itself is formulated somewhat differently than in the Directive. The rules refer to a standard of "fair dealing", in addition (or alternatively?) to the requirement of "good faith".[23] Given that the relation between both requirements is indeed ambiguous, it is not entirely clear whether this modification tightens or attenuates the standard of control.[24]

More significant than these substantive differences of the specific rules, however, is the functional differentness of the respective rulebooks. Neither the Acquis Principles, nor the PECL, nor the DCFR constitute legal instruments. They all lack any binding effect on either Member States or individual parties; and they have not been promulgated by any legislator, but are products of the work of groups of academics (even though their elaboration has increasingly been supported by the European Commission). All three rulebooks fall within the manifold category of *soft law*; their impact depends on the persuasive power of their substance rather than on any kind of state authority.[25] Above all, the respective rules on standard

[19] Arts 6:101 and 6:301 para. 2 Acquis Principles; Arts 4:110 PECL and II-9:405 DCFR; more extensively T Pfeiffer, 'Non-negotiated terms' in R Schulze (ed), *The Common Frame of Reference and Existing European Contract Law* (Munich, Sellier, 2 ed, 2009) 183, 188 et ff; F Zoll, 'Unfair Terms in the Acquis Principles and Draft Common Frame of Reference' (2008) *Juridica International, Law Review University of Tartu* 69, 71.

[20] Compare Art. 6:101 Acquis Principles; Art. II-1:110 DCFR; see also D Mazeaud and N Sauphanor-Brouillaud, 'Art. 7' in R Schulze (ed), *Common European Sales Law (CESL) – Commentary* (Munich, Beck, 2012) para 4.

[21] Art. II-9:103 (1) DCFR; see Zoll, 'Unfair Terms', 73.

[22] Art. 6:201; see Micklitz and Reich, 'Unfair Terms in the Draft Common Frame of Reference', 60.

[23] More extensively discussed in M Mekki and M Kloepfer-Pelèse, 'Good Faith and Fair Dealing in the DCFR' (2008) 4 *European Review of Contract Law* 338.

[24] Similar J Stuyck, 'Unfair Terms' in G Howells and R Schulze (eds), *Modernising and Harmonising Consumer Contract Law* (Munich, Sellier, 2009) 115, 126; see also T Pfeiffer, 'Unfaire Vertragsbestimmungen' (2011) 19 *European Review of Private Law* 835, 849 (no additional requirement).

[25] For a general functional analysis of non-binding instruments in European private law, see A Schwartze, 'Europäisierung des Zivilrechts durch 'soft law' – Zu den Wirkungen von Restatements, Principles, Modellgesetzen und anderen nicht verbindlichen Instrumenten' in T Eger and H-B Schäfer (eds), *Ökonomische Analyse der Europäischen Zivilrechtsentwicklung* (Tübingen, Mohr Siebeck, 2007) 130; see also O Lando, 'The Structure and the Legal Values of the Common Frame of Reference (CFR)' (2007) 3 *European Review of Contract Law* 245, 256; Mekki and Kloepfer-Pelèse, 'Good Faith and Fair Dealing in the DCFR', 339.

contract terms aim at reflecting commonalities of national jurisdictions (PECL) and the current state of EC Private Law (Acquis Principles), or even at expressing a best solution chosen from among these sources. They may therefore indeed serve as toolboxes for future rule-makers at national and EU level.[26] As such, however, their rules will never be applied in practice, simply for lack of any binding force. The rules cannot even be applied by opt-in: Even if parties agree to incorporate (specific) 'soft law' provisions into their contract, this contract will still be subject to the applicable national law determined by conflict-of-law rules of the forum, in particular to its rules on standard contract terms.[27]

In terms of regulatory density and scope of regulation, however, all three instruments are much more comprehensive than the Directive. Their content is not restricted to the regulation of standard contract terms, but embraces the entire width of contract law or, more broadly, private patrimonial law.[28] As a consequence and in contrast to the Directive, all three instruments contain the necessary legal framework that could serve as a yardstick and reference order for the unfairness test. Theoretically, their respective comprehensiveness would therefore facilitate the control of standard contract terms.

4.2.3 Common European Sales Law

In substance, the rules on standard contract terms in Chap. 8 of the CESL do not fundamentally differ from these predecessor provisions.[29] The similarity is best demonstrated by revisiting the same three aspects: firstly, the scope of application again extends to commercial contracts between professionals, with Article 86 CESL

[26] See, for instance, H Schulte-Nölke, 'From the Acquis Communautaire to the Common Frame of Reference – The Contribution of the Acquis Group to the DCFR' (2008) *Juridica International, Law Review University of Tartu* 27; L Anatoniolli and F Fiorentini, 'Introduction' in L Anatoniolli and F Fiorentini (eds), *A Factual Assessment of the Draft Common Frame of Reference* (Munich, Sellier, 2011) 1, 34–39; and F Möslein, 'Legal Innovation in European Contract Law: Within and Beyond the (Draft) Common Frame of Reference' in Micklitz and Cafaggi (eds), *The European Private Law after the Common Frame of Reference*, 173, 176–179.

[27] Extensively discussed, with respect to the DCFR: H Muir-Watt and R Sefton-Green, 'Fitting the Frame: An optional instrument, party choice and mandatory/default rules' in Micklitz and Cafaggi (eds), *The European Private Law after the Common Frame of Reference*, 201, 206-210; also more generally in G Cordero-Moss, *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (Cambridge, Cambridge University Press, 2011).

[28] With respect to the DCFR, see S Grundmann, 'The Structure of the DCFR – Which Approach for Today's Contract Law?' (2008) 4 *European Review of Contract Law* 225, 227 ff; Anatoniolli and Fiorentini, 'Introduction', 36.

[29] For more extensive accounts, see P Hellwege and L Miller, 'Control of Standard Contract Terms' in G Dannemann and S Vogenauer (eds), *The Common European Sales Law in Context* (Oxford, Oxford University Press, 2013) 423; MBM Loos, 'Incorporation and Unfairness of Standard Contract Terms Under the Proposal for a Common European Sales Law' in L Moccia (ed), *The Making of European Private Law: Why, How, What, Who* (Munich, Sellier, 2013) 191; F Möslein, 'Kontrolle vorformulierter Vertragsklauseln' in M Schmidt-Kessel (ed), *Ein einheitliches europäisches Kaufrecht?* (Munich, Sellier, 2012) 255; Pfeiffer, 'Non-negotiated terms', 183.

providing for a somewhat modified standard of review, more specifically, the two lists of terms which are always or typically unfair ('black list' in Article 84 and 'grey list in Article 85 CESL) do not apply in case of B-to-B transactions and the standard of review requires that the respective contract term 'is of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing' (Article 86 para. 1 lit. b CESL). While this wording and that regulatory technique are rather ambiguous, the rule maker clearly aimed at providing for a more relaxed standard of review, with more flexibility for commercial contracts.[30] A second similarity to the soft law instruments—and a difference to the Directive—concerns the inclusion of terms in the contract. Again, the CESL contains various provisions with regard to transparency and the acquaintance of the client with the terms.[31] However, not all of them are contained in Chap. 8: Art. 70 CESL establishes a duty of information that places parties supplying standard terms under the obligation to ensure that the other party is aware of them; Art. 62 and 65 CESL stipulate rules of interpretation, providing for a prevalence of individually negotiated terms and for a *contra proferentem* rule; and Art. 82 CESL imposes a duty of transparency on traders who supply standard contract terms. Finally, the third aspect concerns the general fairness test (for consumer contracts). This test is again formulated somewhat differently than in the Directive, but similar as in the soft law instruments: Art. 83 para. 1 CESL qualifies a standard contract term as unfair "if it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer, contrary to good faith and fair dealing". While this is sometimes understood as a two-fold standard,[32] the general definition in Art. 2 lit. b) CESL clearly shows the rule maker's intention to establish good faith and fair dealing as a single, uniform standard, to be interpreted in a similar manner to the Directive.[33]

[30] Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 284; also sceptical are H Eidenmüller, E-M Kieninger, N Jansen, G Wagner, and R Zimmermann, 'Der Vorschlag für eine Verordnung über ein Gemeinsames Europäisches Kaufrecht: Defizite der neuesten Textstufe des europäischen Vertragsrechts' (2012) *Juristenzeitung* 269, 279 ff; MW Hesselink, 'Unfair terms in contracts between businesses' in R Schulze and J Stuyck (eds), *Towards a European Contract Law* (Munich, Sellier, 2011) 131, 147.

[31] More extensively (and in comparison also to the Feasibility Study): Hellwege and Miller, 'Control of Standard Contract Terms', 430–436.

[32] Mekki and Kloepfer-Pelèse, 'Good Faith and Fair Dealing in the DCFR', 345 ff. (subjective vs. objective standard); see also R Brownsword, 'Regulating Transactions: Good Faith and Fair Dealing' in G Howells and R Schulze (eds), *Modernising and Harmonising Consumer Contract Law* (Munich, Sellier, 2009) 87.

[33] Notwithstanding the recent rewording of that provision by the Legal Affairs Committee: The definition now reads: '"good faith and fair dealing" means a standard of conduct characterised by honesty, openness and, in so far as may be appropriate, reasonable consideration for the interests of the other party to the transaction or relationship in question', see Amendment 37 as proposed by the European Parliament's report on the proposal for a regulation on a Common European Sales Law, http://www.europarl.europa.eu/document/activities/cont/201309/20130925ATT71873/20130925ATT71873EN.pdf.

Also in terms of their regulatory character, the CESL provisions are a hybrid between the Directive and the soft law instruments. According to the European Commission's proposal (which has recently been backed by the European Parliament),[34] the CESL is designed to be 'a self-standing uniform set of contract law rules including provisions to protect consumers […], which is to be considered as a second contract law regime within the national law of each Member State'.[35] This implies, on the one hand, that the CESL will be 'true' law, enacted by the European legislator and enshrined in a European legal instrument (a Regulation with an Annex) and additionally forming part of the national law of each Member State. On the other hand, however, the CESL will be optional: Its application will always require that parties opt-in, i.e., that they choose this instrument instead of the otherwise applicable national law.[36] While having the status of law, the CESL will therefore have a much softer regulatory character than the Directive and the Directive's national implementations with their strictly mandatory rules. Moreover, the regulatory character will even be even softer than that of conventional national contract law which mainly consists of default rules: while such default rules apply as long as parties do not opt out, the CESL will require a positive, explicit opt-in.[37]

Finally, also in terms of regulatory density and in terms of the scope of regulation, the CESL provisions are some kind of hybrid between the Directive and the soft law instruments. While the content of the CESL reaches far beyond standard contract terms regulation and covers sales law in general, its scope of application will most likely be limited to distance selling contracts such as transactions made by consumers over the internet. Article 6 of the proposed Regulation even excludes mixed-purpose contracts and contracts with a credit element.[38] The comprehensiveness of the CESL is therefore much more restricted than that of the soft law instruments. As a consequence, the CESL's capacity to serve as a yardstick and reference order for the unfairness test will be restricted accordingly.

4.3 Control of the Optional Instrument's Rules as Standard Terms?

In the light of CESL's optional regulatory character, one may well ask whether the CESL rules themselves could potentially become subject of control under (national) standard contract terms legislation. After all, these rules are provided in a standard

[34] ibid.

[35] COM(2011) 635 final, 4.

[36] For details, see C Herresthal, 'Das geplante europäische Vertragsrecht: Die optionale Ausgestaltung des sog. Optionalen Instruments' (2011) *Zeitschrift für Wirtschaftsrecht* 1347.

[37] F Möslein, *Dispositives Recht – Zwecke, Strukturen und Methoden* (Tübingen, Mohr Siebeck 2011) 72 ff.

[38] Sceptical European Law Institute (ed), *Statement on the Proposal for a Regulation on a Common European Sales Law* (2012), www.europeanlawinstitute.eu, 21 ff.

format and they are adopted by the contracting parties' opt-in. An answer to this question requires a closer look to the opt-in mechanism, i.e., to the parties' choice of the CESL.

4.3.1 Opt-in Mechanism

As policy options, two conceptually distinct mechanisms would have been available to make contracts subject to the CESL rules. One possibility would have been that parties choose these rules as the applicable law, substituting for the national legal order that would otherwise apply. Alternatively, parties can incorporate the same rules in their contract as a set of standard terms, subject to the mandatory rules of the invariably applicable national law.[39] While in the first alternative, the CESL would constitute a contract law that parties may choose in accordance with the rules of private international law just like any other national contract law, the second alternative implies that the CESL rules will exist alongside each member state's contract law and that parties may choose those rules if the law of a member state applies. Whereas parties are free to choose this second alternative within their national law,[40] the first track would have required further legislative intervention at the European level. This is because the current wording of Article 3 (1) of the Rome-I-Regulation does not provide for the possibility to choose the CESL as applicable law. According to this provision, parties may choose the law that applies to their contract. However, there is no indication that their choice could also be a non-state or a supra-national law such as the CESL. In the light of the provision's legislative history and in accordance with the majority opinion, the freedom of choice would rather seem to be restricted to state law.[41] As a consequence, the Rome-I-Regulation currently does not allow for the private international law choice of the CESL, as opposed to the choice of any national contract law.[42] Moreover, the Commission made

[39] In more detail, see, for example: A Stadler, 'Anwendungsvoraussetzungen und Anwendungsbereich des CESL' (2012) 212 *Archiv für die civilistische Praxis* 473, 475 ff; W Ernst, 'Der 'Common Frame of Reference' aus juristischer Sicht' (2008) 208 *Archiv für die civilistische Praxis* 248, 263–266. See also C von Bar, 'Coverage and Structure of the Academic Common Frame of Reference' (2007) 3 *European Review of Contract Law* 350.

[40] For instance by pushing a 'blue button': H Schulte-Nölke, 'EC Law on the Formation of Contract – from the Common Frame of Reference to the 'Blue Button'' (2007) 3 *European Review of Contract Law* 332, 348 ff.

[41] See, inter alia, G-P Calliess, 'Article 3 Rome I' in id (ed), *Rome Regulations. Commentary on the European Rules of the Conflict of Laws* (Aalphen ad Rijn, Kluwer, 2011) 73 f; H Heiss, 'Party Autonomy' in F Ferrari and S Leible (eds), *Rome I Regulation* (Munich, Sellier, 2009) 1, 2, 9–12; O Lando and P Nielsen, 'The Rome I Regulation' (2008) 45 *Common Market Law Review* 1687, 1694–1698; G Rühl, 'Rechtswahlfreiheit im europäischen Kollisionsrecht' in D Baetge, J von Hein and M von Hinden (eds), *Die richtige Ordnung. Festschrift für Jan Kropholler* (Tübingen, Mohr Siebeck, 2008) 187, 189 f.

[42] In detail G Rühl, 'The Common European Sales Law: 28th Regime, 2nd Regime or 1st Regime?' (2012) 19 *Maastricht Journal of European and Comparative Law* 148; see also: D Martiny, 'CFR und internationales Vertragsrecht' (2007) *Zeitschrift für Europäisches Privatrecht* 212, 217 ff.

no move to provide for such possibility. It rather favours the alternative mechanism where the CESL rules are chosen within the applicable national contract law.[43]

4.3.2 Opt-in Through Standard Terms

If CESL rules are indeed chosen within the applicable national contract law, the question arises whether this choice can possibly be subject to the control of standard contract terms. More specifically, one may ask whether a standard contract term which exercises the option in favour of CESL can be challenged under rules on unfair contract terms.[44] The Annex of the Directive on Unfair Terms in Consumer Contracts gives some tentative guidance: in its indicative and non-exhaustive list of terms which may be regarded as unfair, n. 1 lit. q) refers to terms that exclude or hinder the consumer's right to take legal action or exercise any other legal remedy. Do opt-in clauses fall within this category? In general, its scope is subject to dispute. Some argue that proper choice-of-law clauses are covered because neither Art. 3 nor Arts. 4 and 5 of the Directive make a sharp distinction between such clauses and substantive law clauses.[45] However, the assessment of such clauses under the Directive should not contradict the autonomy that parties are given by the Rome-I-Regulation.[46] In other words: whenever this Regulation allows for a choice of law, such choice should at least be presumed not to be unfair under the Directive.

While choice-of-law clauses on the application of foreign law and opt-in clauses on the application of the CESL come very close in substance,[47] they nevertheless follow a distinctively different mechanism.[48] While they should equally fall under

[43] See COM(2011) 635 final, 6: 'The Rome I Regulation and Rome II Regulation will continue to apply and will be unaffected by the proposal. It will still be necessary to determine the applicable law for cross-border contracts [….] The Common European Sales Law will be a second contract law regime within the national law of each Member State'.

[44] For an affirmative answer, see S Whittaker, 'An Optional Instrument of European Contract Law an Freedom of Contract' (2011) 7 *European Review of Contract Law* 371, 387 ff; MBM Loos, 'Scope and application of the Optional Instrument' in D Voinot and J Sénéchal (eds), *Vers un droit européen des contrats spéciaux/ Towards a European Law of Specific Contracts* (Brussels, Larcier, 2012) 117, 136-138; for a negative view, however, see J Basedow, 'The Optional Instrument of European Contract Law: Opting-In through Standard Terms' (2012) 8 *European Review of Contract Law* 82.

[45] T Pfeiffer, 'Comment on n. 1 lit. q)', in E Grabitz and M Hilf (eds), *Das Recht der Europäischen Union*, 40th ed (Munich, Beck, 2009) para 160; see also F Graf von Westphalen and G Thüsing, 'Rechtswahlklauseln' in id (eds), *Vertragsrecht und AGB-Klauselwerke*, 33th ed (Munich, Beck, 2013) para 23; E Jayme, 'Inhaltskontrolle von Rechtswahlklauseln in AGB' in T Rauscher and H-P Mansel (eds), *Festschrift für Werner Lorenz zum 80. Geburtstag* (Tübingen, Mohr Siebeck, 1991) 435; D Martiny, 'Europäisches Internationales Vertragsrecht – Erosion der Römischen Konvention?' (1995) *Zeitschrift für Europäisches Privatrecht* 107, 117.

[46] Pfeiffer, 'Comment on n. 1 lit. q)', para 161; similar W Wurmnest, '§ 307' in FJ Säcker and R Rixecker (eds), *Münchener Kommentar zum BGB*, 6th ed (Munich, Beck, 2012) para 238.

[47] Basedow, 'The Optional Instrument', 85.

[48] See 4.2.1.

n. 1 lit. q) of the Directive's Annex, their assessment must therefore not be restricted by the Rome-I-Regulation. As we have seen, this Regulation simply does not allow for the private international law choice of the CESL. The decisive argument against the assessment of choice-of-law clauses under the Unfair Contract Terms Directive does therefore not apply to opt-in clauses.[49]

Moreover, such clauses will not be challenged directly under the Directive, but under national legal rules implementing this Directive. The Directive is, of course, not directly applicable. Since the Directive does, according to its Art. 8, only provide for a minimum standard, Member States may well enact stricter rules.[50] While such rules must, however, not jeopardize the uniform application of the Rome-I-Regulation, this restriction does in turn not apply to national rules on opt-in clauses.[51] In principle, national legislators may therefore even explicitely provide for a control of standard contract terms that exercise the option in favour of CESL.

4.3.3 Subject-Matter of Judicial Control

If one agrees that standardized opt-in terms can in principle be challenged under the rules on unfair contract terms, the additional question arises whether such challenge makes the substantive CESL rules implicitly subject to the control of standard contract terms. If this were the case, the CESL itself would have to stand the unfairness test. At first sight, such a consequence might seem strange for two different reasons.

Firstly, Article 1 para. 2 of the Unfair Contract Terms Directive states that "contractual terms which reflect mandatory statutory or regulatory provisions and the provisions or principles of international conventions to which the Member States or the Community are party, particularly in the transport area, shall not be subject to the provisions of this Directive". While the Directive allows for a judicial review of contractual terms, this provision seems to imply that legal rules are to be excluded from such control, irrespective of whether they form part of Member State law or of a legal instrument of the EU on matters of contract law.[52] However, it is important to note that the provision only exempts contractual terms reflecting *mandatory* statutory or regulatory provisions. Ever since the adoption of the Directive, this wording has been criticized as vague and imprecise,[53] but with re-

[49] For a different view, see Basedow, 'The Optional Instrument', 84 ff.

[50] For example, the original German law on standard terms enacted in 1976 contained an expicit prohibition of standardized choice-of-law clauses in § 10 no 8 AGBG (repealed in 1986): See Basedow, 'The Optional Instrument', 84 ff.

[51] Differently, again, Basedow, 'The Optional Instrument', 85 ff.

[52] Basedow, 'The Optional Instrument', 83.

[53] See, for instance, N Reich, 'Kreditbürgschaft und Transparenz' (1995) *Neue Juristische Wochenschrift* 1857, 1859; O Remien, 'AGB-Gesetz und Richtlinie über mißbräuchliche Verbraucherverträgsklauseln in ihrem europäischen Umfeld' (1994) *Zeitschrift für Europäisches Privatrecht* 34, 45; more recently A von Vogel, *Verbrauchervertragsrecht und allgemeines Vertragsrecht* (Berlin, de Gruyter, 2006) 81 ff.

spect to the CESL, it will imply new interpretative challenges. While the exemption clearly covers mandatory law, the majority opinion extends it to default rules, the argument being that such rules also have a binding effect as long as parties do not opt out.[54] Moreover, the French and Italian wording of the provision seems more comprehensive ('dispositions législative ou réglementaires imperatives') and recital 13 of the Directive points in the same direction ('statutory or regulatory provisions of the Member States which directly or indirectly determine the terms of consumer contracts').[55] Conversely, however, legal provisions which simply enable specific contractual arrangements are generally believed to fall within a different category.[56] As a consequence, respective contractual terms are not exempted from judicial review under the Directive.[57] In light of this subtle distinction between default and enabling rules, the crucial question is whether the legal regime of the CESL falls within the first or rather within the second category. Given that the CESL only applies if parties explicitly opt-in, its optional regime comes much closer to enabling provisions than to the opt-out regime of default rules. As a consequence, it does not seem wholly unlikely that the CESL—or rather any contractual term that reflects its rules—might indeed have to stand the unfairness test.[58]

A second, more teleological argument refers to the rationale behind the judicial review of standard contract terms: 'Since such terms are drafted and imposed by one of the parties in view of a multitude of similar transactions, whereas the other party, seeking a single bargain, usually has no sufficient incentive to understand or to negotiate the terms, there is a stark risk of one-sidedness which judicial review is intended to cure'.[59] Such information asymmetry, it is argued, only occurs where standard contract terms are drafted by one party, the professional.[60] On the other hand, terms which have initially been drafted by a third party, for example by pri-

[54] H-W Eckert, 'Die EG-Richtlinie über mißbräuchliche Klauseln in Verbraucherverträgen und ihre Auswirkungen auf das deutsche Recht' (1993) *Wertpapier-Mitteilungen* 1070, 1072; E Kapnopoulou, *Das Recht der mißbräuchlichen Klauseln* (Tübingen, Mohr Siebeck, 1997) 97; W Nasall, 'Die Anwendung der EU-Richtlinie über mißbräuchliche Klauseln in Verbraucherverträgen' (1995) *Juristenzeitung* 689, 691; G de Nova, 'Italian Contract Law and the European Directive on Unfair Terms in Consumer Contracts' (1995) *European Review of Private Law* 221; K Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts* (Berlin, de Gruyter, 2003) 432; M Schmidt, *Konkretisierung von Generalklauseln im europäischen Privatrecht* (Berlin, de Gruyter, 2009) 209 ff; differently, however: Reich and Micklitz, *Europäisches Verbraucherrecht*, para 502 et ff.

[55] T Pfeiffer, 'Comment on Art. 1 Unfair Terms Directive' in Grabitz and Hilf (eds), *Das Recht der Europäischen Union*, para 25.

[56] See Reich, 'Kreditbürgschaft und Transparenz', 1859; Pfeiffer, 'Comment on Art. 1 Unfair Terms Directive', para 25 for various examples.

[57] Different, however, de Nova, 'Italian Contract Law', 225 ff. (with respect to Art 1373 Codice Civile).

[58] In a similar vein S Whittaker, 'An Optional Instrument', 388; differently, however, Basedow, 'The Optional Instrument', 83 ff.

[59] Basedow, 'The Optional Instrument', 83.

[60] In much more detail on this economic rationale: P Leyens and H-B Schäfer, 'Inhaltskontrolle allgemeiner Geschäftsbedingungen: Rechtsökonomische Überlegungen zu einer einheitlichen Konzeption von BGB und DCFR' (2010) 210 *Archiv für die civilistische Praxis* 771, 779–786.

vate standard-setters or, *a fortiori*, by democratic legislators, should be exempted from judicial review on the ground that they do not raise the same concerns.[61] However, while such information asymmetries were originally the central argument for regulating standard contract terms, at least in Germany, those restrictions are not fully incorporated in the text of the Directive. This is not only because the scope of Article 1 para. 2 is much more limited (as we have seen), but also because the Directive—as opposed to § 305 para. 1 of the German Civil Code—does not require that standard contract terms are 'set' by one party.[62] In principle, terms set by third parties are therefore covered by the Directive.[63] The exemption in Art. 1 para. 2 must not be interpreted extensively. As a consequence, these teleological arguments do not prevent standard contract terms which reflect the CESL from judicial review either.[64] Strange as it may seem, the CESL might indeed have to stand the unfairness test, even though implicitely. Whether any specific CESL rule will ever be regarded as unfair is, however, an entirely different question.

4.4 Control of Standard Terms Under the Optional Instrument

The CESL's optional character has further implications at a second, more obvious level. This optionality has an impact on the mode of function of the CESL's own rules on standard contract terms, for judicial control of such terms closely interacts with substantive contract law. This interaction can be illustrated in three different respects.[65]

4.4.1 Terms of a Declaratory Nature

As we have seen with respect to Art. 1 para. 2 of the Unfair Terms Directive, contract terms of a declaratory nature, i.e. terms that simply reflect substantive contract law, are exempted from the unfairness test. In an optional regime, however, this exemption becomes somewhat ambiguous: does it only concern terms reflecting the contractual regime that parties have actually chosen (the CESL rules), or does it also cover terms reflecting the alternative regime (the conventional national contract law)? The CESL itself states a clear-cut answer in its Art. 80 para. 1, providing

[61] In this sense Basedow, 'The Optional Instrument', 83; see also F Möslein, 'Inhaltskontrolle und Inhaltsregeln im Schuldvertragsrecht' in K Riesenhuber and Y Nishitani (eds), *Wandlungen oder Erosion der Privatautonomie* (Berlin, de Gruyter, 2007) 233, 241.

[62] Cf. J Basedow, '§ 310' in Säcker and Rixecker (eds) *Münchener Kommentar zum BGB*, para. 60.

[63] With respect to German law, note that the fiction in § 310 para. 3 no 1 BGB produces similar results as far as consumer contracts are concerned.

[64] Differently, again, Basedow, 'The Optional Instrument', 83.

[65] Möslein, 'Inhaltskontrolle und Inhaltsregeln', 240.

that the unfairness test does 'not apply to contract terms which reflect rules of the Common European Sales Law which would apply if the terms did not regulate the matter'.[66] According to this provision, the exemption does clearly not cover terms reflecting national contract law.

As unambiguous as the wording of this provision may sound, its regulatory content is not very convincing on normative and systematic grounds. Generally, its scope is overly narrow. As opposed to the Directive, for example, the provision does not exempt terms that reflect 'provisions or principles of international conventions to which the Member States or the Community are party';[67] and as opposed to many national legal systems, it does not refer to unwritten general rules either.[68] Above all, it implies that national contract laws will indirectly become subject to a comprehensive judicial control, simply because standard contract terms that replicate specific rules thereof are not exempted from the unfairness test under the CESL regime.[69] Such control of national contract law 'by the back door' is highly inconsistent with the Directive on Unfair Contract Terms. According to the recitals of this Directive, the European legislature had, at the time, determinedly refused such control: '[…] the statutory or regulatory provisions of the Member States which directly or indirectly determine the terms of consumer contracts are presumed not to contain unfair terms'.[70] In contrast, the CESL no longer contains a similar presumption. Such wide scope of the unfairness test not only raises questions of competence, but also leads to inconsistencies at the more concrete level of application: with respect to matters that are not addressed in the CESL itself, recital 28 of the proposed Regulation explicitly refers to the pre-existing, otherwise applicable national law.[71] As a consequence, for example, national set-off rules apply even if parties opt for the CESL. At least these rules of national contract law should be covered by the exemption and excluded from the unfairness test: Even though respective contract terms do not reflect proper CESL rules, the reflected rules are at least incorporated into the CESL by way of reference.[72] However, even such extensive interpretation of Art. 80 para. 1 cannot fully avoid this first ambiguity that the optional regulation of standard contract terms implies.

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[66] The provision did not raise much concern so far; see, for instance: C Wendehorst, 'Regelungen über den Vertragsinhalt (Teil III CESL-Entwurf)' in C Wendehorst and B Zöchling-Jud (eds), *Am Vorabend eines Gemeinsamen Europäischen Kaufrechts* (Vienna, Manz, 2011) 87, 100 ('Selbstverständlichkeit').

[67] Extensively on this exemption: Pfeiffer, 'Comment on Art. 1 Unfair Terms Directive', paras 28 ff.

[68] See, for example, Wurmnest, '§ 307', para 7.

[69] Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 271.

[70] Recital 13 of the Unfair Terms Directive, see thereon Riesenhuber, *Europäisches Vertragsrecht*, 255 (para 613: 'vom Gesetzgeber nicht gewollte mittelbare Vertrags*rechts*kontrolle', emphasis in original).

[71] This incorporation also raises further concerns, see Eidenmüller et al. 'Der Vorschlag für eine Verordnung über ein Gemeinsames Europäisches Kaufrecht', 279.

[72] Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 271.

4.4.2 Standard of Review

A second, even more significant ambiguity concerns the standard of review. As we have seen, Art. 83 para. 1 CESL qualifies a standard contract term as unfair 'if it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer, contrary to good faith and fair dealing'. Notwithstanding this qualification, the unfairness test remains arbitrary as long as those general clauses lack further specification. Articles 84 and 85 give some additional guidance with their grey and black lists of terms that are presumed to be unfair.[73] Beyond the terms contained in these lists, however, the standard of review remains rather vague. As a remedy, default rules could provide for a less arbitrary yardstick. After all, default rules have a model character (*Leitbildfunktion*) for they contain the legislator's fundamental value judgments (*Gerechtigkeitsgehalt*).[74] As a rough guide, one can suppose that the further a standard clause deviates from such rules, the more likely it is to be assessed unfair.[75] However, as opposed to § 307 para. 2 n. 1 BGB and some other national contract laws,[76] neither the CESL nor the Directive provide for an explicit recognition of such yardstick. The Unfair Terms Directive renounced on purpose: In default of a comprehensive European contract law, any reference to default rules in (unharmonized) national contract laws would have undermined the harmonization objective of this Directive.[77] In contrast, the same concern is not to be feared within the optional regime of the much more comprehensive CESL, at least as long as this instrument's own default rules are concerned. For lack of alternatives, the courts will therefore refer to that yardstick anyhow, even without any explicit reference in the CESL. At least this happened in Germany where the courts applied the same guidance much earlier than it was laid down in the Civil Code; recently the ECJ followed exactly the same pattern with respect to the Unfair Contract Terms Directive.[78]

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[73] See already above, 4.2.1.; more extensively Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 281–283.

[74] More extensively Möslein, *Dispositives Recht*, 40 ff, 118 ff; see also J Schapp, 'Die Leitbildfunktion des dispositiven Rechts für die Inhaltskontrolle von Allgemeinen Geschäftsbedingungen nach § 9 Abs. 2 AGB-Gesetz' (1978) *Der Betrieb* 621; G Weick, 'Die Idee des Leitbildes und die Typisierung im gegenwärtigen Vertragsrecht' (1978) *Neue Juristische Wochenschrift* 11.

[75] Seminally, L Raiser, *Das Recht der allgemeinen Geschäftsbedingungen* (Bad Homburg, Gentner, 1961) 295; see also C-W Canaris, 'Wandlungen des Schuldvertragsrechts – Tendenzen zu seiner „Materialisierung"' (2000) 200 *Archiv für die civilistische Praxis* 273, 285; J Drexl, *Die wirtschaftliche Selbstbestimmung des Verbrauchers* (Tübingen, Mohr Siebeck 1998) 305; K Larenz, *Richtiges Recht* (Munich, Beck, 1979) 76 f; J Schapp, *Grundfragen der Rechtsgeschäftslehre* (Tübingen, Mohr Siebeck, 1986) 94–99.

[76] From a comparative perspective: Hellwege and Miller, 'Control of Standard Contract Terms', 442 ff; Möslein, 'Inhaltskontrolle und Inhaltsregeln', 242–247.

[77] Riesenhuber, *Europäisches Vertragsrecht*, 262 f.

[78] See, on the one hand, Wurmnest, '§ 307', paras. 65 ff, with further references ; on the other hand ECJ Case C-415/11 *Mohamad Aziz v Catalunycaixa* [2013] ECR-0000 (not yet reported), para. 68: '[...] it must in particular be considered what rules of national law would apply in the absence of an agreement by the parties in that regard.'

The more difficult question is whether default rules of the alternative regime, i.e. the national contract law, may serve as a meaningful *Leitbild* as well. On similar grounds as above, one can argue that such rules can be treated as de-facto CESL rules as far as they are explicitly incorporated by the regulation itself.[79] As a consequence, default rules of national contract law which concern one of the matters referred to in recital 28 may also provide guidance for the unfairness test under the CESL. Default rules of another, second category concern matters that are also regulated within the CESL. Those rules of national contract law must give way to the respective CESL rules, because parties choosing the optional regime implicitly accept its general *Leitbild* as well. They will adhere to it even if they try to deviate from specific rules by standard contract terms. This result complies with the ratio of Art. 80 para. 1 CESL. Finally, the most difficult category concerns default rules of national contract law that are neither explicitly incorporated nor simultaneously regulated within the CESL. In case of such 'hidden gaps', neither actual nor de-facto CESL rules can provide any guidance for the fairness control of standard contract terms.[80] While parties have actually opted out of the *Leitbild* of national contract law, one can still argue that the judge may nonetheless refer to the respective default rules: if the optional regime refers to national contract law in some cases (with respect to the matters referred to in recital 28), it generally allows for cross-references and, as a consequence, for a 'spreading' of standards of review.[81] Moreover, it thereby accepts a certain divergence of various CESL regimes operating under different national laws.[82] Last but not least, the opt-in mechanism itself, not providing for a proper choice of law, but rather for a choice within the applicable national contract law, implies that legal relationships remain embedded in this framework even if parties opt for the CESL. Therefore, the *Leitbild* of national contract law serves as a 'guidance of last resort' for the control of standard terms under the optional regime as well.

4.4.3 Gap-Filling

Similar questions arise whenever a standard contract term is assessed to be unfair. Art. 79 para. 1 CESL simply provides such terms not to be binding on the other party, but the provision gives no guidance on how to fill the ensuing gap. If a specific contract term is not binding, however, the parties simply did not deviate from the default rule that would also have applied in the absence of any stipulation.[83] As

[79] See III.1.

[80] Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 280.

[81] Cf. again Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 281.

[82] Somewhat differently interpreted in Eidenmüller et al. 'Der Vorschlag für eine Verordnung über ein Gemeinsames Europäisches Kaufrecht', 279 (it will force national legislators to approximate their contract laws to the European standard).

[83] Seemingly similar is Wendehorst, 'Regelungen über den Vertragsinhalt', 101 (no reduction of invalid provisions to their legally permitted core); more generally Möslein, *Dispositives Recht*,

a consequence, default rules come again into play, again with similar differentiations as above (proper and de-facto CESL rules vs. rules of purely national contract law). However, at this level an additional gap-filling mechanism concurs: in lieu of statutory rules, supplementary interpretation of the contract may also fill the gap.[84] The relation between both mechanisms is, however, a more general question, reaching beyond the specific issues of optionality that have been the subject of this contribution.[85]

4.5 Conclusion

The optional regulation of standard contract terms gives rise to several functional peculiarities and to a number of difficult systematic questions. Most of these problems have one single cause: according to the European legislator's design of the opt-in mechanism, two different optional contract law regimes operate within the very same national legal system. This two foldness implies ambiguities, namely because the control of standard terms strongly interacts with substantial rules of contract law. On the one hand, the optional regime itself runs the risks of becoming subject of the unfairness control, given that the parties' opt-in may well be rooted in a standard contract term. On the other hand, the control of standard contract terms under the optional instrument does not operate on an entirely independent basis, but rather interacts with national contract laws at different levels (exemptions, standard of review, gap-filling). This interaction is a necessary, unavoidable consequence of the embeddedness of the optional regime in national contract law, as provided for by the European legislator—even though it seemingly contradicts the parties' explicit opt-out.

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190–192; Möslein, 'Inhaltskontrolle und Inhaltsregeln', 250 ff.

[84] Cf Möslein, 'Kontrolle vorformulierter Vertragsklauseln', 285.

[85] Seminally K Larenz, 'Ergänzende Vertragsauslegung und dispositives Recht' (1963) *Neue Juristische Wochenschrift* 737; in summary: Möslein, *Dispositives Recht*, 433–437.

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Chapter 5
Law *or* Economics—Some Thoughts on Transnational Private Law

Leone Niglia

Abstract Economization is transforming private law from within. The chapter considers the structures of economization as they encroach upon European private law's autonomy, towards promoting critical awareness over the challenge of taming economization.

5.1 Introduction

The 'marketization' (or 'economization') of transnational private law[1] is not theoretical venture but real-life development that is transforming law from within.[2] 'Economization', described as the phenomenon of 'the growing importance of the economic efficiency doctrine' and as 'a process that reduces the scope of Member States' redistributive interventions to that of providing a fair chance to benefit from the Internal Market',[3] can be taken to mean both things at once, as I argue in this chapter in which I call this perspective 'economics-that-replaces-law' or 'law-economized'. The case of contract law is exemplary. The widespread practice through which contracts are concluded, standardization, is one that has been traditionally regulated via protectionist rules but that is now being concurrently regulated via market facilitative rules, which entails at once an instrumentalisation of contractual justice to the requirements of efficiency and an adverse effect on the social sphere (nation-state).[4] Key market sectors and related contractual practices increasingly follow the same patter.[5] Unless one argues for the mere replacement of law by

[1] H-W Micklitz 'The Visible Hand of European Regulatory Private Law' (2009) 28 *Yearbook of European Law* 3 (on economization); L Niglia, *The Transformation of Contract in Europe* (The Hague, Kluwer Law International, 2003) (on marketization).

[2] Niglia, *The Transformation*.

[3] Micklitz, 'The Visible Hand', 13 f.

[4] For discussion see Niglia, *The Transformation*.

[5] Micklitz, 'The Visible Hand'.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_5,

economics, one is left with the challenge of taming that development, that is, of understanding where to draw the boundaries within which law as opposed to economics applies—towards actively 'governing' economic processes rather than passively accepting them.[6] Even resisting monistic temptations, that is, taking the pluralist stance of attempting to 'govern' pluralization as yielded by economic processes on the basis of normatively orientated plans,[7] requires that law preserves a minimum of integrity if it is to be effectively capable of accommodating any of the conflicts that underlie economization. One first needs a description of the phenomenon as a way to gain awareness of its problematic character. As a first step towards description I propose to look into the structure of economization (5.1.1) before considering ongoing conflicts that arise as a result of economization processes (5.1.2) as well as techniques for taming economization-related conflicts (5.1.3).

5.1.1 The New Narrative—From 'Economic Law' to 'Economics-that-Replaces-Law'

The new narrative of economics-that-replaces-law is a variation of, and is grounded on, a concurrent shift in vocabularies towards law-and-economics in the context of the Europeanisation process. The following statements on both fundamental and technical aspects of private law are representative of the latter shift, which I quote independently of the perspective of each author on 'economizing' as 'the object' of their description (favorable *or* otherwise):

'[T]he main features of the EU Market State are the following: the shift from private into public—the State outsources its regulatory functions; the shift from law and regulation to regulation and outsourcing privatisation, such as may be observed in the areas of utilities, transportation and healthcare. The bottom line: sovereignty loses its Nation State force as the State shifts away from providing top-down regulatory and welfare entitlements to fostering and preserving market conditions for the maximisation of economic opportunity.'[8]

'This private law is different from national private legal orders based on private autonomy and free will. This private law takes its form, procedure and content from being instrumentalised for building and shaping markets.'[9]

'In order to grasp the change in paradigm in full, I draw on institutional economics as an analytic framework.'[10]

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[6] On 'boundaries' cf H Lindahl, 'A-legality: Postnationalism and the Question of Legal Boundaries' (2010) 73 *Modern Law Review* 30.

[7] L Niglia, 'Pluralism in a New Key–Between Plurality and Normativity' in L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart, 2013) 249.

[8] H-W Micklitz, 'Monistic Ideology versus Pluralistic Reality–Towards a Normative Design for European Private Law' in Niglia (ed), *Pluralism and European Private Law* 32. See H-D Assmann, G Brüggemeier, D Hart and C Joerges, *Wirtschaftsrecht als Kritik des Privatrechts* (Königstein im Taunus, Athenäum, 1980).

[9] Micklitz, 'Monistic Ideology versus Pluralistic Reality', 39.

[10] Ibid, 42.

'an efficiency-minded lawmaker desiring to achieve some degree of legal harmonisation to promote cross-border trade, would prefer to use an optional instrument over minimum harmonisation (always) and over full harmonisation (under the condition that firms may produce and operate under two sets of rules)'[11]

'Within the EU, we have done away with borders for the *physical* movement of people, but are lagging behind in eliminating these same borders for the movement of *law*. To eliminate the requirements of territoriality and internationality in private international law is the next logical step in this European integration process. However, this would not be enough: citizens ideally should also be able to profit from the richness of non-European views of what is just. Only in that way it is possible for them to benefit fully from a market for laws.[12]

I consider the Draft Common Frame of Reference (DCFR) to have been the decisive step towards the institutionalisation of the vocabulary of 'economics-that-replaces-law', this being in turn a radical perspective developed out of the broader shift away from 'law' towards 'law-and-economics' that the above statements exemplify. Some provisions of the Draft Common Frame of Reference exemplify key features of that institutionalization process. Specifically:

When writing about the right of cancellation and about contractual information duties the DCFR considers that '[i]nterferences with freedom of contract may be justified on the ground that they can serve to promote economic welfare if there is reason to think that because of some market failure (such as that caused by inequality of information) the agreement is less than fully efficient' and that '[c]onsumer protection rules, for example, can be seen not only as protective for the benefit of typically weaker parties but also as favourable to general welfare because they may lead to more competition and thus to a better functioning of markets.' This 'market failure' line of argumentation is deployed with a view to craft consumer protection rules that only serve the overarching aim of leading to a 'more competitive market.' For 'efficiency' is explicitly presented as one and the same thing with the promotion of contractual and market freedoms,[13] rather than as an argument that may help 'rationalise' any kind of legal intervention, whether 'enhancing' or 'limiting' contractual freedom and competitiveness. Here law-and-economics, a vocabulary that arguably does not just lend itself to such rationalization, takes instead a rigidified structure—it becomes 'economics-that-replaces law'. This is a line of argument relied upon when, for instance, the authors of the DCFR apply a pro-market interpretation of pre-contractual rules on information duties and of liability for products.

[11] F Gomez and JJ Ganuza, 'The Economics of Harmonising Private Law Through Optional Rules' in Niglia (ed), *Pluralism and European Private Law* 177, 180.

[12] J Smits, 'A Radical View of Legal Pluralism' in Niglia (ed), *Pluralism and European Private Law* 168 f., quoting and agreeing with EA O'Hara and LE Ribstein, *The Law Market* (Oxford, Oxford University Press, 2009) (arguing that the 'mobility of people, assets, and transactions makes deciding which laws to apply to a legal problem increasingly arbitrary').

[13] C von Bar and E Clive (eds), *Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference* (Oxford, Oxford University Press, 2009), and the two previous editions without comments and notes: C von Bar et al (eds), *Principles, Definitions and Model Rules of European Private Law: the Draft Common Frame of Reference* (Munich, Sellier, 2009) 38; C von Bar et al (eds), *Principles, Definitions and Model Rules of European Private Law: the Draft Common Frame of Reference* (Munich, Sellier, 2008).

Thus, the authors of the DCFR put forward a regime of product liability, borrowed from the Product Liability Directive, that empowers producers to avoid liability by relying on the 'risk development defence,' with a view to encouraging the 'minimisation of insurance costs' and to just safeguarding the values of 'industrial innovation and technical progress.'[14] This is illustrative of a logic that permeates the whole body of DCFR rules, leading as it does to the enumeration of 'lists' of market-friendly rules for both consumer and commercial transactions. That logic equally applies whenever the DCFR puts forward rules that protect the provider of services from liability for non-performance or mis-performance, in cases in which it would have been too costly for him to prevent the damage, or makes the duty to provide pre-contractual information conditional on similar cost considerations. This is provided for, respectively, at Art. IV.C-2:105 DCFR (providing for the obligation on the service provider to 'perform the service with the case and skill which a reasonable service provider would exercise under the circumstances' and, at Art. IV.C.-2:105 (4) DCFR (b), that 'in determining the care and skill the client is entitled to expect, regard is to be had, among other things, to… if damage has occurred, the costs of any precautions which would have prevented that damage or similar damage from occurring') and at Art. II.-7:205(3)(b) DCFR ('[i]n determining whether good faith and fair dealing required a party to disclose particular information, regard should be had to all the circumstances, including… the cost to the party of acquiring the relevant information').[15] Together with the explicit DCFR preference for 'corrective' over 'distributive' considerations,[16] the above demonstrates the DCFR's endorsement of the Commission's strategy to favor a 'market-orientated' *qua* competitive-ridden private law.[17] That is, at work is an assemblage of substantively orientated formal techniques incorporating the command that there are circumstances in which

[14] On such strands of economic analyses, see DCFR (outline version), at 16 and on product liability specifically, see DCFR 2009 (full edition) at 3522 (discussing the UK state of the art of the directive generated law of risk development defense and mentioning scholars favoring and criticising the minimisation cost arguments).

[15] For critical discussion and for further illustrations see L Niglia, 'The Question Concerning the Common Frame of Reference' (2012) 18 *European Law Journal* 739.

[16] See DCFR (outline version), at 24. See T Wilhelmsson, 'Varieties of Welfarism in European Contract Law' (2004) 10 *European Law Journal* 716 (conceptual link between, on the one hand, 'corrective justice' and market-facilitating contract law policy instruments such as those that I am describing in relation to the DCFR and, on the other hand, between 'distributive justice' and more progressive forms in which to organise contract law including internally and externally redistributive elements).

[17] On market competitiveness as the driving ideological force behind the Commission agenda of private law reform: see, e.g. 'Manifesto of the Study Group on Social Justice in European Private Law' (2004) 6 European Law Journal 655–656 (discussing the 'technocratic' approach to contract law in the EU as one narrowly focused on removing impediments to cross-border trade with little consideration for social aspects); Wilhelmsson, 'The Variety of Welfarism', 726 ff. (considering the consumer contract directives to be predominantly geared towards market facilitating objectives); Niglia, *The Transformation*, (reconstructing the Unfair Terms Directive as instrumental to the promotion of market competitiveness); H-W Micklitz, 'The Concept of Competitive Contract Law' (2005) 23 Penn State International Law Review 549.

the law requires that established domestic consumer protectionist standards be altogether relaxed (economization).[18]

The same line of argument applies to the case of the DCFR key 'principles' (efficiency, freedom, security and justice). Here economization operates via the exclusion of the eleven principles that were contained in the previous edition, some being key 'social principles'[19] such as protection of human rights, solidarity and social responsibility; protection of consumers and others in need of protection; preservation of cultural and linguistic plurality; protection of reasonable reliance; and the *proper* allocation of responsibility for the creation of risks. 'Efficiency' not only recalls the key rationale around which the Commission has developed its project of private law marketization as incorporated in the DCFR model rules as discussed above, but it is the key principle around which the remaining three core principles revolve. In the words of the DCFR:

'[a]t one level, *freedom*, *security* and *justice* are ends in themselves. People have fought and died for them. Efficiency is less dramatic. In the context of private law, however, *these values* are best regarded not as ends in themselves but *as means to an end—the promotion of welfare*, the empowering of people to pursue their legitimate aims and fulfil their potential.'[20]

Then, in explaining the 'meaning' of 'efficiency,' '[t]he rules in the DCFR are in general intended to be such as will promote economic welfare; and this is a criterion against which any legislative intervention should be checked.'[21] In this understanding, three aspects look contiguous—efficiency means welfare; welfare is taken to be the overarching end goal of the DCFR; welfare entails the twin aim of keeping interventionism at a minimum whilst maximising market competitiveness. The programme of minimum intervention spelled out at the beginning of the DCFR, when identifying the foundational principles of private law, in the stated conviction that the values and principles of 'freedom' and 'efficiency' are 'interchangeable,'[22] defines a legal hermeneutical horizon within which private law actors are supposed to operate. *En bref*, economization is one and the same thing with the four principles understood as a proxy for implementing the welfare efficiency, minimum intervention rationale. 'Economics-that-replaces-law' is, deep down, 'law-economized'.

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[18] On 'assemblage' in relation to the Europeanisation of private law see Niglia, 'The Question'.

[19] See eg, for an analysis of how the insiders to the DCFR project understand the principles to be more or less 'social', MW Hesselink, 'If You Don't Like Our Principles We Have Others' in R Brownsword, H-W Micklitz, L Niglia and S Weatherill (eds), *The Foundations of European Private Law* (Oxford, Hart, 2011) 59.

[20] DCFR 2009 (full edition), 37 [Emphasis Added].

[21] ibid, 61.

[22] ibid, respectively, 38 ff and 59 ff. ('The promotion of freedom overlaps with the promotion of efficiency', at 38, thus precluding the relevance of any kind of efficiency-based interpretation that goes towards 'limiting' freedom).

5.1.2 The New Narrative and the Old—Ongoing Conflicts over the Meaning of Private Law

The question as to whether economization should be accepted or reacted against is increasingly a major point of conflicts among the insiders to the private law realm. It is a question that increasingly characterizes the world of pluralization that we inhabit. Let me give a first illustration taken from the CJEU case-law and another from EU legislative activities in both of which such 'conflicts' emerge in the context of the living law itself, placing the law before the dilemma of having to choose whether or not to surrender to economization.

In *Freiburger*[23] at stake has been the issue of the extent to which contractual terms should be held to be unfair independently of the economic convenience for the buyers of the overall deal. At paras 16 and 23 of the judgment both guarantee and price have been balanced out against the contractually provided for obligation on the buyers to pay the price only after the seller's performance. First, the Court held that the contractual arrangements at stake, in contemplating payment before as opposed to the moment of execution of the parking space, both reduces the price for the work (it reduces the need for the builder to finance the building work through use of borrowings) and limits the disadvantages faced by the buyers (it ensures the return of the sum paid in the case of non-performance, defective performance or insolvency of the builder). Therefore, in the opinion of the Court, disadvantage of the payment being due before the conclusion of the contract—that stems, in the words of the defendants in the main proceedings, from the derogation of the fundamental rule-principle 'recognized in all systems of civil law, that mutual obligations must be performed contemporaneously'—is unfair only in the abstract but not in the circumstances at stake (para 16). Second, the Court held that the term providing for anticipated performance on the part of the buyers is not 'solely to the benefit of the seller' nor can one argue that it 'contained no benefit in return for the consumer' (paras 23–24). On the contrary, it is a term that benefits the seller in the context of a contractual package that also benefits the buyers in terms of price and guarantee. It is on the basis of this balancing argument that the Court then held that the term providing for an anticipated performance in the payment on the part of the buyers was fair under the Directive on Unfair Terms. The CJEU resisted the argument put forward by the buyers whereby consumers deserve protection on the basis of the civilian principle that mutual obligations must be performed contemporaneously, yielding a conflict between traditional (principled) and innovative (economization) conceptions of economic law. Whilst allowing to domestic courts to have the last word on the matter did moderate the impact of the decision, it remains true that the core aspects of the case have been decided on the basis of the vocabulary of economic convenience rather than the legal vocabulary of un-fairness. It has been noted in the literature how this decision is far from uncontroversial in that it is

[23] Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v Ludger Hofstetter and Ulrike Hofstetter* [2004] ECR I-3403.

about shaping law in the light of economic calculations. Here private law becomes aligned to CJEU cases (*Laval*; *Viking*) in relation to which the economic objectives of lowering salaries has led to the playing down of the 'integrity of the law', giving rise to decisions that place market freedoms above workers' rights as incorporated in traditional private law structures. Cases such as these indicate how judges and scholars are continuously exposed to the challenge of countering economization or passively accepting it.

Turning to legislation, the proposed Regulation on a Common European Sales Law of October 2011[24] poses a similar problematic. Various voices have been raised against the proposed optional code that stem from the substantive consideration that its approval and implementation would entail sacrificing the range of domestic mandatory rules otherwise typically applied to sales contracts (trans-border). These mandatory rules vary depending on each jurisdiction and may be, for example, pre-contractual information rules such as those that impose on the seller the duty to disclose a certain amount of information regarding the goods to be sold *or* liability rules such as the rule whereby third parties are protected from the negative effects of a contract. Critically, scholars object to the eventuality of a complete setting aside of domestic mandatory rules. In their view this would lead to what they call 'social dumping'. By 'social dumping' scholars refer to the phenomenon whereby the elimination of the relevance of the range of applicable domestic mandatory rules to sale contracts providing for an opt in clause would be bound to cause the lowering of regulatory standards that protect the interests of weak contractors (and consumers) in each member state, according to the domestic constitutional politics of social protection enshrined in private law systems.[25] This polemic is another example of a tension between economization, the project of eliminating domestic mandatory protectionist standards, and traditional economic law (including welfare law) as developed nationally.

5.1.3 The New Narrative and the Old—Between Economization and Harmonisation

What is remarkable is that structures of accommodation are available towards mediating between the opposing requirements, legal and economic, reinstating the power of law over economics rather than simply surrendering to the logic of economization. Proportionality may be taken to be one such tool key to the resolution of many of the relevant conflicts in that it allows for room for the law *qua* national legal traditions (national legal traditions as precondition for, and as 'limits' on, harmonisation) as opposed to superimposing economization (over-harmonisation and its

[24] Proposal for a Common European Sales Law, COM(2011) 635 final.

[25] MW Hesselink, 'An Optional Instrument on EU Contract Law: Could It Increase Legal Certainty and Foster Cross-Border Trade?' European Parliament, Policy Department, PE 425.642, 16–17; J Rutgers, 'An Optional Instrument and Social Dumping' (2006) *European Review of Contract Law* 199.

bad consequences). Let me discuss briefly what I mean by accommodation via proportionality (a) before considering the need for the Commission to avoid the danger of 'over-harmonisation' (b).

a) Accommodation by proportionality entails the requirement to avoid unnecessary economic-orientated intervention (EU-driven, market integrationist) whilst opting for the least restrictive legislative action. Specifically, proportionality means—as per the case law of the CJEU that, notably, draws inspiration from the experience of German administrative law—that Union institutions are required to (s)elect legislative means effectively suitable for the purpose of achieving the objectives in view. This means that they are required inter alia to disregard means that cannot plausibly be assumed 'in logic and/or in experience' to lead to attain the stated objectives.[26]
b) Major regulatory moves on the part of the European Commission such as the DCFR and the Optional Sales Law Code go in the direction that is the opposite of the objective of accommodation via proportionality. It seems to me clear that the Commission (and its scholarly brethren) are attempting to shift the ground away from reconciliation and towards placing economization at the core of private law Europeanisation. They do this by disregarding proportionality and by aiming at superimposing on national legal traditions a kind of regimented harmonisation private law regime that aims at economising whilst de-legalising. The consequences of these moves must be 'over-harmonisation', that is, the pathology of European legislation that is substantively ambitious, in that it aims at harmonising on the basis of a strong agenda that conflicts with that of national private laws, but that ends up with creating new fragmentation, it being partly enforced only, if at all—a lesson from the past given the many resistance patterns that have typically accompanied any attempt at enforcing economization via the consumer private law Directives, whenever national legal actors have chosen to defend social private law as nationally regulated.[27] Harmonisation tools are far from neutral in that they are deployed in different ways depending on the strategies of the actors that happen to make use of them. Specifically:

The *DCFR* is a first potential case of 'over-harmonisation'. The Draft is indirectly the product of the activities of the European Commission as it is a text written by scholars under the scrutiny and support of the European Commission, that is, under its intimation that scholars should merge the *acquis* with the heritage of the model rules (Lando Commission's *Principles of European Contract Law*).[28] If adopted,

[26] I am drawing on GA Bermann, 'Proportionality and Subsidiarity' in C Barnard and J Scott (eds) *The Law of the Single European Market. Unpacking the Premises* (Oxford, Hart, 2002) 75, 80 (reconstructing the requirement of proportionality as 'rational relation' test). For this overall argument see L Niglia, 'Of Jurisdictional Balancing in European Private Law' in Brownsword et al, *The Foundations of European Private Law*, 309.

[27] For discussion see L Niglia, 'Of Constitutionality and Private Consumer Law in Europe' (2012) *Journal of European Consumer and Market Law* 223.

[28] O Lando and H Beale (eds), *Principles of European Contract Law, Parts I and II* (The Hague, Kluwer Law International, 2000); O Lando, E Clive, A Prum and R Zimmermann (eds), *Principles of European Contract Law, Part III* (The Hague, Kluwer Law International, 2003).

partly or entirely and whatever the option(s) that will be chosen for adoption in future years, the DCFR is bound to fail proportionality in that it is a code-project, thus lacking the needed flexibility to accommodate the variety of values as they underlie private law throughout Europe.[29] If the Directives (minimum harmonisation) have been resisted in many ways, as it has no doubt been the case, this will certainly apply to the case of a 'code'. Even if one disregarded the specific character of the DCFR as a code-like instrument, the DCFR would be no less convincing nevertheless in terms of proportionality in that, it would be about cascading a set of supposedly 'common' rules and principles on national legal systems regardless of a proportionality-orientated consideration of domestic specificities of values and techniques. For example, the text provides for a set of principles hardly representative of, and indeed at odds with, the variety of principles that constitute domestic private law orders.[30] They are principles that incorporate a sheer strategy of economisation, as discussed above. This is why a polemic did develop on this point within the networks of scholars that have been working on the task of compiling the Draft, in relation to the exclusion of certain principles that some scholars believe to be representative of national private laws.[31] The same criticism applies to the Draft's model rules, which tend to be no less representative of actual law than it is the case of the principles. For the DCFR is a composite text in which one can find many model rules fundamentally at odds with established laws in domestic jurisdictions. This is true if one looks, for example, at the model rules applicable to services, as discussed above, that is, those DCFR rules that protect the provider of services from liability for non-performance or mis-performance, in cases in which it would have been too costly for him to prevent the damage, or makes the duty to provide pre-contractual information conditional on similar cost consideration. Here the value of ensuring fair dealings through the obligation on the part of the service provider to respect mandatory quality standards, or to observe strict information disclosure duties, is explicitly and unconditionally subordinated to cost-based considerations.

The second potential case of 'over-harmonisation' is the proposed Regulation on a Common European Sales Law of October 2011, a first concrete step towards implementing the Common Frame of Reference project via an optional code.[32] This

[29] Cf Wilhelmsson, 'Varieties of Welfarism', 734 (discussing the incompatibility between a 'general European civil code, contract code or consumer code and solutions based on the 'varieties of welfarism').

[30] Cf H Eidenmüller et al, 'The Common Frame of Reference for European Private Law—Policy Choices and Codification Problems' (2008) 28 *Oxford Journal of Legal Studies* 659. Lack of 'representativeness' is problematic in terms of proportionality because it is about constructing a self-standing kind of private law not grounded on the practices of national jurisdictions, which prepares the ground for further fragmentation.

[31] For discussion see D Kennedy, 'A Transnational Genealogy of Proportionality in Private Law' in Brownsword et al., *The Foundations of European Private Law*, 187; Hesselink, 'If You Don't Like Our Principles We Have Others', 59.

[32] For this opinion see e.g. European Economic and Social Committee, Opinion on the Green Paper, [2011] OJ C 84/1.

Proposal is equally unconvincing in terms of proportionality. Let me give just one reason why this is so. In attempting to lower mandatory standards of consumer protection as they exist throughout Europe,[33] the Proposal is in obvious continuity with previous Proposals (e.g. the Proposal leading to the now approved Directive on Consumer Rights). The technique may well have changed—the Commission is not attempting to establish maximum harmonisation through a Directive but an optional regime through a Regulation—but the substance of the operation remains unaltered. And it is substance that (also) matters in relation to the proportionality question. For, assuming that the Draft Proposal will be approved as it stands (in contrast to what has happened to the Proposal for a Directive on Consumer Rights), it is bound to bring about over-harmonisation, that is, rejection and resistance leading to the perpetuation of fragmentation patterns. Over-harmonisation here would be consequential to the fact that, the Proposal targets entire sets of domestic mandatory rules related to sales law which, notably, incorporate exactly those protectionist standards that Member States are unwilling to give up, with a view to avoid social dumping.

5.1.4 Law or Law-Economized?

What remains open for debate and expecting resolution is the issue of how to act out of justice in conditions of economically driven pluralization. The same dilemma that constitutionalists are facing affects the work of private law scholars—whether to cling on 'rule of law' and 'legal certainty' monistic templates *or* to accept the new challenges by reframing the law towards capability in facing the challenge of normatively governing pluralization.[34] Taking the latter pluralist perspective, accommodation techniques can only work if law remains relatively speaking 'autonomous' and does not just melt into economization. There is a value in law's integrity (law that resists economization) even without having necessarily to embrace certain well-known abstract theories about the integrity of the law; it is sufficient (and imperative) to look at European private law history to understand the contingent value of law's 'integrity' as developed in the nation state in times of materialization.[35] This is not at all an invitation to abandon economic law altogether but, to the contrary, it is about raising awareness about the need for reaffirming the virtues of economic law against the temptations of 'law-economized' *qua* radical understandings of economics that 'de-legalizes', turning economic law in sheer economization.[36] The following excerpt from Hans Micklitz's writings is representative of the work of those who are consciously taking up this challenge, and in my view epitomizes the point at which the debate currently is. That is, private law finds itself in a dilemmatic condition—it needs to choose whether to passively accept economization understood

[33] See the scholarly debate on the dangers of 'social dumping' as discussed above.

[34] Niglia, 'Pluralism in a New Key'.

[35] L Niglia, *A Critique of Codification* (Oxford, Hart, 2014).

[36] For discussion see ibid.

as a total project of remaking law altogether ('law-economized') *or* whether to preserve the tradition of active engagement vis-à-vis economic change as embodied in private law as developed at least over the last 60 years or so. What I find intriguing is the 'yielding its own pattern of justice' to which Micklitz refers, no doubt having in mind the traditional patterns of justice ('economic law') as we have known them up until now. As this is a chapter in a book dedicated to Micklitz, I find it obvious to leave it to him the concluding words, with a quotation this time not abridged as earlier but evidencing the 'attention' that Micklitz gives to law's role in an increasingly complex transnational private law world in which economics is relentlessly taking control of the law. I understand that much of the future shape of (transnational) private law (European and not) will depend on the path that the community of interpreters will choose in relation to the argument regarding a transformed private law "'yielding its own pattern of justice' as opposed to private law orders 'based on private autonomy and free will'"—whether or not it will choose to act out of the lesson from history that 'a full appreciation of society as it really is' and 'an unequivocal commitment to law' are both 'essential prerequisite of any productive legal science' rather than mutually incompatible.[37] Here are the relevant passages:[38]

'The regulatory private law, in its negative variant through the impact of the four freedoms on the private law and in its positive variant through the bulk of EU rules that have been adopted in the aftermath of the Single European Act outside consumer and anti-discrimination law, deserves the utmost attention. This is the *European regulatory private law*, in which the *modern variant of the European Union as a Market State* comes clear. This private law is different from national private legal orders based on private autonomy and free will. This private law takes its form, procedure and content from being instrumentalised for building and shaping markets, yielding its own pattern of justice. It covers the setting of the regulatory frame through the EU institutions, the EU-driven building of new market surveillance authorities, the fine-tuning of the rules through intermediary forms of cooperation between EU and Member State institutions—be they called comitology, Lamfalussy process, open method of coordination, the development of new substantive legal mechanisms that reach beyond traditional private law rules and, last but not least, the enforcement of the self-standing rules through the sectorial regulatory agencies and through new forms of alternative dispute settlement mechanisms.'

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[37] F Wieacker, A History of Private Law in Europe (Oxford, Clarendon Press, 1995) 488.

[38] Micklitz, 'Monistic Ideology versus Pluralistic Reality', 39 [Emphasis in original].

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Chapter 6
A 'Competitive Contract Law'?

Karl Riesenhuber

Abstract In an analysis of EU contract law, Hans Micklitz has developed the concept of a 'competitive contract law'. The present chapter exposes the central elements of the concept and discusses its merits. The cornerstones of Micklitz' concept are withdrawal rights and the sellers' duty to provide information. Its claim is to promote a genuine notion of justice. Our analysis suggests that 'classical' contract doctrine still provides the superior theory to explain EU contract law. Withdrawal rights and their, as Micklitz maintains, 'extension of competition beyond the moment of formation of contract' cannot and should not replace *pacta sunt servanda* as the general rule of contract law. This would not only have devastating effects for a market economy but also compromise the interests of consumers.

Hans-W. Micklitz and I first met at a conference on 'Party Autonomy and the Role of lnformation in the lnternal Market'[1] in May 2000 in London. Hans Micklitz was a wellestablished and renowned consumer law theorist already, and I was a young 'hotspur', highly critical of regulatory interventions to freedom of contract (critical I remain). My own work at the time focused on 'System and Principles of EU Contract Law'[2]—a subject that Hans Micklitz had already addressed in a 1998 paper on 'Perspectives of European Private Law'.[3] In the context of 'Principles of a European Contract Law', Micklitz introduces the concept of 'Competitive Contract

[1] S Grundmann, W Kerber and S Weatherill (eds), *Party Autonomy and the Role of lnformation in the lnternal Market* (Berlin, de Gruyter, 2001).

[2] K Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts* (Berlin, de Gruyter, 2003); id, 'System and Principles of EC Contract Law' (2005) 1 *ERCL* 297.

[3] H-W Micklitz, 'Perspektiven eines Europäischen Privatrechts' (1998) *Zeitschrift für Europäisches Privatrecht* 253 (my translation).

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_6,

Law',[4] a concept that received considerable, if critical, attention.[5] In later publications, Micklitz has taken up the subject again, emphasising different aspects of the general theme. The present *liber amicorum* is perhaps a good opportunity for a critical re-evaluation. I still disagree with Hans Micklitz. But the recurrent discussion of the subject illustrates how stimulating his proposal was and remains. And thus, where I disagree, I do so with the greatest respect for a colleague whose work in its impressive scope demonstrates a sound consistency of scholarly interests and a refreshing curiosity for new developments.

6.1 The 'Concept' of a 'Competitive Contract Law'

My difficulty with the concept of a 'competitive contract law' begins with the concept itself, for it is not quite easy to grasp. The ambiguous label 'competitive'[6] has not provided much guidance either. While Micklitz refined the concept in later publications, the initial 1998 proposal[7] still seems to express the general thrust most comprehensively. Here is a summary of his proposal:

- 'Competitive contract law' complements the models of discrete and relational contracts.[8]
- 'Competitive contract law' instrumentalises contract law for the purposes of the internal market.[9]
- 'Competitive contract law' is opposed to *pacta sunt servanda* as the leading principle of what Micklitz terms 'classical contract law'. It is concerned with 'flexibility' rather than with commitment. In 'competitive contract law', competition is extended beyond the conclusion of the contract. Its aim is no longer to uphold a contract once formed. Instead, where a party realises that there is an opportunity to obtain the product or service at a better price, it should have the opportunity to resolve the contract.[10]

[4] Micklitz, 'Perspektiven eines Europäischen Privatrechts' (my translation); see already id, 'Ein einheitliches Kaufrecht für Verbraucher in der EG?' (1997) *Europäische Zeitschrift für Wirtschaftsrecht* 229, 236 f; further id, 'Zur Notwendigkeit eines neuen Konzepts für die Fortentwicklung des Verbraucherrechts in der EU' (2003) *Verbraucher und Recht* 2, 9 f; id, 'The Concept of Competitive Contract Law' (2004–05) 23 *Penn State International Law Review* 549 ff.

[5] See e.g. C Baldus, *Binnenkonkurrenz kaufrechtlicher Sachmängelansprüche nach Europarecht* (Baden-Baden, Nomos, 1999) 94 ff; C-W Canaris, (2000) 200 *Archiv für die civilistische Praxis* 273, 344 f; B Heiderhoff, *Grundstrukturen des nationalen und europäischen Verbrauchervertragsrechts* (Munich, Sellier, 2004) 372 ff; C Meller-Hannich, *Verbraucherschutz im Schuldvertragsrecht* (Tübingen, Mohr Siebeck, 2005) 178 f; Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts,* 579 f; H Roth, 'EG-Richtlinien und nationales Recht' (1999) *Juristenzeitung* 529, 534; K Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag* (Tübingen, Mohr Siebeck, 2012) 156 ff.

[6] See e.g. K Riesenhuber, 'A Competitive Approach to EU Contract Law' (2011) 7 *European Review of Contract Law* 537, where I use the term 'competitive' to refer to regulatory competition.

[7] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 265 ff.

[8] ibid, 265.

[9] Micklitz, 'The Concept of Competitive Contract Law', 553 ff.

[10] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 265 and 267.

- Elements of 'competitive contract law' are: (1) termination rights, (2) information and transparency, (3) a redistribution of responsibilities and (4) effective enforcement. The concept presupposes a high level of information of both parties and transparency of the market.[11]
- 'Competitive contract law' enhances the development of a 'genuine notion of justice' ('*genuine Gerechtigkeitslogik*'). This is again linked to the termination rights: This 'notion of justice' is ensured by the right to 'exit' one contract and 'switch' to another. It is 'no longer merely allocative, and at the same time not necessarily social'.

In the 1998 proposal, Micklitz does not expressly address the scope of his concept of 'competitive contract law'. While it is well-known that his research focuses on consumer protection law, there is no such restriction in the concept of 'competitive contract law'. Indeed, while later discussions mention the concept in the context of consumer contract law, the initial proposal was made in the context of EU private law and, more specifically, EU contract law. So it can be assumed that Micklitz considers the concept to be one for contract law as such. This is confirmed by the fact that Micklitz speaks of 'competitive contract law' as 'a new paradigm in contract law theory'[12] and discusses both, consumer and business contract law in this context[13]. In the same vein, Micklitz says:

'Contract law [sc of the EU] follows a primacy of competition law. This is why European consumer contract law is competitive contract law. This new orientation opens up perspectives for the extension and construction of a European system of private law. In this respect the conceptual foundations of consumer contract law reach way beyond the scope of its actual subject matter. The central elements of competitive contract law are not limited to consumer contract law.'[14]

6.2 What is the Concept About—A Third Type or Class, Complementing Discrete and Relational Contracts?

Let us now discuss the various aspects of 'competitive contract law' as thus submitted by Micklitz, starting with the question of what the concept of 'competitive contract law' is about. In the 1998 proposal, Micklitz says: 'The model of competitive contract law complements discrete and relational contracts'.[15] Discrete contracts are singular transactions which are completed in a short period and do not run over a longer period of time such as the sale of a loaf of bread. The notion of relational contracts in contrast refers to contracts that establish long-term relations between

[11] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 265 f; id, 'The Concept of Competitive Contract Law', 561 ff.

[12] Micklitz, 'The Concept of Competitive Contract Law', 551.

[13] ibid, 553 ff and 556 ff.

[14] Micklitz, 'Zur Notwendigkeit eines neuen Konzepts für die Fortentwicklung des Verbraucherrechts in der EU', 9 f (my translation).

[15] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 265.

the parties with long-lasting or recurring obligations.[16] Duration and the intensity of the parties' relations are thus the distinctive criteria. 'Competitive contract law' is not, however, defined with a view to these characteristics, and thus it is difficult to see how it can complement the distinction of discrete and relational contracts. In fact, further discussion reveals that Micklitz' concept is on a different scale. Rather than describing a *type* of contract or a *class* of contracts, it aims at defining the concept and principles of contract law as such, what German-tongue lawyers consider the 'inner system' of contract law[17].

6.3 Contract Law as an Instrument for Building the Internal Market

While this was not in the foreground of the initial 1998 conception of 'competitive contract law', Micklitz has in a later publication emphasised that the EU has 'instrumentalised' contract law for building the internal market.[18] This is a somewhat perplexing observation. Freedom of contract is an essential element of every market. Thus, an instrumentalisation seems to be unnecessary. To the contrary, interference with freedom of contract is an obstacle to the (internal) market. Indeed, the Treaty on the Functioning of the European Union defines the internal market with a reference to freedom of contract: 'The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties', Article 26(2) TFEU. Extending freedom of contract is the basic principle behind the fundamental freedoms.

Micklitz' observation is however right when he speaks of an instrumentalisation of contract law by the EU.[19] Consumer contract law in particular is not only aimed at remedying market failures but also at fostering consumer confidence with a view to promoting the internal market.[20] This is arguably one of the driving forces behind the Distance Selling Directive (now incorporated into the Consumer Rights Directive) and the Consumer Sales Directive. Yet, it is unclear how such *instrumen-*

[16] On relational contracts, see IR MacNeil, 'The Many Futures of Contracts' (1974) 47 *California Law Review* 691; id, 'Economic Analysis of Contractual Relations' (1981) 75 *Northwestern University Law Review* 1018; MA Eisenberg, 'Why there is no Law of Relational Contracts' (2000) 94 *Northwestern University Law Review* 805; CJ Goetz and RE Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1089.

[17] On concepts of 'system' C-W Canaris, *Systemdenken und Systembegriff in der Jurisprudenz,* 2nd ed (Berlin, Duncker & Humblot, 1983).

[18] See in particular Micklitz, 'The Concept of Competitive Contract Law', 561 ff.

[19] See in detail C Schmid, *Die Instrumentalisierung des Privatrechts durch die Europäische Union* (Baden-Baden, Nomos, 2010).

[20] Heiderhoff, *Grundstrukturen des nationalen und europäischen Verbrauchervertragsrechts*, 219 ff.

tal use of contract law, motivated by the respective regulatory goal, leads to a *new paradigm in contract law*.

6.4 The Central Element: Opposed to *pacta sunt servanda*

The central and distinctive element of Micklitz' concept of 'competitive contract law' is its relativisation, more than that, its denial of the fundamental principle of *pacta sunt servanda.* As this is a crucial point, let us look at Micklitz' own words:

'Competitive contract law is opposed to the central idea (*Leitidee*) of classical doctrine on legal transactions (*Rechtsgeschäftslehre*), to "*pacta sunt servanda*". Competitive contract law is not guided by commitment (*Bindung*) but rather by flexibility. It extends competition beyond the moment of the formation of contract. Competitive contract law does not replace the principle of "*pacta sunt servanda*", it demonstrates, though, that in a Europeanised contract law "*pacta sunt servanda*" does not bear the same weight as in the national systems of private law. (…) That a contract lasts (*Bestand haben*) no longer seems to be the goal of a European model of contract law. Where a party to a contract realises, on short notice, that there is an opportunity to buy the product cheaper elsewhere or to obtain the service for a better price, there should be an opportunity for it to step back from the contract.'[21]

It is this aspect of his concept in particular that met with fierce opposition. Irrespective of this criticism, Micklitz has, in later publications, maintained his opposition in principle against *pacta sunt servanda.* Thus, in a 2004/2005 article he says:

'Both together, the unconditional right to withdrawal and the comprehensive right to rescission, are not easily to be made compatible with *pacta sunt servanda*. Legally, there may be justifications for each and every particular context, in practice, the borderlines are sweeping. Consumers tend to think that they are free to return the product and get their money back, even if the product is not defective at all. Thus, there is an overall trend to enlarge easily accessible rescission and cancellation rights beyond the existing boundaries—and further undermine the principle of *pacta sunt servanda*.'[22]

And in his 2012 report to the *Deutscher Juristentag,* Micklitz maintains: 'Efficiency of the contract rather than *pacta sunt servanda* is the *leitmotiv* of competitive contract law.'[23]

[21] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 265 (my translation).

[22] Micklitz, 'The Concept of Competitive Contract Law', 576.

[23] H-W Micklitz, 'Brauchen Konsumenten und Unternehmer eine neue Architektur des Verbraucherrechts?', *Verhandlungen des 69. Deutschen Juristentages* (Munich, CH Beck, 2012) A 60 (my translation).

6.4.1 A Theory of EU Contract Law?

Micklitz develops his concept based on EU legislation in the area of contract law. But is 'competitive contract law' a theory of EU contract law? Does it, in other words, explain the rules of EU contract law? Recall that Micklitz' claim is not limited to EU consumer contract law. Micklitz expressly states that 'the central elements of competitive contract law are not limited to consumer contracts'.[24]

Obviously, the basis for Micklitz' claim regarding the binding nature of contracts lies in the rights of withdrawal in consumer contract law. When Micklitz first proposed his concept, EU contract law provided for rights of withdrawal in the Doorstep Selling Directive, the Distance Selling Directive, in the Timesharing Directive and in the Life Insurance Directive. Since then, a right of withdrawal has also been added to the reformed Consumer Credit Directive. But these rights of withdrawal are not sufficient basis for Micklitz' claim. First, they do not cover all contracts but only consumer contracts. As far as I can see, nobody advocates the extension of rights of withdrawal to business-to-business relationships.[25] But even within the limited area of consumer contract law—where business-to-consumer relationships are concerned—rights of withdrawal are no more than punctual exceptions to the general principle of *pacta sunt servanda.*[26] Again, to my knowledge, it has never been proposed to give *both sides,* business and consumer, a right of withdrawal. And furthermore, while some would perhaps advocate a general right of withdrawal for consumers, this is not the law in the EU.

To this day, EU contract law provides no more than punctual interventions to the national contract laws of the Member States. These regulatory interventions presuppose the existence of national 'general' contract laws. They rely on the Member States' laws to provide for rules on, e.g, formation of contracts, breach, assignment, damages etc. If we try to infer principles of contract law from EU legislation we have to keep in mind this supplementary character.[27]

The finding is the same if we consider the proposed Common European Sales Law which, as an optional code, provides for a full-fledged (if incomplete) contract law. Here, too, *pacta sunt servanda* is the general rule and rights of withdrawal are the exception.

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[24] Micklitz, 'Zur Notwendigkeit eines neuen Konzepts für die Fortentwicklung des Verbraucherrechts in der EU', 10.

[25] I leave out here the questions of (a) protection of start-ups and (b) protection of small businesses, e.g. mom-and-pop-shops.

[26] Heiderhoff, *Grundstrukturen des nationalen und europäischen Verbrauchervertragsrechts*, 379 f.

[27] Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 554 f.

6.4.2 *Do Rights of Withdrawal Infringe with the Principle of* pacta sunt servanda?

Looking at the narrow scope of rights of withdrawal in EU contract law, it is another question whether they actually do interfere with the principle of *pacta sunt servanda* in the first place. This still seems to be the dominant view[28] but there are different conceptions. Thus, Jan Dirk Harke points out that *pacta sunt servanda* does not necessarily require the binding force of the contract to set in at the moment the parties consent.[29] While this is the standard model in German law (and beyond), Harke argues, it may still be complemented by a second model of contract pursuant to which one party, for a certain time, retains the right to step back from the agreement. He points out that both Roman law and the *ius commune* knew innominate contracts which, effectively, allowed the parties subsequently to withdraw. Similarly, Caroline Meller-Hannich says, where rights of withdrawal are involved, the principle of *pacta sunt servanda* should be interpreted so as to mean that the binding force of the contract does not yet apply once the parties have reached consensus but only after the withdrawal period has expired without the consumer exercising his right of withdrawal.[30]—Following this approach, Micklitz' rejection (or, in any case, relativisation) of *pacta sunt servanda* would be based on a misconception of the principle. Alternatively, this approach could be read as a confirmation of his theory in other words (at least in part; Harke explicitly refers to *two* models of contract).

Obviously, the different approaches to *pacta sunt servanda* can be explained as a mere matter of terminology. Arguably, though, there is more behind it. Harke rightly emphasises that rights of withdrawal can well be understood as merely establishing a new *mechanism* for the formation of contracts (for specific cases). They may thus be compared to form requirements (you have to go to a notary and have the contract sealed in order to make it binding, even though you have already reached agreement) or the requirement of consideration (you have to give something in return). The difference is, though, that where the law provides for a right of withdrawal it does accept that the contract has already been validly concluded:[31] The parties have exchanged promises and reached agreement, and if they subsequently perform their obligations (even before the withdrawal period expires) we consider this to be based on and justified by the contract already concluded. The contract, in other words, is already perfect—and binding—even before the withdrawal period expires. The

[28] Canaris, 'Wandlungen des Schuldvertragsrechts', 344 f; Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 561 ff; S Lorenz, *Der Schutz vor dem unerwünschten Vertrag* (Munich, CH Beck, 1997) 32 ff; M-P Weller, *Die Vertragstreue* (Tübingen, Mohr Siebeck, 2009) 291 ff, critically discusses objections against withdrawal rights as infringements of *pacta sunt servanda*; ultimately, however, he does not deny that they do interfere with the principle but argues that the infringement was *justifiable.*

[29] JD Harke, *Allgemeines Schuldrecht* (Berlin, Springer, 2010) 74 f.

[30] Meller-Hannich, *Verbraucherschutz im Schuldvertragsrecht*, 178 f.

[31] See recently Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag*, 173 ff.

point is amplified by the fact that it is only the consumer, and not both sides, who has a right to withdraw from the contract. The other party cannot, of its own right, call the binding force of the contract into question.

6.4.3 Rights of Withdrawal: Exceptions to the Rule

To sum up what we have said so far: While rights of withdrawal thus do interfere with the principle of *pacta sunt servanda* (above, 6.4.2) they only provide for limited exceptions (6.4.1). The justifications for these exceptions are certainly controversial. Still, it is widely accepted that the justifications are in principle compatible with 'classical' contract theory. The general idea is that rights of withdrawal are intended to safeguard individual self-determination of the consumer under specific circumstances or in regard of particular (complex) contracts. Based on this justification, the rights of withdrawal do not deny *pacta sunt servanda* as the rule but rather provide for limited and objectively justifiable exceptions to it.[32]

6.4.4 Should pacta sunt servanda *be Rejected* de lege ferenda?

We can, of course, re-interpret Micklitz' concept of 'competitive contract law' as a proposal *de lege ferenda.* But could the principle of *pacta sunt servanda* be abrogated, and should it? I submit that both questions should be answered in the negative.

First, it must be doubted that it would at all be possible for a legal system to reject the principle of *pacta sunt servanda.*[33] Its binding force is the essence of the contract; contract is consensus to be bound. It is hard to imagine what else the meaning of contract could be in the first place.[34] To do away with the binding force of contracts is no less than unthinkable.[35] Certainly, business relies on the binding nature of contracts and cannot do without. But that is no less true for consumers. Indeed, the binding nature of contracts certainly also protects consumer interests. They too need to rely on the stability of the agreement, e.g when prices or supply change.

Economics apart, a contract involves promises and to keep one's promises is a fundamental ethical tenet, too.[36] As Karl Larenz, Manfred Wolf and Jörg Neuner

[32] Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 561 ff; Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag*, 158 ff.

[33] On the fundamental principle of the 'sanctity of contracts' in historical and comparative perspective, see the seminal book by Weller, *Die Vertragstreue*.

[34] Canaris, 'Wandlungen des Schuldvertragsrechts', 279; K Larenz, *Richtiges Recht* (Munich, CH Beck, 1979) 57.

[35] In the same direction Canaris, 'Wandlungen des Schuldvertragsrechts', 344 f ('incalculable consequences'); Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 580; Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag*, 164.

[36] Canaris, 'Wandlungen des Schuldvertragsrechts', 344 f.

put it: 'That contracts should be honoured (*pacta sunt servanda*) does not only follow from the command of the respective legal system but rather is inherent in the binding nature of the promise as a moral act of the person and it is a prerequisite of any order among individual people as well as among states which is not based on power.'[37] Contracting is thus an expression of the moral claim of the individual person: its willingness and ability to abide by his word.[38] This moral claim thus has its roots in the individual's personality and dignity.[39] Again, it is inconceivable how a legal system could give up the fundamental tenet of *pacta sunt servanda.*[40]

This does, of course, not mean that the principle of *pacta sunt servanda* was absolute or that it would not tolerate any compromise. Like any other principle, it needs to be weighed and balanced with other—countervailing or reinforcing—principles.[41] It does mean, though, that on economic and ethical considerations, inroads to the general principle of *pacta sunt servanda* require sound justification and corresponding limitation.[42] The legal system cannot, in other words, abrogate the principle of *pacta sunt servanda* as such; it may only limit its scope in a limited number of certain specific cases.

6.4.5 The Practice of Agreed Withdrawal Rights as a Confirmation of the Model?

Micklitz insinuates, though, that the widespread practice of *contractually agreed* rights of withdrawal confirm the claim of a relativisation of *pacta sunt servanda* as the central element of the concept of 'competitive contract law'.[43] Indeed, we can observe in many contexts that sellers happily agree to give customers a right to return the goods. Oftentimes they do so on the customer's request, quite frequently, it is the sellers who, of their own initiative, offer a right to return goods and get the money back.

What does this mean for the theory or concept of contract law? Basically, it confirms the functioning of the market and the 'classical' liberal contract model.

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[37] M Wolf and J Neuner, *Allgemeiner Teil des Bürgerlichen Rechts,* 10th ed (Munich, CH Beck, 2010) § 10 para 23 (my translation); this passage can be traced to K Larenz, *Allgemeiner Teil des Bürgerlichen Rechts*, 7th ed (Munich, CH Beck, 1989) § 2 II e).

[38] Roth, 'EG-Richtlinien und Bürgerliches Recht', 529, 534.

[39] Larenz, *Richtiges Recht*, 57 ff, id, *Allgemeiner Teil des Bürgerlichen Rechts*, § 2 I and II; F Bydlinski, *Privatautonomie und objektive Grundlagen des verpflichtenden Rechtsgeschäfts* (Vienna, Springer, 1967) 109 ff.

[40] Lorenz, *Der Schutz vor dem unerwünschten Vertrag*, 35 ff; Roth, 'EG-Richtlinien und Bürgerliches Recht', 534, argues that a violation of *pacta sunt servanda* as proposed by Micklitz would be incompatible with freedom of contract as a fundamental right of the German constitution.

[41] On the 'nature' of principles, see Canaris, *Systemdenken und Systembegriff in der Jurisprudenz,* 52 ff.

[42] To this effect also Canaris, 'Wandlungen des Schuldvertragsrechts', 344 f.

[43] Micklitz, 'The Concept of Competitive Contract Law', 576.

Agreed rights of withdrawal are an expression of freedom of contract. Their value depends on—*pacta sunt servanda:* the binding nature of the contractual agreement.

(We may note, incidentally, that it can safely be assumed that such contractual rights of withdrawal pay for the sellers. They are businessmen and conclude contracts on a large scale. Indeed, offering a contractual right of withdrawal may induce the undecided customer to conclude the contract. Experience with legal rights of withdrawal suggests that only a small number of customers actually use such right. Behavioural economics suggest a number of explanations for low withdrawal quotas, including the avoidance of cognitive dissonance, an endowment effect [though controversial here] and a feeling of being in the other party's debt.[44] No doubt, before too long this commercial practice will be called into question as being unfair.)

6.5 Elements of 'Competitive Contract Law'

Let us look at the elements of 'competitive contract law'. Following Micklitz, '[e]lements of competitive contract law are rights of withdrawal, information and transparency, a redistribution of responsibility and effective enforcement'.[45]

6.5.1 Rights of Withdrawal and Freedom of Contract

We have already rejected Micklitz' general claim as to the abrogation or relativisation of *pacta sunt servanda.* Let us consider rights of withdrawal in the context of his concept of contract law in more detail.

6.5.1.1 Rights of Withdrawal as Extension of Competition?

Here is the root of the idea that 'competitive contract law' 'extends competition beyond the moment of the formation of contract'. Indeed, rights of withdrawal are in some cases intended to remedy a deficit in *ex ante* competition. This is true, in particular, in the case of doorstep-selling. Taken by surprise (be it intentionally or merely in effect), the consumer is 'deprived'[46] of a chance to compare competing offers on the market. The withdrawal period gives the consumer an opportunity to

[44] Cf H Eidenmüller, 'Der homo oeconomicus und das Schuldrecht' (2005) *Juristenzeitung* 216, 221 f.

[45] Micklitz, 'The Concept of Competitive Contract Law', 265 (my translation).

[46] We should not overlook the fact, that the consumer, even though taken by surprise, is not the object in this play but one of the two actors—Thus, it should not be taken for granted that the law removes responsibility from him to the seller; K Riesenhuber, 'Der Grundsatz der Selbstverantwortung im Europäischen Privatrecht', in K Riesenhuber (ed), *Das Prinzip der Selbstverantwortung* (Tübingen, Mohr Siebeck, 2011) 225 f.

survey the market *ex post* and reconsider his contract decision in the light of this better knowledge.

The same rationale does not, however, justify other rights of withdrawal in the same manner. Certainly, it is difficult to see how distance selling should inhibit competition—or prevent the consumer from taking advantage of its effects. Where consumer credit and timeshare contracts are concerned, we may often find that consumers do not use the information available in the market. The wish to obtain consumer goods (on credit)[47] or the lure of the vacation may trigger an irrational blindness for competing offers and (thus and otherwise) negatively influence the contract decision. But these are intrinsic deficits rather than deficits of competition. It is therefore difficult to justify the rights of withdrawal as extension of competition.

No, the general rule remains that competition ends at the finishing line, and in the market, this is the conclusion of the contract. While the rights of withdrawal in doorstep selling may be justified on the consideration that the consumer should have a second chance to obtain information in the market, extension of competition is not a sustainable rationale for withdrawal rights in general. Nor would such extension of competition beyond the conclusion of the contract be sound policy. As with the abrogation of *pacta sunt servanda,* it would make the world less reliable and presumably goods and services more expensive.

6.5.1.2 Withdrawal Rights as Procedural Mechanism

But what is the relation of rights of withdrawal and *pacta sunt servanda.* We have already seen that some authors argue that rights of withdrawal do not interfere with the *pacta sunt servanda* in the first place but rather modify it (above, 6.4.2). While we have rejected this view, we can concede that, as a procedural mechanism, rights of withdrawal constitute a comparatively mild interference with the binding nature of the contract.[48] This is true, in particular, given that the burden of action is on the consumer; inaction 'validates' the contract. Rather than calling the binding force of contract into question, rights of withdrawal confirm the principle of *pacta sunt servanda* and provide only limited exceptions to it.

6.5.2 Information and Transparency

Micklitz further highlights information obligations and transparency of the market as elements of the concept of 'competitive contract law'.

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[47] Cf Canaris, 'Wandlungen des Schuldvertragsrechts', 348 f ('considerable temptation').

[48] Canaris, 'Wandlungen des Schuldvertragsrechts', 344 f; Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 563.

It is true, EU contract law as it stands today largely follows an information model.[49] Information is the preferred instrument to remedy deficits in individual self-determination of the consumer. Pre-contractual information figures particularly prominently.[50] This was already the case when Micklitz first proposed the concept of 'competitive contract law'. Subsequently, the Unfair Commercial Practices Directive and recently the Consumer Rights Directive have substantially expanded information obligations in consumer contracts. Indeed, Article 5 Consumer Rights Directive now provides for a general pre-contractual information obligation in regard of consumer contracts, even outside the narrow scope of doorstep-selling and distance selling (a far reaching and, to my mind, too far-reaching regulation).

Note, though, that EU legislation in the field of contract law by no means provides for a general obligation to disclose all and any information. First, even the information obligations under the Consumer Rights Directive remain limited, providing only for a fixed catalogue of information. Beyond the scope of these provisions, *caveat emptor* remains the general principle.[51] Second, the information obligations otherwise only apply in specific circumstances; they are intended to remedy specific deficits. Third, the information obligations mainly apply in business to consumer-transactions (so again, they are not sufficient basis for a theory of EU contract law more generally).

Irrespective of the prevalence of information obligations in (consumer) contract law, it must be doubted whether their introduction signals a change of the concept of contract law. It is true, mandatory information obligations interfere with the freedom of contract (of both parties, consumer and business). But information is the mildest interference possible. For the business, it weighs comparatively lightly where standardised information can be used for a large number of transactions. And the consumer is free (and responsible!) to use or not to use the information offered. This latter point is important also with a view to the principle of self-responsibility: Information alleviates the consumer's burden of individual responsibility only slightly. It remains for him to decide what to do with the information offered, whether and how to use it. So, while such information obligations indicate a turn from formal to substantive freedom of contract, they do not do away with the principle as such. In many ways, information obligations do not change but rather adhere to and amend the 'classical' concept of contract. Certainly, they do not trigger a paradigm change.

As regards transparency: 'Transparency' has become a popular catchphrase. Transparency is not a value in and of itself, though. Indeed, there are numerous countervailing considerations including, in particular, the value of acquired (and sometimes hard-earned) information or the protection of personal data. Transparency is neither a principle of contract law. The parties to a contract always hide

[49] See in particular S Grundmann, W Kerber and S Weatherill (eds), *Party Autonomy and the Role of Information in the Internal Market* (Berlin, de Gruyter, 2001); S Grundmann, 'Parteiautonomie im Binnenmarkt—Informationsregeln als Instrument' (2000) *Juristenzeitung* 1133.

[50] See e.g. Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 288 ff, 557 ff.

[51] Micklitz, 'The Concept of Competitive Contract Law', 569, concedes this with regard to the Consumer Sales Directive.

some things and reveal others. This is, as a general matter, unobjectionable. Thus, if we speak of transparency, we should define clearly what we mean. In EU contract law, we can consider the information obligations as an element of transparency. We can also label the obligation to provide information in a 'clear and comprehensible manner' 'transparency'. Or we can speak of a 'transparency' requirement where the Unfair Terms Directive, for clauses concerning the main subject matter or the adequacy of the price, makes it a precondition for exemption from judicial control that they be drafted in plain and intelligible language. All this is true but it does not mean that we evidence a paradigm change in contract law.

Thus, information obligations as a remedy for specific deficits can easily be explained on terms of 'classical' contract theory. The same is true for any requirement to provide information in plain and intelligible language or in a clear and comprehensible manner: Given the purpose of information, such requirements are inherent in the obligation itself. And finally, the reservation in the exemption of clauses regarding the main subject matter or the adequacy of the price seamlessly fits the market failure-rationale of the directive.[52] If judicial control applies for a lack of competition in regard of contract terms then it is only consequential that it may also apply if such competition fails for lack of transparency.

Here, Micklitz is certainly right: a market economy requires a certain degree of transparency and comparability. But this is one of the basic tenets of classical contract law and thus not a sound basis for a new contract theory.

6.5.3 Reallocation of Responsibility

Micklitz further argues that EU contract law reallocates responsibility in contractual relations:

'EU contract law increasingly questions the traditional allocation of responsibilities in contractual relations. We can discern a shift in responsibilities to the producer. He should be liable under a contract claim. This means that the seller drops out of the contractual chain. Europeanised private law thus codifies a practice established in the Member States. Reallocation of responsibility does not mean, though, that it should solely be borne by the producer or the service provider.'[53]

The basis for this element of 'competitive contract law' is presumably to be found in the Products Liability Directive on the one hand and in the Consumer Sales Directive on the other. The former is, of course, not directly concerned with contract law but rather with a kind of torts. Indeed, the directive only twice refers to contracts: as regards contractual derogations and as regards contractual liability as provided by the national law. Still, functionally it may be seen in the context of contract law. Here, though, it does not, as a matter of law, exonerate the seller. As to

[52] Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 453.

[53] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 266 (my translation); see also id, 'Ein einheitliches Kaufrecht für Verbraucher in der EG?', 236 f (with different emphasis).

the Consumer Sales Directive, it does not ameliorate the seller's liability but rather aggravates it. Indeed, the seller may also be held responsible for public statements of the producer. This latter burden, however, is balanced by his right of redress.

Both directives can smoothly be explained on terms of 'classical' contract law. In fact, they follow traditional considerations of privity. The seller by no mean 'drops out of the contractual chain'.

Again, undeniably, though, EU contract law does shift responsibilities. Every piece of consumer protection legislation alleviates the consumer's burden of self-responsibility and shifts it to the seller or service provider. Where such shift can be explained on economic terms such as market failure, it is certainly compatible with established ('classical') contract theory.

6.5.4 Effective Enforcement of Rights

A final element Micklitz addresses is effective enforcement of rights.

'Competitive contract law requires effective enforcement of rights, also and in particular preventively, for this alone ensures the possibility of switching from one contract to another. It has hitherto been the Court of Justice's goal to apply Community law to the full extent. In secondary legislation this principle of law converts into a principle of effective enforcement of rights which requires more than just a formally correct transposition of Community law: certainty that the Directives' goals will effectively be attained with the means employed.'[54]

Micklitz does not refer to the substantive rules of EU legislation in the area of contract law here but rather the transposition obligations of the Member States, in particular the principles of equivalence and of effectiveness.[55] He thus silently changes the object of his discussion. Yet, we may concede that the transposition obligations occupy an intermediate-position: On the one hand they determine the Member States' duties in regard of the transposition of directives ('in the abstract'). On the other hand, they can be considered as teleological interpretation of the substantive regulation itself: While the equivalence principle refers to the respective national legal system of a Member State, the principle of effectiveness provides for an 'objective' standard which the Court determines based on the individual directive.

Even so, it is unclear how effective enforcement of rights determined by EU law could be considered the basis for a new concept of contract law. Under Roman law as actional law, the formula was *ubi remedium, ibi ius.* Micklitz turns this around and says: *ubi ius, ibi remedium.* This may well be true, for a right is not worth much without a remedy. But this is hardly a distinctive feature of EU contract law. Indeed,

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[54] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 266 f (my translation); see also id, 'The Concept of Competitive Contract Law', 577 ff.

[55] See e.g. Case C-472/11 *Banif Plus Bank v Csipai,* not yet published, para 26; Case C-177/10 *Rosado Santana v Consejería de Justicia y Administración Pública de la Junta de Andalucía,* not yet published, para 89.

the enforceability of rights can also be regarded as an implicit presumption of 'classical' contract law.

6.6 'A Genuine Notion of Justice'

Competitive contract law is not only intended as a theory to explain existing legislation but it also has a moral claim.

'Competitive contract law promotes the emergence of a genuine notion of justice. This is ensured by the exit from one contract and the switch to a new contract. Such a notion of justice is no longer only allocative but at the same time it is not necessarily social. Legitimate expectations of the parties are being instrumentalised for the creation of an internal market and at the same time charged with goals of social policy.'[56]

This condensed statement is not easily understood.[57] In the first part, Micklitz seems to refer to rights of withdrawal again in the latter part he introduces the concept of legitimate expectations. As to the rights of withdrawal, we have already seen that they do not support a general right to 'switch' from one contract to the other. It may be considered fair to let the consumer off the hook if he concluded a contract at the doorstep or at a distance; or in the case of consumer credit contracts or timesharing contracts. Rights of withdrawal are, however, by no means uncontroversial,[58] and thus declaring them a matter of justice seems to be reaching a little far. (Is a society without a right of withdrawal for distance selling contracts unjust?) But maybe this is not what Micklitz refers to when he declares this 'notion of justice' 'no longer only allocative but not necessarily social'. Consumer contract law certainly has allocative effects: It initially gives the consumer rights vis-à-vis the business (seller, service-provider). To the extent possible, the business will take the costs of such rights into account when it determines the prices of his goods and services. In effect, thus, consumer rights transfer wealth from one group of consumers to another: for all consumers have to pay the price, irrespective of whether they want or need the respective right and businesses cannot offer competing products with or without such right.[59] Perhaps it is this redistributive effect which Micklitz considers 'not necessarily social'.

[56] Micklitz, 'Perspektiven eines Europäischen Privatrechts', 267 (my translation).

[57] See already Roth, 'EG-Richtlinien und Bürgerliches Recht', 534; Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 580 with fn 155; Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag*, 162.

[58] Roth, 'EG-Richtlinien und Bürgerliches Recht', 534.

[59] Riesenhuber, *System und Prinzipien des Europäischen Vertragsrechts*, 580; Sedlmeier, *Rechtsgeschäftliche Selbstbestimmung im Verbrauchervertrag*, 164.

6.7 Outlook

While I remain sceptical of the concept of 'competitive contract law', I applaud Micklitz' courageous attempt which, with its openness for manifold interpretation, triggered an intensive, if controversial, debate about contract law and contract theory. Undeniably, the European Union's regulatory interventions change the shape of contract law. It is the responsibility of contract theory to discuss the implications and consequences of these changes: whether they require a new theory of contract law (as Micklitz submits) or whether they may be integrated into 'classical' contract doctrine. This discussion is all the more important as we have to take into consideration what we gain by a new concept of contract law—and what we lose by discarding the 'old' ('classical') theory. Contract law is a central element of the legal framework for the exercise of individual freedom. Where we interfere with the principles that have been developed over centuries—such as *pacta sunt servanda*—we have to beware of the negative consequences for individual freedom and for a functioning market economy.

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Chapter 7
The Horizontal Effect of Fundamental Rights in Private Law—On Actors, Vectors, and Factors of Influence

Marek Safjan

Abstract This article deals with the horizontal effect of fundamental rights in private law from the perspective of a justice system understood in a broad sense, depending on the type of jurisdiction which decides to apply them when examining private law relationships. The first part focuses on the perspective of the constitutional court, the second of the ordinary courts dealing with civil cases, and the third of the Court of Justice of the European Union.

Firstly, the impact of the constitutional courts on private law is twofold: on the one hand, the process eliminates unconstitutional norms from the legal system, and on the other, an interpretation of legal norms applied in private relationships in compliance with fundamental rights is adopted. This has been illustrated via a few examples of judicial decisions rendered by the Polish Constitutional Tribunal.

Secondly, from the jurisprudence of the ordinary courts an indirect and a direct horizontal effect of fundamental rights might be observed. The former leads to a limitation of rights or an elimination of certain obligations that are inherent in the horizontal relationship, rights and obligation which are deprived of their validity or effectiveness consequent to the application *in casu* of general clauses. In this way, new legal structures are not created and the rules of law governing private law relationships remain fully binding and effective, as the indirect horizontal effect will be effectuated only in the horizontal case at hand. The latter, inevitably leads to the courts encroaching on the lawmaker's area of competence, as it is equal to creating a new legal norm because a refusal to apply a binding norm leads *de facto* to a creation of a new provision thereby introducing a different equilibrium of rights and obligations of parties as opposed to the statutory model. As a result predictability and legal certainty can be seriously jeopardized.

Thirdly, in the ECJ jurisprudence the horizontal application might be done though an evaluation of national regulations which directly transpose EU law or through an assessment of national legal acts, which do not directly transpose EU law, but nonetheless find connection to European Law application, as defined in

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_7,

Art. 51 (1) of the Charter of Fundamental Rights. Different forms of this application relate at times to direct effect and, on other occasions, to indirect horizontal effect.

Finally, more general remarks on the mechanisms which ensure radiation of the values of social justice into European law—what might lead to imposing a certain vision of "social justice" through the application of fundamental rights—are presented.

7.1 Introduction

The horizontal effect of fundamental rights in private law has been widely debated in academic literature,[1] so much so, it is even possible to conclude that by now the most important features have been thoroughly examined. That being said, little attention has been devoted to a particular aspect of this phenomenon, namely the division of competence between the law-making and law-applying bodies especially when these activities are considered against the background of a justice system understood in a broad sense. The key issue is whether it is acceptable to invoke fundamental rights in private law relationships, and—of equal importance—whether fundamental rights can be operationalized as specific guidelines in relation to the rights and duties attributable to private parties. In addition, the scant attention paid to the inevitable transfer of competence that occurs—from lawmakers to judges—when the latter employ fundamental rights deserves more profound attention so as to map more specifically the phenomenon and to delineate the precise process involved. Therefore, this second issue will be analysed demonstrating the different perspectives and methods which emerge depending on the type of jurisdiction which decides to apply fundamental rights when examining private law relationships. On this basis, the first part of this article focuses on the jurisprudence of the Polish Constitutional Tribunal, the second concentrates on the jurisprudence of the ordinary courts in civil cases, and the third part examines the approach adopted by the Court of Justice of the European Union (CJEU). Finally, I will present more general remarks on the mechanisms which ensure radiation of the values of social justice into European law.

[1] *Cf* eg A Sajo and R Utiz (eds), *The Constitution in Private Relations: Expanding Constitutionalism* (The Hague, Eleven International Publishing, 2005); KS Ziegler, *Human Rights and Private Law. Privacy as Autonomy* (Oxford, Hart Publishing, 2007); O Cherednychenko, *Fundamental Rights, Contract Law and the Protection of the Weaker Party. A Comparative Analysis of the Constitutionalisation of Contract Law, with Emphasis on Risky Financial Transactions* (Munich, Sellier, 2007); D Oliver and J Fedtke (eds), *Human Rights and the Private Sphere. A Comparative Study* (London, Routledge, 2007); C Mak, *Fundamental Rights in European Contract Law. A Comparison of the Impact of Fundamental Rights on Contractual Relationships in Germany, the Netherlands, Italy and England* (The Hague, Wolters Kluwer, 2008); A Seifert, 'L'effet horizontal des droits fundamentaux. Quelques réflexions de droit européen et de droit comparé' (2012) *Revue Trimestrielle de Droit Européen* 801; M Kumm, 'Who is Afraid of the Total Constitution? Constitutional Rights as Principle and the Constitutionalization of Private Law' (2006) 7 *German Law Journal* 342.

7.2 The Radiation of National Constitutions into Civil Law

The constitutionalization of legal systems, a phenomenon that has been well identified in the preceding decades, is mostly connected with the evolution of constitutional justice.[2] Thanks to this very evolution, the guarantees embedded in constitutional norms are now treated seriously and realistically. They are no longer seen as a way to communicate a system's ideological message or postulations for a certain vision of a political structure supporting the state. It was through judicial decisions rendered by constitutional courts that constitutions were enabled to radiate into all disciplines of law and a concept of 'living constitution' was created, emanating from a tendency towards activist, creative and adaptive interpretation. In other words, these advances can be understood as an attempt to find new content in old norms considered better suited to modern social context and civilization. Those constitutional norms which reflect fundamental rights could not be limited to a few selected areas but rather encompassed the whole legal system, including civil law. Their application as norms expressing universal values of the legal order played a key role in the constitutionalization of the system and constitutional radiation. In addition, we must not neglect the specific character of the constitutional review of law, which—at least in most systems—is based on a hierarchical review of law (the traditional Kelsenian model) and not on the horizontal application of constitutional norms. If the role of the constitutional court is limited to a hierarchical review of norms, then it is restricted by nature to vertical relations and to defining the boundaries within which public authority may make law. According to this approach, the impact of the constitution—especially of the guarantees embedded in fundamental rights—on civil law is not entirely excluded. However, it will not take the shape of direct horizontal effect. In this model of constitutional review, the norms of civil law that govern relationships between individuals are rather examined through the lens of fundamental rights. The impact on private law is twofold: firstly, the process eliminates unconstitutional norms from the legal system, and secondly, an interpretation in compliance with fundamental rights of legal norms applied in private relationships is adopted. Each of these instruments has been widely applied in constitutional court practice, illustrated below via a few examples of judicial decisions rendered by the Polish Constitutional Tribunal. According to the Polish model of constitutional review, even the most respected structures of private law rooted in long-established traditions have been the subject of examination for compliance with constitutional guarantees.

[2] See W Sadurski, *Rights before Courts. A Study of Constitutional Courts in Post-communist States of Central and Eastern Europe* (Berlin, Springer, 2005); CW Canaris, *Grundrechte und Privatrecht* (Berlin, de Gruyter, 1999); S Weatherill, 'The Constitutional Competence of the EU to Deliver Social Justice' (2006) 2 *European Review of Contract Law* 135; M Davies, 'Government of Judges. An Historical Review' (1987) 35 *American Journal of Comparative Law* 559; J Limbach, 'Promieniowanie konstytucji na prawo prywatne' (The Radiation of Constitutions on Private Law) (1999) 3 *Kwartalnik Prawa Prywatnego* 405.

One such constitutional complaint examined by the Constitutional Tribunal involved the legal concept of usucaption by a long-term disseisor which—as argued by the applicant—was contrary to the constitutional guarantee of ownership protection.[3] Although the Tribunal did not decide that usucaption was unconstitutional, in doing so it had to apply a test of proportionality and weigh-up the protection of ownership against the general interest, which required a stabilization of a legal status quo that in fact had already been in existence for many years. In another case, the use of the equity principle in private law as a criterion to examine the so-called 'abuse of right' concept was questioned. In this case, the constitutionally guaranteed right of individuals to predictable and certain law—the so-called '*prawo do przyzwoitej legislacji*' (the right to good law)—the aim of which is to prevent law enforcing bodies from making arbitrary decisions,[4] was invoked. While the court confirmed that the provision was constitutional, two visions of justice guaranteed by the law could be confronted: one established on the constitutional level and the other based on the traditional structure of private law.

Another field of relevance can be delineated here, that is, civil law provisions which envisage financial compensation for so-called *moral damage*. More specifically, a constitutional complaint brought under the legal spotlight whether this remedy could optionally be applied by the Tribunal as a substitute for a mandatory norm that imposed an obligation on every tortfeasor to compensate for moral damage.[5] Other examples that can be taken from the domain of constitutional review include solutions applied in inheritance and family law. In relation to the former, we can note a challenge to a norm establishing that the State Treasury was permitted to acquire ownership of a farm based on its status as legal successor in a case where no heirs having required qualifications to manage a farm (the challenged regulation dated back to the pre-transformation period) could be established. The said norm was questioned on the grounds of the constitutional guarantee of ownership rights.[6] With regard to the latter example mentioned above, the Constitutional Tribunal ruled that it was unconstitutional to prohibit a man who is not his child's mother's husband from filing a paternity suit; more specifically, it held that an interpretation in the opposite direction would breach the child's right to family life and personal identity.[7]

In the area of broadly understood consumer and tenant protection, two significant judgments of the Polish Constitutional Tribunal have proven to be important for subsequent horizontal relationships. The first one referred to the scope of application of consumer protection with regard to a fuel seller's obligation to inform

[3] *Cf* Constitutional Tribunal, 14/12/2005, SK 61/03.

[4] *Cf* Constitutional Tribunal, 17/10/2000, SK 5/99.

[5] *Cf* Constitutional Tribunal, 7/2/2005, SK 49/03, 13/2/A/2005. The Constitutional Tribunal did not accede to the request but, in its interpretation, it considerably narrowed the margins of discretion of the judicial decision considering the purpose of compensation.

[6] *Cf* Constitutional Tribunal, 31/1/2001, P4/99.

[7] *Cf* Constitutional Tribunal, 28/4/2003, K18/02.

the buyer when biofuels were introduced on the market.[8] In this case, the Constitutional Tribunal found that regulations which allowed fuel sellers to sell biofuel without precisely informing the buyer of the quality and composition of the product were unconstitutional. In the other case, the right of a private house owner to request eviction—regardless of whether or not alternative living accommodation was proposed to the tenant—was declared unconstitutional on the grounds of tenant protection rights and respect for human dignity.[9]

These are just a few classical examples of the impact exerted on Polish civil law[10] by standards of protection emanating from fundamental rights through a mechanism which may be associated with the largely understood indirect horizontal effect of the application of fundamental rights. I will briefly review some of its features.

Firstly, it does not directly refer to a given private law relationship but rather to legal provisions which determine the form of horizontal relationships between individuals or single entities. Only after constitutional courts have issued a decision, can the complainant effectively pursue their rights before the ordinary courts, all the while in reference to the new legal context established by the constitutional court even though the final outcome is based on the general instruments of private law. This process can be exemplified via the situations depicted above e.g. only when the unconstitutional provisions of inheritance law were waived could the general inheritance mechanisms be applied; only when the ban on paternity requests was waived could the general procedure for establishing paternity be subsequently implemented; the revocation of the legal provision that permitted eviction without providing a replacement home automatically allowed the court to limit the lessor's request to evict tenants etc.). Considering the role of the constitutional court as the so-called 'negative legislator'—according to which it should not replace the lawmaker in formulating legal norms—it must be noted that in certain situations indirect horizontal effect allows the moulding of private law relationships in conformity with fundamental rights and is rendered possible only after intervention by the lawmaker. This two-step process may be particularly relevant to the mechanisms involved in constitutional review based on the principle of non-discrimination. In this regard, we can consider a case establishing that a labour law provision permitting the employer to terminate the employment contract with an employee who has reached the retirement age should envisage the same age for men and women however it does not automatically imply which retirement age should apply.[11]

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[8] *Cf* Constitutional Tribunal, 21/4/2004, K33/03, OTK ZU-A 2004, no 4, item 31. For the first time, the Constitutional Tribunal found that an obligation to inform the consumer is rooted in the Constitution.

[9] *Cf* Constitutional Tribunal, 4/11/2010, K19/06, OTK ZU 2010/9A/96 in an eviction case. The Constitutional Tribunal has also had to consider other aspects of tenancy, for example the protection of tenants not only against excessive rent but also by ensuring the stabilization of tenancy agreement, cf e.g. Constitutional Tribunal, 2/10/2002 K48/01, OTK ZU-A 2002, no 5, item 62; Constitutional Tribunal, 17/5/2006, K33/05, OTK ZU-A 2006, no 5, item 57.

[10] *Cf* in relation to the Polish doctrine M Safjan, 'Efekt horyzontalny praw podstawowych w prawie prywatnym: autonomia woli a zasada równego traktowania' (2009) 2 *Kwartalnik Prawa Prywatnego* 297; E Łętowska, 'Wpływ konstytucji na prawo cywilne' in M Wyrzykowski (ed), *Konstytucyjne podstawy systemu prawa* (Warsaw, Instytut Spraw Publicznych, 2001) 125.

[11] *Cf* Constitutional Tribunal, 28/3/2000, K27/99.

Secondly, any examination relating to the constitutionality of a private law provision usually employs, on a general and abstract level, the so-called 'double proportionality test'.[12] Inherently, conflicts between guaranteed fundamental rights arise in that affording priority to one invoked right necessarily means that the other fundamental right must be restricted (e.g. the balance between a property right versus a tenant's right to a decent standard of living; between a child's right to family life versus a mother's right to privacy jeopardized vis-à-vis potential lawsuits filed by men attempting to establish paternity etc.). Although it may seem banal, the essential role of the double proportionality test performed by constitutional courts in such cases targets a balancing of the pertinent interests and values in a much wider perspective than would be possible where reasoning is conducted with regard to the specific horizontal relationship at issue in any given case. This particular perspective not only allows for consideration of the general systemic and axiological context and potential consequences of the decision for future horizontal relationships in a given area of private law, but it also paves the way for a contemplation of existing social and economic conditions which in turn fortifies the structurally underprivileged position of some categories of individuals, for instance, those whose position is unequal to that of their more powerful partners (consumers, tenants, employees). The aforementioned examination is therefore inevitably associated with a hierarchization of legal values of the system in addition to the choice of the general abstract norm which will be applied not only to those who directly file a constitutional complaint but—in the future—to all other subjects who find themselves in the same situation.

Thirdly, such a mechanism of achieving indirect horizontal effect of fundamental rights used by all constitutional courts whose competence is limited to the review of law, is in fact more closely related to the activity of the lawmaker than to the function typically reserved to the ordinary courts of law, namely, administering justice. Bearing in mind the generally binding nature of constitutional decisions, although this model does not eliminate concerns relative to the transfer of legislative competence from the democratically legitimate lawmaker to judges in the courts, it does not breach values important for legal systems, such as predictability of law and legal certainty. In fact, this process assumes that constitutional review can be conducted exclusively by constitutional courts, which means that ordinary courts—in principle—have no such prerogative. The ultimate goal of the constitutional review of law based on fundamental rights is to delineate a legal framework according to which an individual will be free to pursue one's rights in a way that respects constitutional norms. In this sense, constitutional court decisions have a legislative effect that is not reflected directly in a particular legal relationship. Here lies the difference between the model of abstract review and the so-called concrete control particularly exercised by some constitutional courts, such as the *Bundesverfassungsgericht*. For

[12] *Cf*, regarding the application of the double proportionality test in the case of horizontal application of fundamental rights, eg H Collins, 'On the (in)compatibility of Human Rights Discourse and Private Law' (2012) 7 *LSE Law, Society and Economy Working Papers* 41.

example, the ruling issued in the well-known *Bürgschaft* case,[13] where a fundamental right, in this case human dignity, was directly applied to a specific private law relationship, created a basis for direct assessment of a horizontal relationship between, in this case, the bank and a guarantor. This form of fundamental rights effect oriented towards the evaluation of specific horizontal relationships will be discussed in the following section.

7.3 Horizontal Effect of Fundamental Rights from the Perspective of Ordinary Courts

7.3.1 Indirect Horizontal Effect

Evaluating specific horizontal relationships and adjudicating on the rights and obligations arising out of an existing legal relationship is a domain of common courts. From this perspective, we can examine the two forms of fundamental rights' impact on private law relationships, namely indirect and direct effect. The former will emerge—as it is widely described especially in the German doctrine concerning *mittelbare Drittwirkung*[14]—in reference to the use of fundamental rights as tools for the correct interpretation and application of private law instruments to specific horizontal relationships. This concerns the granting of rights (claims) to a party of a horizontal relationship directly on the basis of a constitutional fundamental right, thus avoiding the effects which would result if private law were applied exclusively.

Indirect horizontal effect seems to be well-established in the nature of private law mechanisms in that they have always used flexible instruments in an attempt to attenuate and adjust the impact of specific mandatory and prohibitive orders laid down in the provisions of positive law that otherwise risk—in a given context—incoherence with the sense of justice and provocation of moral repulsion. Traditional rules of good faith, equity, good morals and so-called *rules of social co-existence* (being a direct equivalent of '*equity*'[15]) played a fundamental role in the establishment of indirect horizontal effect. In conjunction, the concept of abuse of rights—first formed in French law[16] and then transferred to other legal systems—stimulated the fortification of this concept. It paved the way in some circumstances for a limitation of rights to which an individual is entitled or even—when broadly interpreted—for constructing an independent claim against a party abusing its prerogatives.

[13] *Cf* German Federal Constitutional Court, 19/10/1993, (1994) *Neue Juristische Wochenschrift* 36.

[14] *Cf* eg Canaris, *Grundrechte und Privatrecht*. This kind of indirect effect which is achieved through general clauses of private law is precisely identified as *mittlelbare Drittwirkung*.

[15] This category of general clauses was introduced into the Polish civil law system during the Communist period. Presently, the sense and the content of the notion is the same as the traditional equity clause.

[16] *Cf* I Josserand, *De l'esprit des droits et de leurs relative: théorie dite de l'abus de droits,* 2nd ed (Paris, Dalloz 1939).

It is also worth noting that already at the beginning of the 19th century, the Austrian Civil Code stipulated a provision referring to the natural rights of every human being.[17] This was considered a fundamental general clause[18] containing an important interpretative indication. The classical 'adaptation' mechanisms, which made it possible for courts to correct horizontal relationships in reference to an objectively established and commonly respected system of values creates—as judicial experience in many European countries confirms—a link between the system of values and axiology reflected in the constitutional norms, including fundamental rights and traditional rules of equity.

The adaptation of traditional equity clauses of private law to constitutional axiology and fundamental rights is a complex and relatively new process, one which has become more prominent only over the last sixty years. It has run in parallel to the process of forming a European 'ideology' of fundamental rights (in which the role of the European Convention of Human Rights and Fundamental Freedoms should not be underestimated) and to the process of strengthening the constitutionalization of legal systems. 'Inserting' the concept of fundamental rights protection 'into' the axiology of private law was not a natural process in that they did not stem from within private law but were assumed as part of private law due to an increasing consciousness that the guarantees embedded in fundamental rights were effective only when practically applied at all legal levels, including the horizontal sphere. It was therefore a process that was deliberately stimulated by judicial decisions, in line with the idea of constitutional radiation. Undoubtedly, there is a difference between understanding and practically applying equity clauses established in the tradition of private law on the one hand, and employing the method of '*mittelbare Drittwirkung*' on the other, since it assumes a deliberate and intentional application of equity clauses with a view to transposing the guarantees embedded in fundamental rights into the sphere of horizontal relationships. The latter seems to be positioned autonomously with respect to the former inasmuch as it introduces a new assessment mechanism which goes beyond the established sense of justice, moderation and good morals, radically demanding respect for certain values simply due to their place in the axiology of fundamental rights. In other words, it can be characterised as a phenomenon which consists in stimulating the application of new values or—more frequently—their re-interpretation in accordance with private law axiology. In this way, even those values not considered strictly as fundamental rights and those which would probably not be placed among the values defining the ordinary and common sense of justice, have become a point of reference for the evaluation of horizontal relationships.

Despite the differences between the method of '*mittelbare Drittwirkung*' and the classical equity method identified above, the correction mechanism to which we allude here employs the principal characteristics of both techniques. Firstly, it is a

[17] *Cf* § 16 ABGB, which provides that every human being has 'natural rights' and is therefore considered as a person.

[18] Throughout this text, the term 'general clause' is intended to reflect those elements lying outside the positive system of law encompassing, for instance, the general clause of good faith, fair dealing, justice, customs and so on.

primarily negative method in the sense that it leads to a limitation or an elimination of certain rights and obligations which are deprived of their validity or effectiveness consequent to the application of an equity-based method of evaluation. Secondly, under this method, judges applying the law consistently operate within the scope of private law instruments making reference to methods of evaluation and criteria situated beyond the sphere of positive law. This is, for example, the case when restrictions are directly introduced connected with the obligation to respect the principles of equity when interpreting a general clause expressing the principle of freedom of contract and autonomy of the parties.[19] Or, to give a second example in relation to the concept of abuse of right, which directly allows us not to protect a substantive right if it is exercised in a manner which violates the principles of equity. In this way, new legal structures are not created and the rules of law governing private law relationships remain fully binding and effective. The indirect horizontal effect will be effectuated only in the horizontal case at hand since judges do not assume a contradiction between a fundamental right and a mandatory legal norm whose application could produce unacceptable effects in light of principles of equity reflecting constitutional axiology but rather they aim to interpret the existing norm taking into account a new context and a purpose coherent with constitutional axiology. In judging according to the norms of civil law, the judge precisely delineates the boundaries of the substantive right to which a party is entitled on the basis of the structure provided for by the general clauses, for instance, by concluding that the contract provisions contradict the principles of equity or good morals as they violate the dignity of a contractee who finds him/herself in a coercive situation. The principle of autonomy of the parties in itself is not challenged but is rather restricted as a result of judicial evaluation, which, in turn has not exceeded the boundaries set by the law. Without much likelihood of error, we can assume that the above-mentioned *Bundesverfassungsgericht* decision in the *Bürgschaft* case[20]—as an example of horizontal application of the constitutional right to protection of dignity in the sphere of horizontal relationships—would not have been necessary if, at an earlier stage (i.e. prior to the commencement of the constitutional procedure) the judge had applied an equity-based evaluation resulting from a general clause using constitutional axiology as a reference. For instance, Polish doctrine in civil law has long established that gross breach of the principle of mutual obligations of the parties to a contract, leading to a situation whereby a totally inexperienced party is placed in a coercive situation, could in fact render the contract null and void.[21]

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[19] *Cf* Art 353(1) of the Polish Civil Code*: 'The contracting parties may shape their legal relationship at their own discretion, so long as the subject matter or the purpose thereof does not conflict with the character (nature) of the relationship, statute or the principles of social co-existence.*'

[20] See J Raz, *Between Authority and Interpretation: On the Theory of Law and Practical Reason* (Oxford, University Press, 2009) namely chapter 12 on interpretation; on positivism (also in the shape given to it by J Raz) see, for instance: J Gardner, 'Positivism—5 ½ Myths' (2001) 46 *American Journal of Jurisprudence* 199; also in id., *Law as Leap to Faith—Essays on Law in General* (Oxford, University Press, 2012) 19–53; *Stanford Encyclopedia of Jurisprudence,* 'Legal Positivism' (L Green); on the confrontation with J Esser and also on positivism more generally, see as well: S Grundmann, 'Chapter 1'.

[21] *Cf* eg Supreme Court, 18/3/2008, IVCSK 478/07, LEX no 371531, which stipulates that: 'A contract which is objectively unfavourable for one party deserves a negative moral evaluation,

Undoubtedly, evaluation based on general clauses of private law, enriched with the axiology based on fundamental rights, which provides a basis for the corrective mechanism described above, has its limitations. Firstly, it cannot lead to an annihilation or deformation of the nature of private law relationships, depriving them of their primary function and purpose, namely a free exercise of individual interests.[22] Such an effect could emerge if—by means of the general clauses of civil law—an attempt was made to automatically transpose the principle of equal treatment and its application to the so-called *objective* equivalence of consideration of both parties of the contractual relation instead of *subjective* equivalence of consideration adopted in contract law. Such an attempt would be far removed from the trend observed in consumer law, for instance, which tends in particular to strengthen the starting position of the weaker party to the contract.[23] In fact, any such sweeping alteration would essentially overpower the essence of the principle of freedom of contract,[24] directly and aggressively introducing a simplified idea of distributive justice into private law relationships.

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and, in consequence, leads to a consideration of the contract as conflicting with the rules of social co-existence in a situation in which it was possible to shape an evidently harmful contractual relationship by taking advantage of a stronger position of the other party, whether deliberately or by negligence. A contract signed by a party acting under pressure of the actual advantage of the partner may not be considered as an expression of a fully free and reasonable decision taken by this party.'

[22] The principle of equivalence of parties to civil law relationships cannot be automatically translated into a positive version of the non-discrimination principle. Such a thesis may be found in Supreme Court, 7/10/2004 IIPK 29/04, OSNP 2005, no 7, item 97, which provides that a different legal situation of an employee and a party to a civil law contract is not a breach of the constitutional principle of equal treatment.

[23] Judicial decisions consistently stress that it is the abuse of economic position which disturbs the balance between the equal starting position of the parties to consumer contracts, and not an imbalance as such. *Cf* eg Supreme Court, 13/7/2006 I CK 832/04.

[24] It should be emphasised that in at least some constitutional systems freedom of contract is treated as one of the guarantees of personal freedom and is directly based on constitutional norms. In a judgment of 29/4/2003, SK 24/02, OTK ZU-A 2003, no 4, item 33 the Polish Constitutional Tribunal concludes: 'The connection between the freedom of contract with the constitutional guarantee of personal freedom lies in the fact that the obligation to respect freedom is imposed by the Constitution on all parties in legal relationships, also on the parties in civil law'. In Germany, Federal Constitutional Court, 7/2/1990, 81 *Entscheidungen des Bundesverfassungsgerichts* 242, 254, stipulates that autonomy in some contractual relationships means that only the parties define the balance between their different interests and that is why they enjoy constitutional protection, while the state must in principle respect the rules adopted under private autonomy; *cf* also K Hesse, *Verfassungsrecht und Privatrecht* (Heidelberg, CF Müller, 1988) 86. In Spain, the Constitutional Court, 30/4/1985 (STC 58/1985), qualified private autonomy as a guarantee of personal freedom. In its later decisions the Court stressed that 'Equality needs to be harmonized with freedom of contract' (Constitutional Court, 10/10/1988, STC 177/1988). In general, the Court has tried to strike a balance between the interests at stake in each case, in light of the principle of proportionality, *cf* VF Comella, *The Constitution of Spain. A Contextual Analaysis* (Oxford, Hart Publishing, 2013) 255. In France, the Conseil Constitutionnel, not without hesitation, considered contractual freedom as a value of constitutional rank (*cf* Conseil Constitutionnel, 19/12/2000, 2000-437 DC) seeking its foundation in Art. 4 and Art. 16 of the Universal Declaration of Human Rights. See also on the approach in Union law see J Basedow, 'Freedom of Contract in the European Union' (2008) 6 *European Review of Private Law* 901.

Let us therefore stress that the above method leading to an 'indirect effect' of fundamental rights must not be used to eliminate private law structures but only to correct the effects of their application. In other words, a judge who applies general clauses, fuelled by fundamental rights axiology, refers to a methodology which is well-established in the tradition of private law. In fact, s/he will simply be employing a wider range of tools in the form of values in his/her evaluation. Secondly, the 'indirect effect' method does not replace the lawmaker in its role and cannot, in consequence, lead to a refusal of application of these structures of private law which could not be in principle an object of an equity-based evaluation[25] as they do not permit an evaluation based on instruments lying outside the sphere of private law since these structures express precisely the axiology adopted by the lawmaker.

The concept of indirect effect of fundamental rights presented above is only one of the two—theoretically possible—ways of applying fundamental rights in private law. A more profound conception assumes that it is possible to directly apply fundamental rights on the basis of the *lex superior derogat lege inferiori* principle.

7.3.2 Direct Horizontal Effect

Any reference made to direct application of fundamental rights in private law in this part will only concern situations in which two assumptions are met. Firstly, where interpretation of a private law regulation does not lead to an effect that could be reconciled with a specific fundamental right embodied in a higher norm—i.e. in a constitution, a convention or legal acts enjoying priority, such as norms of European law. Secondly, for a fundamental right to be considered as having direct effect, a binding mandatory provision of private law should be circumvented so as to pave the way for an interpretation based on the fundamental right. In consequence, a party will be granted direct protection by way of procedural access to bring a claim on the basis of a hierarchically higher norm. Such a mechanism may be justified by an intention to ensure—on all levels of law—a real and effective protection resulting from fundamental rights, whose universal and superior character should always be respected. The difference between this mechanism and the one described above is hardly tangible. Both methods may be mutually competitive because the same effect may on occasion be achieved by using a general clause or by referring directly to a fundamental right. However, as already mentioned, referring to a wide range of private law instruments has its limitations, defined by the categorical wording of mandatory provisions that do not confer any margin of interpretation to the decision-making body. Resorting to the concept of direct effect of fundamental rights

[25] The question of which private law regulations may be considered as part of this category of norms, which have to be strictly interpreted and must not be undermined by the application of general clauses is also a matter of controversy. In Polish private law, regulations determining the so-called *numerus clausus* of rights in property, limitation periods (deadlines), and regulations governing filiation or obligation to pay child maintenance belong to this category. *Cf* here A Stelmachowski, *Wstęp do teorii prawa cywilnego* (Warszawa, Państwowe Wydawnictwo Naukowe, 1984) 150 and M Safjan, *System Prawa Cywilnego*, 2nd ed, vol I (Warsaw, CH Beck, 2012).

may, in such cases, be treated as *ultima ratio* or that necessary in order to achieve the desirable effect i.e. the desirable protection of rights and interests of one of the parties to a horizontal relationship.

In my opinion, treating equity clauses (including the so-called 'common sense' clauses) as a special 'conveyor belt' for fundamental rights does not change the nature and concept of direct application, as long as it contains a refusal to apply an imperative and explicit mechanism of private law while the content of the fundamental right becomes the only designatum of the general clause. Such a technique appears to simply be an external and formal application of the mechanism which is essentially far from permitting indirect effect which is traditionally reserved for equity-based evaluation via the application of general clauses. However, we can justify an interpretation of this approach as equivalent to a direct application of fundamental rights in the sphere of horizontal relationships. This approach is reflected, for example, in the following statement: 'Nowadays, each judge may resolve a case directly on the basis of the Constitution and therefore according to the rules of social co-existence (a general clause being equivalent to the equity/good faith principle in Polish Civil Law—M.S.) even if a binding provision of law stipulates otherwise'.[26] The same concept has been shared by one of the Polish Courts which concluded that: 'Article 5 of the Civil Code (abuse of rights—M.S.) is only complementary to the legal order established by legal norms and its aim is to derogate or modify the binding provisions of law'.[27]

With the above set out, it will now be interesting to examine some Polish judicial decisions in which the court decided not to employ explicit and mandatory norms, with no freedom of appreciation, but rather applied its 'own' concept of justice in order to guarantee the protection of substantive rights of one party to a horizontal relationship.

In a case concerning usucaption by a long-term disseisor, the court refused to confirm usucaption even though the formal conditions had been met (long-term, 'owner-like' possession of property) due to an *in casu* contradiction with 'common sense', and, in fact, a contradiction with the sense of equity which in this particular case was called upon to protect the property right of the previous owner.[28] This ruling *de facto* applies the concept of direct protection of a superior value originating from the constitutional level. In doing so, the Court replaces an explicit legal norm, which—through the mechanism of usucaption—had already struck the balance between the conflicting interests of the parties according to a totally different axiology: protecting security and stability of legal relationships above the interests of the property owner.

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[26] K Pietrzykowski, *Komentarz do Kodeksu cywilnego*, vol I, ed 5 (Warsaw, CH Beck, 2008) 65; such a position stands in clear contradiction with the position expressed by the Polish Constitutional Tribunal, which expressly concluded that general clauses are not superior in respect of the other provisions of civil law, and therefore, pursuant to Art. 5 of the Civil Code, also referring directly to the fundamental rights, imperative provisions of civil law must not be excluded because it could put in jeopardy the principles of the state of law (*cf* Constitutional Tribunal, 17/10/2000, SK 5/59, point III.3 of Principal Reasons for the Ruling).

[27] Court of Appeal of Poznań, 13/11/1996, LEX database no 31315.

[28] *Cf* Supreme Court, 18/11/1992 III CZP 133/92.

In a case concerning heterological artificial insemination, which was performed upon attaining the husband's consent, the court excluded denial of paternity by the mother's husband, claiming that ascertaining the rights of civil status in accordance with so-called objective truth would stand in direct contradiction with the principle of protection of the superior interest of the child, which is fundamental for the legal system.[29] This decision preceded a legal reform, which was eventually effectuated some twenty years later, forbidding—*expressis verbis*—denial of paternity in such cases. With no intention of questioning this decision, it should be noted that in this way the Supreme Court created a new legal norm, changing significantly the existing legal provisions which based filiation of the child on the sole criteria of referring to the objective truth. In consequence, the court essentially replaced the lawmaker which required many more years to decide on this issue considering the ethical dilemma it posed at least for some members of society.

Difficult moral and philosophical dilemmas were encountered by the courts in Poland, and in many other countries, in relation to the cases that brought so-called *wrongful life* and *wrongful birth* actions to the fore.[30] Decisions issued in these cases use mostly constitutional argumentation making reference to fundamental rights: on the one hand, to protection of the fundamental right to life, and, on the other hand, to the principle of autonomy and privacy in terms of safeguarding parents' freedom to family planning.[31] In consequence, as a result of the desire to protect the value of human life, the courts have rejected children's claims on the grounds of *wrongful life*.[32] However, parents' claims on the grounds of child-rearing costs have been held to be admissible in cases where the parents were denied the right to abortion despite the fact that this right was expressly granted by the law (for instance, in the case of rape and so-called eugenic grounds, i.e. serious genetic defects). A 'direct' character of application of constitutionally guaranteed fundamental rights can be drawn from the fact that the grounds for the compensation claim were established based on the unlawful breach of the parents' fundamental right i.e. that deriving from the right to decide about one's personal life. It is worth noting that the courts—when issuing the decision—expressed their conviction that intervention of the lawmaker in the field would be necessary as a result of the major controversy that the specifics of these types of cases conjured in relation to the desired level of intervention considering the balance between the fundamental rights which stood in opposition.[33] Therefore,

[29] *Cf* Supreme Court, 27/10/1983 III CZP 35/83 exemplifying a case where a resolution was attributed the status of a so-called legal rule.

[30] *Cf* eg H Nieuwenhuis, 'Fundamental Rights Talk. An Enrichment of Legal Discourse in Private Law?' in T Barkhuysen and SD Lindenbergh (eds), *Constitutionalisation of Private Law* (Leiden, Martinus Nijhoff Publishers, 2006) 6; J Smits, 'Private law and Fundamental Rights. A Skeptical View', ibid, 11.

[31] *Cf* Supreme Court, 21/11/2003, V CK 16/03, which provides that 'freedom—broadly understood and which has its foundation in the Constitution is a personality right and each person therefore has the right to decide about his/her personal life'.

[32] *Cf* Supreme Court, 13/10/2005, IV CK 161/05, in which it is expressly stated that 'no right of the child is violated by the above mentioned culpable acts of the doctors as there is no such right as the child's right not to be born (…) and the very fact of being born may not be considered a damage.'

[33] *Cf* Supreme Court, 22/2/2006, III CZP 8/06, which provides that 'The Supreme Court was aware of the controversy caused by the problem of claims related to childbirth as a consequence of rape,

only in the absence of such legislative intervention was it justified to look for a solution which referred directly to the sphere of rights and values superior to private law.

With the case law examples concerning the concept of direct application of fundamental rights in the sphere of horizontal relationships delineated, by way of summary the following observations can be made:

Firstly, this concept usually inevitably leads to the courts encroaching on the lawmaker's area of competence. Issuing judicial decisions which are based directly on superior values, placed outside the sphere of private law regulations, in a way which makes possible this omission and refusal of application of those regulations, and which, at the same time, involve solutions conflicting with imperative regulations (as for instance in the case of usucaption and child's filiation) is equal to creating a new legal norm. In this sense, such a concept paradoxically extends further than constitutional review in the model presented earlier. The constitutional court acts as a negative legislator and therefore, when eliminating an unconstitutional norm, it does not replace this norm automatically with another positively expressed one, but rather reserves this competence for the lawmaker. However, in the concept of direct effect of fundamental rights, a binding norm—which is not applied—is replaced *de facto* with a new provision thereby introducing a different equilibrium of rights and obligations of parties as opposed to that stemming from the statutory model. The basic conception of this differs substantially from the method based on courageous and creative functional interpretation supported by general clauses which introduce an element of constitutional axiology of fundamental rights.

Simultaneously, we should not neglect the sometimes very subtle differences between a situation in which the court decides to replace an existing legal norm with another norm derived from fundamental rights, and a situation in which the court is confronted with some kind of 'legal vacuum' and fills it with a rule deriving from superior legal values. This difference will often be only apparent since everything depends on a philosophical concept which explains the very existence of a legal loophole, when it takes the form of the so-called apparent or axiological vacuum. Without exploring this further, we can conclude at this point that in situations concerning so-called 'apparent vacuums', when the law is undoubtedly silent and provides neither a positive nor negative solution, we could reasonably talk about a classical function of the court, which—in a totally legitimate way—administers justice. I do not think, however, that, for example, the above dispute relating to the *wrongful life* and *wrongful birth* compensation claim could be characterised as a dispute situated within a legal vacuum since the lack of rules in this field could equally be considered as an 'axiological vacuum' which becomes apparent only when we *a priori* make some value assumptions. I would also draw a distinction between a situation in which a judge creating—on the basis of a fundamental right—a new rule which *de facto* replaces a statutory norm, and other situations in which the judge decides

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when abortion was unlawfully denied. For that reason, it is desirable to initiate legislative work which would make it possible for the state to bear the expense of child maintenance if a woman did not exercise her right to legal abortion or if she was denied this right by an unlawful decision'.

on the grounds of constitutionally based reasoning about the content of the substantive rights as for which the lawmaker itself leaves the necessary freedom of decision, within the limits of constitutionally protected values.[34]

Secondly, in the case of direct application of fundamental rights in the horizontal dimension, courts will usually be forced to apply the so-called double proportionality test due to the very nature of these cases i.e. a fundamental right, which is finally considered as a foundation for decision, is confronted with another fundamental right.[35] The conflicting nature of fundamental rights can clearly be deduced from the case law examples set out above as can the judicial struggle inherent in choosing between values in sharp and direct conflict necessitating the construction of a certain hierarchy, which is in principle the role of the legislator and not of the court.

To illustrate: in the case of usucaption the conflict arose between the property rights of the original possessor on the one hand and the current owner on the other; in the case concerning heterological artificial insemination the conflict concerned the child's right to a stable family life and the right of the same child to establish its civil status in conformity with the biological status quo, and, consequently, protection of a person's genetic identity was at stake; in the case regarding *wrongful life* the right to life on the one hand had to be juxtaposed with the right to plan a family etc. In each case the court had to delineate the boundaries of each of the fundamental rights involved, and therefore has to apply a complicated analysis of proportionality in order to find the point of equilibrium. Doubts concerning the application of such a test do not arise from the fact that it is essentially impossible or that it gives inconsistent results, but rather from the fact that this approach substantially differs from the typical function of the courts in that in principle they have not been charged with independently defining the axiology of a legal system, particularly when it comes to bitter social controversies pertaining to the hierarchy of particular values.[36] With a different assumption, the borderlines between the competences realized by the ordinary courts, the legislator and constitutional courts are blurred and there emerges a

[34] The above can be located in the well-known conflict between the right to protect honour and the right to the freedom of speech, in a horizontal dispute between parties in private law. It is a well-known issue in all democratic systems of law and, not without a reason, this conflict which arose before the German Constitutional Court in the *Lüth* case (BVerfG, 15/1/1958, 7 *Entscheidungen des Bundesverfassungsgerichts* 198) marks the beginning of the discussion about constitutional radiation into private law. Apparently, in this case there is no other way but to resolve the conflict of fundamental rights making reference to constitutional values on the level of each specific dispute, *cf* also Supreme Court SN, 18/2/2005, (7) III CZP 53/04, in which it is correctly concluded that: 'Collision between the right to freedom of speech as well as the society's right to information and an individual's right to protect honour will always be resolved in the context of a specific case (….).'

[35] *Cf* Collins, 'On the(In) compatibility of Human Rights discourse and Private Law', 41: '(…) what is necessary in most cases is the application of the 'ultimate balancing test', which is in effect a double application of the test of proportionality to both of the rights at stake'.

[36] However, we must not forget the exceptions mentioned above in the context of the conflict of the right to protect privacy, honour and freedom of speech. We have to accept that in such cases the double proportionality test is virtually indispensable and it is a fully legitimate method of resolving conflicts on the horizontal level.

question concerning democratic legitimacy of the judicial power. If this assumption is followed, a transformation of the democratic system necessarily ensues, of which an essential, although not exclusive, feature is the principle of the separation of powers. Consequently, we approach the model of 'judicial government'.[37]

Thirdly, in the context of the direct application of fundamental rights, predictability and legal certainty become seriously jeopardized. Even in cases where the mandatory norms of private law fail to guarantee the results of future decisions, the use of direct application of fundamental rights may considerably abate trust in the idea of the state ruled by law. Not without a reason, as a result of an increasingly 'activist' jurisprudence, a question of retroactive effect of judicial decisions *de facto* introducing a new rule is now often discussed.[38] The threat to legal certainty is even greater because judicial decisions do not create (at least in the systems of continental law) a universal norm binding on all other courts which in turn are constricted to issue similar decisions. The influence of a created rule on the jurisprudence of other courts will depend on the procedural provisions binding the lower instance courts to follow the decisions made by higher instance courts. The effect of this necessarily weakens the principles of the state ruled by law and is, in a certain sense, paradoxical since a wider introduction of the axiology based on fundamental rights into a legal system simultaneously—in principle at least—leads to a strengthening of the modern concept of the democratic state, which is supported not only by the formally understood idea of the 'rule of law' but also it directly imposes respect of fundamental rights.[39]

This last observation should be stressed in the context of the current discussion on the direct application of fundamental rights in horizontal relationships. It seems that the line of controversy is often incorrectly drawn according to the ideological criteria, in that it places the opponents and actors of the direct effect in the role of opponents and protagonists of the application of fundamental rights in private law. However, in my opinion, this does not represent the core of the dispute. The crux rather is not whether fundamental rights should influence private law, but who (i.e. the legislator, constitutional courts, ordinary courts of law) and by which means should ensure the radiation of fundamental rights into all branches of law, including private law.

[37] *Cf* AS Sweet, *Governing with judges. Constitutional politics in Europe* (New York, Oxford University Press 2000) 198; AC Hutchinson, 'The Rule of Law Revisited: Democracy and Courts' in D Dyzenhaus (ed), *Recrafting the Rule of Law: The Limits of Legal Order* (Oxford, Hart Publishing, 1999) 212.

[38] *Cf* eg DN MacCormik and RS Summers (eds), *Interpreting Precedents-A Comparative Study* (Dartmouth, Ashgate, 1997).

[39] *Cf* eg J Rawls, *Theory of Justice* (Cambridge, Mass., Harvard University Press, 1971); J Raz, *The Authority of Law: Essays on Law and Morality* (Oxford, Clarendon Press, 1979); G Palombella, 'The Rule of Law and its Sense' in *Relocating the "Rule of Law"* (Florence, European University Institute, 2007).

7.4 Reflections on the Horizontal Effect of Fundamental Rights in EU Law—Limits of Direct Influence of CJEU Decisions

7.4.1 Introductory Remarks

In this part, the aim is to probe some aspects of the specific methodology of fundamental rights' application in European Union law as compared with the problems analysed above, with specific focus on the national context. From the outset, it is imperative to note the limits posed to the application of the Charter of Fundamental Rights by the Treaty and the Charter itself, permitting reference to the guarantees of fundamental rights only within the field of application of European Law.[40]

Secondly, we must not neglect the fact that regulations concerning private law relationships are still, to a great extent, covered by member state competence. Although the influence of European Law on private law relationships is systematically growing and, simultaneously, in many domains public law is proliferates private law and *vice versa*, radiation of fundamental rights guaranteed by EU Law in the field of private law remains limited, shifting the centre of gravity back towards the fundamental rights guarantees applied in individual national systems.[41]

Thirdly, when considering the relationship between EU Law and national law, the influence of fundamental rights by means of CJEU decisions on private law relationships will essentially assume a two-tier form.[42] The process will be effectuated through national law, not by a direct structuring of the existing horizontal relationships, as sometimes occurs in the decisions of national civil courts ruling on disputes between individual parties. It is therefore possible to speak of the horizontal effect of fundamental rights in terms of an indirect effect (through legal acts), although the form and intensity of this impact may not be homogenous. This—first and foremost—results from the different character of situations in which EU Law is applied in national systems in addition to the nature of legal acts themselves, rendering it reasonable and purposeful to apply the guarantees ensured in the Charter of Fundamental Rights. In some respects, the model of horizontal effect of the Charter

[40] *Cf* Art. 51(1) of the Charter of Fundamental Rights which envisages application of the Charter by the Member States only 'when they are implementing Union law'. *Cf* regarding the extensive literature eg T von Danwitz and K Paraschas, 'A Fresh Start for the Charter: Fundamental Questions on the Application of the European Charter of Fundamental Rights' (2012) *Fordham International Law Journal* 1396; A Rosas and H Kaila, 'L'application de la Charte des droits fondamentaux de l'Union Europeenne par la Cour de Justice: un premier bilan' (2011) *Il Diritto dell'Unione Europea* 1; J Kokott and C Sobotta, 'The Charter of Fundamental Rights of the European Union after Lisbon' (2010) *EUI Working Paper* No 6; M Safjan, 'Areas of Application of the Charter of Fundamental Rights of the European Union: Fields of Conflicts?' (2012) *EUI Working Paper* No 22.

[41] *Cf* AS Hartkamp, *European and National Private Law* (Deventer, Kluwer, 2012).

[42] *Cf* C Mak, 'Unchart(er)ed Territory. EU Fundamental Rights and National Private Law' (2013) *Amsterdam Law School Research Paper* No 2013-25; D Leczykiewicz, 'Horizontal Application of the Charter of Fundamental Rights' (2013) 38 *European Law Review* 479.

of Fundamental Rights in CJEU decisions more closely aligns to the methods of horizontal impact that emanate from application of the European Convention on Human Rights to which the European Court of Human Rights in Strasbourg refers in the context of its decisions in the field of so-called positive duties of states. Indirectly, by defining the obligations deriving from the Convention, these duties also define the requirements which must be met by national courts when deciding issues concerning horizontal relationships.[43] There is, however, a crucial difference in respect of the Convention system, resulting from the different character of the relationship between EU law and national laws, which is connected to and influenced by the principle of priority, efficiency and the direct/indirect effect of European Law.

In the following section, I would like to focus solely on the methodological aspect and—more precisely—on the different forms of horizontal effect which could theoretically be employed on consideration of CJEU jurisprudence related to the application of the guarantees embedded in fundamental rights. These remarks will be made through the lens of: firstly, an evaluation of national legal acts which directly transpose EU laws; and, secondly, through an assessment of national legal acts, which do not directly transpose EU law, but nonetheless find connection to European Law application, as defined in Article 51(1) of the Charter of Fundamental Rights.

7.4.2 Evaluation of National Regulations from the Perspective of the Charter of Fundamental Rights in Connection with the Direct Transposition of EU Norms

Beyond doubt, national law that has transposed EU regulations lies within the scope of application of the Charter of Fundamental Rights. Among the CJEU decisions, we can highlight many examples of indirect effect on horizontal relationships, achieved first and foremost by interpreting European laws in conformity with fundamental rights, which, as mentioned, must be taken into account in the national systems implementing EU provisions.[44] Let us now look at the particular situations in more depth.

Firstly, we may note the more classical way of interpreting specific provisions included in a European legal act, which looks for such an interpretative variant—

[43] *Cf* eg ECHR, 13/7/2004 *Pla and Puncernau v Andorra*, Apl. No 69498/01 ECHR 2004-VIII which found that both non-discrimination principle and the right to family life were breached as the national courts established that the testator effectively excluded an adopted child from among the heirs; ECHR, 24/6/2003 *Garaudy v France*, Apl. No 6583/01 ECHR 2003-IX concerning (in the system of) effective protection against an insulting racist publication; ECHR, 26/3/1985 *X, Y v The Netherlands* (series A, no 91) regarding the breach of rights of a mentally ill person in a private nursing home. *Cf* L Garlicki, 'Relations between Private Courts and the European Convention on Human Rights' in Sajo and Utiz (eds), *The Constitution in Private Relations* 129.

[44] *Cf* Joined cases C-397/01 to C-403/01 *Pfeiffer* [2004] ECR I-8835 paras 114–118.

among many possible—which will ensure full conformity of an EU act with a fundamental right.[45]

Secondly, in relation to transposition of an EU legal act, the field of application of fundamental rights and general principles can extend to such regulatory areas that normally fit into the sphere of freedom of the national legislator. More specifically, this situation can arise where the national lawmaker may, but is not obliged to, introduce certain specific legal mechanisms into the national system. In such case, it could—theoretically—be argued that, the process of application of the Charter is shortened since it no longer involves an interpretation of a specific norm being transposed, but rather concerns a direct juxtaposition of the Charter guarantees with the national mechanism in question. In consequence, for example, the national regulation causing contention could be considered as noncompliant with the fundamental right invoked. In turn, this could lead to the national jurisdiction being obliged to decide the rights and duties of the parties in accordance with the fundamental right in refusal of the application of the national norm. Such application of the Charter could be considered—at least in some situations—as close to the above-mentioned methods related to the direct effect of fundamental rights in national systems since the horizontal effect would be achieved without considering all national regulatory tools in existence in a given national system. In this way, application of the Charter or of general principles could somehow evolve into an autonomous method inasmuch as it would take place independently of an interpretation of a specific EU provision.[46]

Thirdly, fundamental rights or general rules, confirmed and developed in secondary law regulations, may provide a basis for the CJEU to evaluate national mechanisms, even in cases where the time assigned for effectuating the transposition into national systems has not yet lapsed. This can occur in situations whereby the application would be supported by the universal character of the values expressed in relevant guarantees provided in fundamental rights or in general principles (e.g. absolute prohibition of discrimination on the grounds of sex or age).[47] This situation is somewhat similar to the one described above due to the fact that it provides a 'shortcut' for the infiltration of fundamental rights and general principles to horizontal relationships at national level.[48] The difference, however, lies in the

[45] *Cf* case C-149/10 *Chatzi* [2010] ECR I-8489 (an EU act should be interpreted in a way which ensures full compliance with the provisions of primary law). Also *cf* eg C-281/98 *Angonese* [2000] ECR I-4139; Case C-447/09 *Prigge* [2011] ECR I-8003, case C-400/10 *McB* [2010] ECR I-8965. In certain situations the assessment of the conformity of a legal regulation with fundamental rights might lead to the declaration of nullity of an EU act, see case C-236/09 *Association belge des Consommateurs Test-Achats and others v Conseil des ministres* [2011] ECR I-773.

[46] *Cf* eg the statement of AG Kokott C-167/12 *CD* (application of child's right to family life to situations not covered by relevant provisions of EU law) as well as judgment of 12 June 2012, joined cases C-611/10 and C-612/10 *Hudziński and Wawrzyniak*, not yet reported (application of the non-discrimination principle with regard to employees of other member States on a territory not covered by an obligatory transposition).

[47] Here *cf* mainly case C-144/04 *Mangold* [2005] ECR I-9981; case C-555/07 *Kücükdeveci* [2010] ECR I-365.

[48] With regard to these decisions *cf* eg M de Mol, 'Kücükdeveci: Mangold Revisited – Horizontal Direct Effect of a General Principle of EU Law' (2010) 6 *European Constitutional Law Review* 293.

fact that the secondary law legal act determines the meaning and content of a given guarantee even though it cannot be applied since the deadline for transposing it has not expired. Direct reference to the Charter or to the general principles, omitting reference to the relevant act of secondary law, may complicate any attempt to define the border between a direct and an indirect effect of an EU Directive.[49]

Fourthly, one could, at least on the basis of some theoretical hypothesis, envisage a situation within the scope of application of EU law whereby the CJEU is evaluating a national law as it stands after its transposition and in doing so refers to the guarantees resulting directly from the Charter of Fundamental Rights. Such reasoning would apply to cases where an EU legal act would be deemed noncompliant with primary law (including the Charter), or where supplemented argumentation based on direct application of the rights and the principles enshrined in the Charter[50] may be required. In such cases, we would in effect generate full autonomization of the Charter as a source of substantive rights and relevant obligations of private law parties. This variant would be closer to the concept, described above in the context of a national system, of direct application of fundamental rights with disregard to relevant private law rules.[51]

The transfer of this process to national level (i.e. the second tier/vertical transmission)—and hence onto specific horizontal relationships as previously mentioned—through national courts, in the correct application of domestic tools, ensures the achievement of goals espoused by the particular European legal act concerned, and in full conformity of national law with Union law.[52] In such situations, the judge has a significant margin of discretion at his disposal, particularly considering the scope of teleological (functional) interpretation.[53]

In light of the foregoing observations, it should be noted that methods of influence on horizontal relationships which are subject to legal acts implementing EU law—by means of the 'two-tier' mechanism described above—may be, at least

[49] *Cf* eg D Simon, 'L'invocabilité des directives dans les litiges horizontaux: confirmation ou infléchissement?', (2010) 3 *Europe*.

[50] *Cf* here eg AG Cruz-Villalón, opinion of 18 July 2013, case C-176/12 *Association de médiation sociale contre Union locale des syndicats CGT*, not yet reported.

[51] It has to be stressed that this idea is only a theoretical hypothesis, since the ECJ jurisprudence states in principle (the judgments in *Kücükdeveci* and *Mangold* should be left aside here, as they intervened in very specific situations) that the use of a directive (even if there is no doubt about its content and meaning) cannot lead to direct effect which would result in rights or obligations for private parties (*Cf* eg case C-91/92 *Faccini Dori* [1994] ECR I-3325, para 20; case C-201/02 *Wells* [2004] ECR I-723, para 56; joined cases C-397/10 to C-403/01 *Pfeiffer* para 108). In consequence, in cases between private parties it is admitted that the refusal of application of national law contrary to a directive, in order to achieve a result in conformity with the European act is not possible.

[52] *Cf* eg case C-14/83 *Van Colson and Kamann* [1984] ECR 1891 para 26; case C-106/89 *Marleasing* [1990] ECR I 4135; case C-456/98 *Centrosteel* [2000] ECR 1-6007 paras 16–17.

[53] We should remain aware that there may arise a situation in which none of these methods will allow us to achieve a desirable effect and intervention of the national lawmaker will be necessary (*interpretation contra legem* is the border line of the given interpretation, *cf* judgment of 24 January 2012, case C-282/10 *Dominguez*, not yet reported, para 25). A party to a given horizontal relationship will be able to file a compensation claim against a public authority on the grounds of lack of adequate implementation of the provisions of national law.

theoretically, quite diverse and may essentially require different degrees of EU law interference with the respective national systems. Moreover, it seems—regardless of the 'two-tier' mechanism of application of fundamental rights—that some of the methods presented herein, if eventually recognized in the CJEU's jurisprudence, would in fact render a situation more closely associated with the concept of indirect effect e.g. the first method set out above, whereas other methods would assimilate more to direct effect i.e. the fourth method.[54] Even though it is outside the scope of this contribution to evaluate these methods in great detail, we can confidently conclude that the indistinct difference between the acts of EU law which invoke a direct effect in national systems on the one hand and those which are subject to implementation and are essentially deprived of such an effect on the other, is an additional element which must be taken into account when applying concepts that are closely related to the direct effect. The principle of primacy of EU law and *effet utile* of European Law may, therefore, in a sense neutralize the differences between various categories of EU legal acts.[55] Secondly, reference made to fundamental rights in the sphere of horizontal relationships could result not only in a gradual change of the paradigm governing private law (following the phenomenon witnessed in national systems as a result of the radiation of national constitutions); but also in a gradual shift—by an 'invisible hand'[56]—of the line which demarcates the competence of the European legislator from that of the national lawmaker.

7.4.3 Evaluation of National Law not Directly Transposing EU Law but Situated Within its Scope of Application (The Consequence of Åkerberg Fransson)

The recent CJEU Grand Chamber decision in the *Åkerberg Fransson* case[57] appears to rule in favour of a flexible and functional interpretation of Article 51(1) of the Charter of Fundamental Rights, setting out its scope of application. With regard to this judgment, there is no doubt that the scope of the Charter extends not only to national law directly transposing EU legislation but also to those national provisions which, while not defined directly as implementing acts, nonetheless remain in direct and close connection with European law by way of ensuring its effective application in the national legal system. This may even encompass those acts of national law which have already been introduced into the national system without

[54] *Cf* on this issue a classification of diverse forms of indirect effect of fundamental rights by Mak, 'Unchart(er)ed Territory', 9 ff.

[55] *Cf* here M Dougan, 'When Worlds Collide! Competing Visions of the Relationships between Direct Effect and Supremacy' (2007) 44 *Common Market Law Review* 931.

[56] In this sense, see H-W Micklitz, 'The Visible Hand of European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation' (2008) *European University Institute Working Paper* 2008/14, in which he clarifies from the outset that the invisible hand refers to the hand of the market.

[57] Judgment of 26 February 2013, case C-617/10 *Åkerberg Fransson*, not yet reported.

any connection to EU law[58] (as was actually the case in *Åkerberg Fransson*).[59] It is, therefore, reasonable to ask to what degree such an interpretation may, against the background of Article 51(1) of the Charter, influence, in future the very concept of the horizontal effect of fundamental rights in the sphere of national law coming within the scope of application of EU law. An additional issue, which arises in the context of CJEU decisions, is the possibility of 'co-existence' of the standards of fundamental rights protection resulting—on the one hand—from the Charter of Fundamental Rights and—on the other hand—from national constitutions. The European Court of Justice explicitly accepted the possibility of an application of superior national standards of protection in the area of application of EU law, with reference to these national acts implementing EU law for which the national legislator enjoys significant regulatory discretion, unless application of these standards negatively affects the level of protection resulting from the Charter and from the primacy, unity and effectiveness of European law.[60]

Prima facie, in relation to the first question, we can, at least theoretically, assume that—in the context of the Court's interpretation of the scope of application of EU law—certain rights and rules guaranteed in the Charter will increasingly develop into autonomous points of reference (thereby loosening their grip with specific legal provisions of European secondary law) that can be utilised in evaluating national mechanisms, including—inevitably—private law mechanisms. We may make reference here to large domains of private law which, in principle belong to the competence of national lawmakers, but simultaneously remain closely connected to the instruments of European law and should, therefore, ensure its effective application. In consequence, it may even appear that—paradoxically—the sphere of relationships regulated by national law not directly implementing EU law, will be subject to a stronger influence of fundamental rights and general principles of EU law than national law transposing specific acts of EU legislation. Theoretically, this may encompass, for instance, general rules of contract law operating in the national system, including limits on freedom of contract and party autonomy, should application of these mechanisms be important to ensure effectiveness of EU law instruments e.g. in the areas of consumer protection, competition or intellectual property. This effect, however, would be mitigated considerably if an explicitly

[58] Reference is made to Swedish regulations regarding administrative, fiscal and penal procedures applied in the case of tax evasion, which were introduced in the national system with no connection with the implementation of an EU legal act and had a more general application, also to situations to which EU law did not apply. In *Åkerberg Fransson* case, the preliminary reference concerned the acceptability two procedures being used with regard to a taxpayer, ie penal and administrative, in connection with *ne bis in idem* ban resulting from Art 50 of the Charter of Fundamental Rights.

[59] *Cf* with regard to this judgment V Skouris, 'Developpements recents de la protection des droits fondamentaux dans l`Union europeenne: les arrêts Melloni et Åkerberg Fransson' (2013) 2 II *Diritto dell`Unione Europea* 229; J Vervaele, 'The Application of the EU Charter of Fundamental Rights (CFR) and its Ne bis in idem Principle in the Member States of the EU' (2013) 6 *Review of European Administrative Law* 113; D Ritleng, 'De l'articulation des systèmes de protection des droits fondamentaux dans l'Union' (2013) *Revue Trimestrielle de Droit européen* 267.

[60] *Cf* para 29 of the *Åkerberg Fransson* judgment; the same position was adopted by the ECJ on the same day in case C-399/11 *Melloni*, not yet reported, para 60.

designated possibility to evaluate national regulations, situated within the scope of EU law application, on the basis of fundamental rights and the standards resulting from member state constitutions, were delineated. This leads us on to the second of the above-mentioned issues.

It should be noted that the sphere of national legislation may become an object of some kind of 'competition' between, on the one hand, the standards of fundamental rights' protection resulting from the Charter, and, on the other, those resulting from the national constitutional provisions. Insofar as the criteria for resolving this potential conflict have been—as shown above—clearly defined (i.e. protection of rights envisaged in the Charter in conjunction with the principle of primacy, effectiveness and unity of EU law), questions arising in the context of the correct standard to be employed in specific situations may cause much difficulty before national courts. Such competition could be envisaged, for instance, in situations where the higher standard of protection of a weaker party in a horizontal relationship, resulting from a national constitutional norm, would clash with a position resulting from EU legal acts, including the interpretation of the scope of legal protection of an employee or consumer (Title IV of the Charter) in respect of the protection envisaged by the Charter. Choosing an appropriate standard of protection in such cases would depend on the hierarchy of values expressed by conflicting fundamental rights, and therefore also on the proportionality test and on the interpretation of the aims pursued by EU law on the one hand, and the classical mechanisms of private law, on the other. Therefore, choosing the higher protection standard would not be a simple trick of semantic and logical interpretation but would rather be an intricate process necessitating the employment of a wide range of evaluating criteria.[61] To some degree, any clash of protection standards in the sense discussed here will essentially be forced to utilise the above-mentioned mechanism of 'double proportionality'. This stands, however, only with regard to the interpretation of fundamental rights rooted in different legal orders (national and that of the European Union), and may reflect the realisation of a somewhat different vision of private law and its functions.[62] In order to overcome such difficulties in the search for the appropriate 'protection' standard, the possibility exists, and in some cases an obligation arises, to make a preliminary reference to the CJEU. In fact, this possibility/obligation was expressly confirmed in the reasoning of the Grand Chamber in the *Åkerberg Fransson* case.[63]

With the foregoing set out, it is possible to disclose another level of complication in relation to the concept of the indirect horizontal effect of fundamental rights in the context of CJEU and national court decisions.

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[61] *Cf* also in relation to possible complications in the relationships between EU law and national systems over private law regulations H Collins, 'The Constitutionalisation of European Private Law as a Path to Social Justice' in H-W Micklitz (ed), *The Many Concepts of Social Justice in European Private Law* (Cheltenham, Edward Elgar, 2011) 163.

[62] With regard to the proportionality test *cf* D Kennedy, 'A transnational Genealogy of Proportionality in Private Law' in R Brownsword, H-W Micklitz, L Niglia and S Weartherill (eds), *The Foundations of European Private Law* (Oxford, Hart, 2011).

[63] See para 30 (national courts interpreting the Charter provisions, may, and in some cases—have to submit a prejudicial question to the Court, pursuant to Art. 267 TFUE).

7.5 Reflections on the Relationship Between the Horizontal Effect Method and the Implementation of the Idea of 'Social Justice'

In deciphering which standard of protection of fundamental rights should be applied (i.e. that emanating from national systems or that resulting from the Charter) difficulties may be encountered particularly where there ensues a clash between different concepts of 'social justice' expressed by legal systems. The discussion as to the most appropriate model of social justice in European private law has not yet provided us with clear results.[64] On the one hand, solutions guaranteeing a just formulation of the rights and obligations of parties to private law relationships, in accordance with objective criteria defining the equivalence of mutual obligations of the parties and in this sense, guaranteeing equal treatment of the parties,[65] have been expressly postulated. On the other hand, it has been argued that it is necessary to introduce instruments which—with a view to bridging the gap posed by the unequal starting position of the parties to private law relationships (for instance the relationship between a consumer and a professional)—would not impose a certain vision of distributive justice but would rather achieve the goals via an adjustment of the content of such relationships thereby fairly distributing the rights and obligations of private parties. In this sense we can understand the distinction—proposed by Hans Micklitz[66]—between the approach defined as 'result-oriented social justice' (the former conceptualisation) and 'access justice' (the latter solution). It seems that—without running risks—we may argue that the concepts based on the first approach will find stronger support in the activist methods of judicial decision-making, rendering it possible to 'forcibly' and directly interfere with private law relationships by referring to fundamental rights, especially to the principle of equality; on the other hand, the concepts based on the 'access justice' approach are more suited to the subtle methods of indirect influence of fundamental rights, mainly by way of adapting general clauses of private law or by an appropriately flexible interpretation of already developed European legal acts, for instance those connected with consumer

[64] *Cf* M Meli, 'Social Justice, Constitutional Principles and Protection of the Weaker Party' (2006) 2 *European Review of Contract Law* 164; R Sefton-Green, 'Social Justice and European Identity in European Contract Law' (2006) 2 *European Review of Contract Law* 274; H Schepel, 'The Enforcement of EC Law in Contractual Relations: Case Studies in How Not to "Constitutionalize" Private Law' (2004) 5 *European Review of Private Law*, 661; Micklitz (ed), *The Many Concepts of Social Justice in European Private Law*.

[65] *Cf* Sefton–Green, 'Social Justice and European Identity in European Contract Law', 275 ff, who says that social justice is not only a simple manifestation of distributive concepts but something much more important as it symbolically expresses European cultural identity, which should pervade private contract law. *Cf* also Study Group on Social European Private Law, 'Social Justice in European Contract Law: A Manifesto' (2004) 10 *European Law Journal* 653.

[66] *Cf* H-W Micklitz, 'Introduction' in Micklitz (ed), *The Many concepts of social Justice in European Private Law*, 42 f.

relationships[67] (especially with abusive clauses[68]) and labour law relationships. The concept based on 'reducing the deficit' of the weaker party is somehow a continuation of the traditional corrective function of private law instruments based on the concepts of contract equity. Indeed, such a concept may well complement legal acts which determine a certain model of 'social justice' in any given legal system. At the same time, it may be fanciful to think that a dividing line between a 'result-oriented social justice' approach and an 'access justice' approach can be clearly and expressly defined. This may stand since in relation to the latter, an excessively activist application of fundamental rights by means of the horizontal 'indirect effect' method may interfere with the functions of private law instruments, excessively limiting the principles of freedom of contract and autonomy of the parties.

As it stands, it appears evident that a prudent and moderate approach in imposing a certain vision of 'social justice' through the application of fundamental rights, which could be assumed from an over-simplified interpretation of most of the recent CJEU decisions, is necessary. Without delving further into this area, which merits a separate publication, we may simply conclude that the concept of 'social justice' in contract law is still being discussed, especially in terms of the method of achieving such justice by means of private law instruments. The outcome of the controversy, closely connected with the debate on the methods and scope of horizontal application of fundamental rights, will also have an important influence on the relationships between EU law and national systems in those domains in which it will be necessary to form an appropriate approach to the issue of 'social justice'. Today, the concept and its meaning are extremely varied according to the different legal systems of member states, resulting from a difference in the adopted model of distributive justice on the one hand, and, on the other hand, from slightly different visions of the mechanisms of private law and the market economy. Perhaps this catalytic situation will intensify the effort towards a unification of the fundamental domains of private law within European law. This move, however, should be made by the European legislator, since an excessively activist approach by judicial decisions could only complicate an already complex landscape, comprised of different legal mechanisms currently operating in the European sphere.

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[67] *Cf* H-W Micklitz, N Reich and P Rott, *Understanding EU Consumer Law* (Antwerp, Intersentia, 2009); F Cafaggi and H-W Micklitz (eds), *New Frontiers of Consumers Protection: The Interplay between Private and Public Enforcement* (Antwerp, Intersentia, 2009); H Schulte-Nölke, 'The EC Consumer Law Compendium: A Pan-European Knowledge Base for Politicians, Business and Consumer Organizations (2009) 20 *European Business Law Review* 383.

[68] A protective trend from consumers' point of view can be discerned, however, oriented mainly towards ensuring a balance in relation to the starting position of the parties, in particular by means of sound information made available to the consumer by a professional in order to give a consumer an opportunity to make an informed choice in relation to the economic sense of contract and its provisions, from the CJEU decisions, *cf* eg judgment of 21 March 2013, case C- 92/11 *RWE Vertrieb*, not yet reported, and judgment of 26 April 2012. case C-472/10 *Invitel*, not yet reported.

7.6 Conclusions

The analysis presented in this short contribution leads to the following conclusions:

Firstly, in relation to the impact of fundamental rights axiology on horizontal relationships, the radiation of fundamental rights should be considered as a desired and unquestionable phenomenon. However, the discourse in current doctrine is not sufficiently focused on the methods to be applied and the goals to be achieved by such radiation. Simultaneously, the criteria which should be taken into account when evaluating the different effects of the horizontal application of fundamental rights in private law need to be discussed at greater length and examined more closely. In other words, we should ask rather whether the stress should be placed on the form of the horizontal effect of fundamental rights, rendering it possible to adjust the deficit of the starting position of the 'weaker party'; or whether stress should be placed on the instruments guaranteeing the achievement of a certain objective vision of a 'just distribution of rights and obligations' of the parties in private law relationships.

Secondly, diverse methods of introducing fundamental rights into the sphere of private law require an in-depth analysis so as to assist in effectively comparing their positive and negative effects on the functioning of legal systems. It seems that some forms of indirect horizontal effect may lead to equally profound interference with the system of private law structures, as in the case of direct application of fundamental rights. Evaluation of the effect of fundamental rights on private law should take into account the diversity of functions realized by legal instruments belonging to different domains of law. We must not forget that even with blurred borders between private and public law, which are clearly noticeable in EU law, different branches of law have their own, irreplaceable roles to play. Too deep an interference of fundamental rights in the private law sphere may lead to an undermining of its functions.

Thirdly, one of the important criteria in selecting a correct method should necessarily involve an appraisal of the consequences on the division of competences amongst the most important institutions deciding on the form and application of law in democratic systems. From this point of view, the differences deriving from the application of diverse methods of horizontal effects seem to be crucial and not sufficiently analysed in the present debate. In the field of EU law, there is an additional fundamental problem connected with the possible consequences of the method and scope of application of the Charter of Fundamental Rights in relation to the division of prerogatives between the European Union and the legal systems of member states.[69]

Fourthly, in the context of the above conclusion, the question of ultimate responsibility for creating a new balance of rights and individual interests arises—in conformity with the axiology of fundamental rights—should be considered in the

[69] *Cf* also D Schiek, 'Fundamental Rights Jurisprudence Between Member States Prerogatives and Citizens Autonomy' in H-W Micklitz and B de Witte (eds), *The European Court of Justice and the Autonomy of the Member States* (Antwerp, Intersentia, 2010) 219.

sphere of private law. Each of the above methods of horizontal effect may lead to a different answer to the above question. The application of methods of direct effect of fundamental rights—or the closest methods of indirect horizontal effect—certainly places greater responsibility on judges. Where methods—more closely related to '*mittelbare Drittwirkung*' i.e. interpretation of general clauses of private law—are applied in accordance with the axiology expressed in fundamental rights, the main responsibility for the ultimate model of justice adopted in a legal system remains on the shoulders of the (national, European) lawmaker.

A clear dilemma remains strictly related to the question concerning which method of horizontal effect is best suited to the effective application of fundamental rights on all levels of the legal system. While the aspiration to ensure the greatest effect of fundamental rights on a legal system may be an important argument in favour of 'judicial activism', at the same time, it is difficult to deny that resolving important social and philosophical disputes that relate to the final shape of the idea of justice realized by law, belongs mainly to the competence of an institution in which the necessary democratic legitimization is vested. This may be considered as an important argument in favour of maintaining the essential responsibility for the content of law in the hands of the lawmaker. The above-mentioned opposition between the role of the courts and that of the lawmaker may be partly moderated by the control function of constitutional courts, which are institutionally placed between the classical judicial and legislative branches. It seems that while judges are to play a key and irreplaceable role in the protection of fundamental rights, it is not up to them to play the role of arbiter, resolving general social, political and philosophical dilemmas, which have an important influence on the entire system of law and its axiology.

This postulate also refers to the choice of an appropriate model of 'social justice'—as advocated by *Hans Micklitz*—and the level at which it should be implemented i.e. via national or EU law. I have no doubt that *Hans Micklitz'* numerous contributions to this debate will remain as inspiring as they have thus far been.

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Chapter 8
European Regulatory Private Law: From Conflicts to Platforms

Yane Svetiev

Abstract The essay provides a reflection on European Regulatory Private Law (ERPL), as both a perspective on and a model of European legal integration. First, it outlines some of the problems familiar to legal and other scholars that give rise to ERPL as a perspective on legal integration, including the pluralisation of legal sources and institutions and the resulting legal fragmentation. This in turn produces the need to manage conflicts or collisions in law-application to concrete legal problems either by making choices from existing alternatives or by innovating. Secondly, it provides possible impulses that inform ERPL as a research agenda and a way of making headway on those familiar problems. The final—and more exploratory—step, is to envisage the shape that ERPL might take given those problems and impulses as a model of normative interaction in the EU context. One guiding intuition is that it might be limiting to speak of the resulting normative framework as one for merely managing conflicts between normative orders. An alternative conception might be that of integration, so that ERPL could be thought of as a platform (or platforms) aiming to integrate to the greatest extent possible the perspectives of the various relevant law producers and enforcers in the pursuit of various dimensions of the public interest. For that purpose, the essay will sketch out some possible platform models drawing on existing examples.

Bocconi University; European University Institute. The author acknowledges the support of the ERC funded project on European Regulatory Private Law hosted at the EUI.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_8,

8.1 Introduction

This essay provides a reflection on the concept of European Regulatory Private Law (ERPL)[1], offered from the perspective of someone who has come to it without being steeped into private law debates in Europe, either at national or at EU level. The essay seeks to outline some ideas about the meaning of ERPL and the impulses that motivate it as an approach to EU legal integration. It will also explore what kind of a model of interaction between normative orders ERPL could entail in the context of European legal integration.

To scholars or practitioners from different backgrounds and disciplinary traditions the ERPL coinage may be quite difficult to comprehend; it seems to contain concepts that are incommensurate, even total opposites to each other. For most national private lawyers such a coinage might be nonsensical, or at worst anathema. Such reactions might reflect both conceptual and practical considerations. The existence of a composite field such as ERPL confounds traditional ideas about the sources of private law, which would also mean that private law research and methods of analysis should be broader and more challenging for both practitioners and scholars. Similarly for many EU lawyers, the coinage could even be regarded as an oxymoron, as EU lawyers ordinarily are viewed and—perhaps more importantly—view themselves as public or even constitutional lawyers, principally interested in relationships between institutions and orders of competence[2]. The private party is ordinarily but a handmaiden in the evolution of EU law, useful principally for bringing to attention the large constitutional issues that require resolution, even if those issues oftentimes stem from her apparently small and mundane problems.

Even for American lawyers and legal scholars who take interest in developments on the other side of the Atlantic, the idea of ERPL might be puzzling. This reaction might be due to a scepticism either about the very idea of private law[3] or about the specific form that EU private law has taken thus far, as well as the direction in which it appears to be going.[4]

As a result, operating from within one of the above perspectives, it may be feasible to ignore some of the developments encompassed under this umbrella concept. Yet it is precisely when we ignore developments outside of our usual field of vision, either because they fall into a blind spot or because we do not have

[1] H-W Micklitz, 'The visible hand of European regulatory private law—The transformation of European private law from autonomy to functionalism in competition and regulation' (2009) 28 *Yearbook of European Law* 3.

[2] e.g. A von Bogdandy and J Bast, 'The Federal Order of Competences' in A von Bogdandy and J Bast (eds), *Principles of European Constitutional Law* (Oxford, Hart, 2009).

[3] J Goldberg, 'Pragmatism and Private Law' (Introduction to the Symposium "The New Private Law") (2012) 125 *Harvard Law Review* 1640.

[4] D Caruso, 'The Baby and the Bath Water: The American Critique of European Contract Law' (2013) 61 *American Journal of Comparative Law* 479, 491.

analytical categories with which to deal with them,[5] that we tend to miss new emergent phenomena that require understanding and characterisation. Disagreement and confusion may suggest there is something worthy of further investigation.

Legal scholars, and not only those, have often written about the influence of perspective on the way in which we approach phenomena or problems.[6] By perspective in this context we typically mean viewpoint or approach. Both from within and from without the field, law seems to be regarded as a discipline where perspective is important: role plays are an important pedagogic tool for law students from many different national backgrounds. Those—even beyond the legal field—who emphasize the importance of perspective, often refer to various literary and artistic works that examine different stories told by storytellers reconstructing the same events from the perspective of a different legal role.[7]

A particular perspective may typically be seen to be associated with a particular rationality. I use this in a rather loose way to indicate specialisation of focus, which need not involve a complete and coherent view of the world. Instead, it might simply involve the narrowing of the objects and objectives of analysis, as well as the instruments with which to transform the objects so as to achieve selected objectives. The ascription of rationalities in this sense is observed within some relevant subfields of law (private law: autonomy and justice/code and common law), regulatory law (public interest/statutes and regulations), EU law (internal market/EU treaties and legislation). Note however, that such rationalities (in the sense of combinations of objectives and instruments) may often be ascribed *ex post facto* so as to provide coherence to specialised (sub-)disciplines, regardless of whether they have truly informed or emanate from or fully explain them. Yet, even if they are imagined or *ex post* rationalisations, they have real effects as they condition the training and the viewpoint of those who operate from within such (sub-)specialties and therefore also their normative worldview.

Returning to the ERPL concept, to get some traction on its content and meaning for a legal scholar—particularly one trained in the German tradition—a useful departure point might be a definition. Note, however, that a more heterodox sceptic would be quite wary of a definition of the object of argument found in the introduction. Despite giving an appearance of formality and discipline in argumentation, the sceptic knows that the introduction is ordinarily written after the argument has

[5] In the context of the firm, see CM Christensen, *The Innovator's Dilemma* (Boston, Harper, 2003); CM Christensen, EA Roth and SD Anthony, *Seeing What's Next* (Boston, Harvard Business Review Press, 2004).

[6] To pick a random example, H-W Micklitz, 'Rethinking the public/private divide' in M Maduro, K Tuori and S Sankari (eds), *Transnational Law: Rethinking European Law and Legal Thinking* (Cambridge, Cambridge University Press, forthcoming).

[7] E Fox, 'Chairman Miller, the Federal Trade Commission, Economics and *Rashomon*' (1987) 50 *Law and Contemporary Problems* 33; cf J Mintz, A Auerbach, L Luborsky and M Johnson, 'Patient's, Therapist's and observer's views of psychotherapy: a 'Rashomon' experience or a reasonable consensus?' (1973) 46 *British Journal of Medical Psychology* 83.

been completed, and so she might suspect that the definition has been tailored and narrowed to fit the argument presented rather than the other way around. A more realist-minded scholar, who has absorbed post-modern lessons about law, might be unfazed by the absence of a definition and might even applaud the blurring of traditional boundaries that ERPL appears to entail, but at the same time be concerned about the continued use of old categories that have typically obscured the real political, social or economic drivers behind the law, both in its making and its application.

The pragmatist scholar might avoid getting bogged down into concepts and *a priori* definitions in order to get down "to the brass tacks;" to "push past the surface" and to get to "what is 'really' at stake"[8]. Note that this question might elicit different responses even from different kinds of pragmatists[9], but for present purposes, and for stimulating debate principally among scholars from diverse backgrounds and perspectives, one departure point is to identify the problem or set of problems that might give rise to the need for this apparently hybrid concept. Recounting the set of problems might give some idea (i) about the reasons for which we have to think beyond existing categories (or the impulses behind ERPL) and (ii) about the possible shape or shapes that the resulting "law" might take.

This is the path I propose to follow in the remainder of this contribution. First, I propose to set out some of the problems that give rise to the need for ERPL as a concept. These are familiar to legal scholars—both from a more practical and more theoretical bent—and include the pluralisation of legal sources and institutions and the resulting fragmentation(s) of law, creating in turn the need to manage conflicts or collisions in law-application to concrete legal problems either by making choices from existing alternatives or by innovating and introducing new ones. The second step is to identify a set of possible reasons or impulses behind the ERPL perspective to EU legal integration as a way of making progress on those familiar problems. Here I am stepping into others' shoes and, to mix metaphors, may be out of my depth, but that is no reason not to try.

The final step, which is more exploratory, is to envisage what shape ERPL might take given those problems and impulses. Here we might distinguish between the more practically minded and more scholarly-minded lawyer. A more practically minded response could be that the problem is more imagined than real: law will always find a solution even in the absence of first (or any other) principles that account for it, since a judicial or other dispute resolution body presented with a legal problem will ordinarily have to find a solution, which will become final at least as between the parties. Judges, just like lawyers, have no choice but to deal with the case before them.[10] But the scholarly task is different,

[8] Goldberg, 'Pragmatism and Private Law', 1641.

[9] see L Menand, *Pragmatism: A Reader* (New York, Vintage, 1997); L Menand, *The Metaphysical Club* (New York, Farrar, Straus and Giroux, 2001).

[10] RA Posner, 'Pragmatic Adjudication' (1996) 18 *Cardozo Law Review* 1; TC Grey, 'Freestanding Legal Pragmatism' (1996) 18 *Cardozo Law Review* 21.

it is to give *ex post* coherence to a field that might otherwise look very messy and reconcile it with some normative commitments we might hold. In exploring the possible shape of ERPL, the intuition offered here is that it might be limiting to speak of the resulting normative framework as one for merely managing conflicts between normative orders. An alternative perspective *might* be that of integration, so that ERPL could be thought of as a platform that aims to integrate to the greatest extent possible the perspectives or rationalities (in the sense of goal/instrument combinations) of the various relevant law producers and enforcers in the pursuit of various dimensions of the public interest. Thus, in the final part I will sketch out some models of what such platforms could look like drawing on existing case examples. My purpose is to offer possibilities based on current templates emerging in different contexts and to explore some of their advantages and possible concerns, without fully evaluating them or endorsing here any one model as preferable.

8.2 Three problems

8.2.1 Normative and Institutional Pluralism

It is not uncommon in contemporary legal debates to begin with a recognition of the plurality of sources of norms that go beyond not only the traditional code or common law sources of private law, but also the usual state law-making processes in general. This is the descriptive claim of legal or normative pluralism.[11] It is worth underscoring that not only do we observe a plurality of sources of normativity, but also a plurality of institutions that fulfil the traditional functions of legal institutions, such as norm enforcement and dispute resolution. In other words, not only do various communities seek to make norms, but also the "touchdown"[12] of these norms is not necessarily judicial, nor does it necessarily take place within any other state institutions. Indeed, rules can sometimes be designed so as to avoid any "touchdown" at all so as to rely on various tools of self-enforcement.[13] Moreover, notwithstanding the plurality of sources, some decision-makers or specific practices can also fall in the interstices and apparently be governed by no law at all.[14]

[11] H-W Micklitz, 'Monistic ideology vs pluralistic reality—on the search of a normative design for European private law' in L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart Publishing, 2013).

[12] R Wai, 'Transnational liftoff and juridical touchdown: The regulatory function of private international law in an era of globalization' (2002) 40 *Columbia Journal of Transnational Law* 209.

[13] e.g. F Partnoy, 'The Shifting Contours of Global Derivatives Regulation' (2001) 22 *University of Pennsylvania Journal of International Economic Law* 421, 479 (ISDA standard term contracts for transactions among derivatives dealers).

[14] G de Búrca, 'The European Court of Justice and the International Legal Order After *Kadi*' (2010) 51 *Harvard Journal of International Law* 1; but also P Lugard and M Möllman, 'A Commitment-a-Day Keeps the Court Away' (2013) 3 *CPI Antitrust Chronicle* 1.

Cross-border economic integration is typically offered as a reason for these phenomena: where transactions take place cross-border they escape the jurisdiction of any single state and may invite transnational solutions.[15] The pluralisation of sources becomes much more visible when such sources or institutions directly compete with states, especially on the 'public' side of law, but it is worth noting that on the private side of regulating transactions and relationships—even if concealed—they have been present for a long time and likely for varying different reasons.[16]

In fact, states have themselves sought to stimulate such pluralism and engage different normative orders for their own needs. Thus, states have co-opted private law-makers in market-building and regulatory activities and outsourced functions to them—sometimes more, sometimes less visibly—on the basis of their supposedly technical and uncontroversial character or at the very least limited spillovers into questions of political controversy.[17]

The EU provides an example in which the outsourcing and the economic integration stimuli for such pluralisation, through reliance on private norm-making for example, intersect and mutually reinforce each other.[18] In the absence of a massive EU bureaucracy and to avoid political gridlock, mechanisms such as the "New Approach" have been used precisely for market building through outsourcing, stimulating not only private normative plurality but also institutional plurality.[19] Sometimes, the resulting standards interact imperceptibly with national private law, as they affect contract terms and conditions, or shape default contract rules and tortious liability standards. At other times, rules may be imposed more intrusively through the EU legislative or regulatory frameworks, particularly in the more heavily regulated national monopoly sectors,[20] where pure outsourcing to private actors would result in the exercise of naked market power.

8.2.2 Fragmented Legal Landscape

The pluralisation described above leads to another well-recognised problem, namely the fragmentation of law and even legal institutions beyond typical hierarchical con-

[15] G Teubner, 'Global *Bukowina*: Legal Pluralism in the World Society' in G Teubner (ed), *Global Law Without a State* (Dartmouth, Aldershot, 1997).

[16] e.g. L Bernstein, 'Private Commercial Law in the Cotton Industry, Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 *Michigan Law Review* 1724.

[17] M Taggart, 'From "Parliamentary Powers" to Privatization: The Chequered History of Delegated Legislation in the Twentieth Century' (2005) 55 *University of Toronto Law Journal* 575.

[18] see H Schepel, *The Constitution of Private Governance* (Oxford, Hart, 2005).

[19] R van Gestel and H-W Micklitz, 'European integration through standardization: How judicial review is breaking down the club house of private standardization bodies' (2013) 50 *Common Market Law Review* 145, 150.

[20] Micklitz, 'The Visible Hand', 55–58; M Cantero Gamito, 'Towards Self-Sufficiency in European Regulatory Private Law: The Case of European Telecommunications Services Law' in H-W Micklitz and Y Svetiev (eds), *Self-Sufficient European regulatory private law: A viable concept?* (2012) EUI Law Working Paper 2012-31, (http://hdl.handle.net/1814/24534).

ceptions. Such fragmentation has been observed both in state public and private law (even long ago[21]) as well as in public international law.[22] Such an outcome might be viewed as the natural result of specialisation of law-making or regulatory activity to tailor it to specific contexts or policy goals.[23] Take the commonly used example of a sports league.[24] Even within the purely domestic domain, there are numerous legal regimes that are relevant to the running of such an endeavour, including contract law for engaging players or other input providers, corporate law for the governance of clubs or leagues, tort law for liability for injuries, specialised provisions of media law as regards the selling of media rights or competition law given the restrictions on competition necessary to run a common league, sell products and distribute revenues. Once we look outwards to international participation, the potential sources multiply as well as the geometries of intersection of rules and institutions. Moreover, the sports leagues themselves draft rules for their governance (domestic and international), that can take different forms, seek to opt out of national private law rules or otherwise modify them to the specific context and the problems it throws up. Such rules can also interfere with public international law rules on trade or human rights.

Fragmentation thus brings into sharp relief the interaction of the different regimes of norms and institutions, sometimes said to possess (or, alternatively, bear the burden of) their own rationalities. As already indicated, one interpretation of the idea of rationality is that legal regimes might possess a degree of unity and coherence. Another interpretation follows from the idea of specialisation, namely that each regime has a set of goals and a set of usual instruments with which to pursue such goals. Just as in economic production, specialisation would suggest an increasing capacity of law-making or enforcement institutions to deal with specific problems within a narrow scope. But one problem of a high degree of specialisation is that it tends to obscure from view the activities of other units highly specialised in other tasks. Since each specialist knows something others do not, specialisation implies "an increased inability to see another person's point of view".[25] A further problem is that high specialisation suggests incapacity to deal with a change in the nature of the problems at hand, either a change in the objectives or the instruments to use. Those who operate in highly specialised regimes might develop habits of thought and action that provide efficient ways of utilising current tools for typical objectives, but they may also be an impediment to innovation or adjustment to new circumstances.

[21] F Wieacker, *A History of Private Law in Europe* (Oxford, Clarendon, 1995) 431.

[22] E.g., M Koskenniemi and P Leino, 'Fragmentation of International Law? Postmodern Anxieties' (2002) 15 *Leiden Journal of International Law* 553.

[23] J Pauwelyn, 'Fragmentation of International Law' in R Wolfrum (ed), *Max Planck Encyclopedia of Public International Law* (Oxford, Oxford University Press, 2012) 1406.

[24] Teubner, 'Global *Bukowina*'; A Duval, '*Lex Sportiva*: A Playground for Transnational Law' (2013) 19 *European Law Journal* 822.

[25] GJ Miller, *Managerial Dilemmas: The Political Economy of Hierarchy* (Cambridge, Cambridge University Press, 1992) 33; also generally A Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 *American Economic Review* 777.

One integrative mode of coping with integration is hierarchy and harmonization, which might be available in the EU setting, if not in many transnational ones.[26] But the interaction of different normative regimes could also be seen through the lenses of conflict and/or choice of rules and institutions to deal with a particular problem.[27] This has revived interest in the discipline of the conflict of laws (or choice of law) even at a conceptual level as a possible way to bring order to a world of plural legalities (or normativities).[28] At least in principle, it seems, a way in which to resolve the problem in the absence of clear hierarchical relationships, is by using the traffic signalisation metaphor in a way that ensures legitimacy. Coherence in such a world need not be substantive, but a softer form may be achieved through the sequencing and complementarity of normative regimes.[29]

In the EU context, such an approach may seem feasible, given the supranational structure that overlays not only the "federal" and different national normative (sub-) orders, but also transnational private ones, which as we said are often used and co-opted into EU law-making and enforcement processes. One way of reconciling supremacy and subsidiarity is for the EU to be viewed as a conflicts regime whereby in the face of collisions choices are made on principled grounds and in a legitimating way so as to "compensate" for the "threat to democracy" inherent in situations where citizens are subject to laws they did not author,[30] which in turn might elide or even merge the constitutional and private law perspectives on European integration.

8.2.3 Conflicts and Choices: Legitimacy and Evaluation

Traditional conflicts law,[31] probably much like the traditional approach in comparative law,[32] is based on an idea of, equality of, and equal respect for, different

[26] Though note the observation that formal harmonization often tends to disguise persistent divergences related to local context. C Knill and A Lenshow, 'Compliance, competition, and communication. Different approaches of European governance and their impact on national institutions' (2005) 48 *Journal of Common Market Studies* 583.

[27] A Fischer-Lescano and G Teubner, 'Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law' (2004) 25 *Michigan Journal of International Law* 999.

[28] e.g. H Muir-Watt, 'Private International Law Beyond the Schism' (2011) 2 *Transnational Legal Theory* 347; J Heymann, 'The Relationship between EU Law and Private International Law Revisited: Of Diagonal Conflicts and the Means to Resolve Them' (2011) 13 *Yearbook of Private International Law* 557.

[29] c.f. F Cafaggi, A Nicita, and U Pagano, 'Law, economics and institutional complexity: An introduction' in F Cafaggi, A Nicita, and U Pagano (eds), *Legal Orderings and Economic Institutions* (London, Routledge, 2007).

[30] C Joerges, P Kjaer and T Ralli, 'A New Type of Conflicts Law as Constitutional Form in the Post-National Constellation' (2011) 2 *Transnational Legal Theory* 153, 154.

[31] HE Yntema, 'The Historic Bases of Private International Law' (1953) 2 *American Journal of Comparative Law* 297, 298 ("assum[ing] a certain cosmopolitan respect, or at least tolerance, for foreign conceptions of justice").

[32] but see R Michaels, 'The functional method of comparative law' in M Reimann and R Zimmermann (eds), *Oxford Handbook of Comparative Law* (Oxford, Oxford University Press, 2006) 342.

legal sources. Such a view was also buttressed by the fact that they emanated from equal sovereigns.[33] Being principally focused on horizontal choice of law, arguably private international law was principally concerned with the legitimacy of the application of legal rules to particular situations: because a particular sovereign State would have been entitled to regulate the conduct, this in turn also makes the choice of law legitimate from the point of view of the parties' expectations as to what constituted legal conduct. Such an approach focuses on identifying the functionally equivalent rules from different jurisdictions and eschews judgments about the quality of the law or the efficacy with which the law achieves its purposes.

Evaluative criteria about the law's purpose and effects however start to be relevant both in conflicts and comparative law for various reasons. In conflicts law, a set of developments originated principally from the US where in the face of substantial market integration leading to a high degree of interdependence and reduced sovereigntist concerns, there was nonetheless continued legal diversity as between the various states. In that context, courts and scholars proposed inquiries into the specific object of legal rules vis-à-vis the conduct involved (the 'governmental interest'[34] a specific rule is meant to promote and whether the conduct falls within that interest), but also evaluations about a rule's efficacy (the 'better law' approach[35]), with a resulting tendency for hybridisation through dépeçage.[36]

In comparative law evaluative criteria beyond doctrinal ones might have been spurred by both the observation of commercial parties in exercise of their contractual autonomy preferring the laws or courts of some jurisdictions to govern their mutual relationships, or even opting for alternative fora such as arbitration to resolve disputes. There is also the parallel, and probably not independent, influence of economics, through the evaluation of the efficiency of individual legal rules[37] and beyond that of entire legal systems or families.[38] This has spurred a substantial critique of the methodologies and approaches that have been used to perform such micro or macro evaluations.[39] For present purposes, a key difficulty to note is the choice of both standard and metric of evaluation. Not only might different communities value efficiency or the growing importance of financial markets differently, but in a fragmented legal landscape, different normative regimes might be pursuing different public goals (if we accept that they are at least to some extent publicly

[33] Yntema, 'Historic Bases', 305.

[34] e.g. B Currie, 'The Constitution and the Choice of Law: Governmental Interests and the Judicial Function' (1958) 26 *University of Chicago Law Review* 9.

[35] e.g. RA Leflar, 'Choice-Influencing Considerations in Conflicts Law' (1966) 41 *New York University Law Review* 267.

[36] W Reese, '*Dépeçage*: A Common Phenomenon in Choice of Law' (1973) 73 *Columbia Law Review* 58.

[37] U Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 14 *International Review of Law and Economics* 3.

[38] e.g. R La Porta, F Lopez-de-Silanes and A Shleifer, 'The economic consequences of legal origin' (2008) 46 *Journal of Economic Literature* 285.

[39] See generally, R Michaels, 'Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law' (2009) 57 *American Journal of Comparative Law* 765.

oriented), which might in some instances either be directly opposed or they might appear incommensurate at least in the short term.

To come back to the issue of dealing with "collisions" in the EU legal landscape, apart from the traditional horizontal legal conflicts, which were the ordinary provenance of private international law, there are also "vertical" conflicts between EU and national rules on the same subject matter.[40] While this might appear to be a question the answer to which depends on who is the competent and/or legitimate rule-maker, the interaction of supremacy and subsidiarity appears to reinterpret legitimacy at least in part through evaluating the extent to which a specific legal instrument at national or EU level achieves commonly identified goals.

Finally, in the so-called "diagonal" conflicts cases, "a national regulation belongs to one field, where the (EU) lacks true legal competence in that field, but where nevertheless the regulation may interfere with European law" such as competition or free movement law.[41] In such diagonal conflicts situations, the problem of the legitimacy/evaluation interaction is exacerbated by the fact that the goals of the different instruments are not identical, even if they bear on the same underlying problem and point to different outcomes in a single case. This brings the spectre of having to prefer some goals (market integration for example) over others (social cohesion or protection of labour rights). As some have argued, given the logic and structure of EU integration and the path-dependent precedential evolution of EU law, such conflicts may ineluctably be decided by preferring the former goals.[42]

There are undoubtedly some cases of diagonal conflicts that can be interpreted as supporting such a systematic preference, there may be others that suggest otherwise and judgments may vary over time.[43] But that probably makes it even more difficult to make pithy evaluations or claims about the logic or rationality of different legal regimes, their legitimacy or efficacy. Beyond a descriptive acknowledgment of legal pluralism and an intuition that it is likely taking us irreversibly in a particular direction, can we make no further headway?

8.3 Three impulses

To return to the original concern of this contribution, we might ask the question whether the ERPL perspective on EU legal integration can assist us in making some headway on the foregoing problems. To answer that question, two lines of inquiry

[40] Joerges et al, 'A New Type of Conflicts', 155.

[41] *ibid*; e.g., CU Schmid, 'Diagonal Competence Conflicts between European Competition Law and National Regulation—A Conflict of Laws Reconstruction of the Dispute on Book Price Fixing' (2000) 8 *European Review of Private Law* 155.

[42] F Scharpf, 'The asymmetry of European integration, or why the EU cannot be a "social market economy"?' (2010) 8 *Socio-Economic Review* 211.

[43] Eg, A Stone Sweet and TL Brunell, 'Trustee Courts and the Judicialization of International Regimes' (2013) 1 *Journal of Law and Courts* 61.

might be useful, including first exploring the impulses behind this perspective and subsequently identifying what ERPL could provide as normative design models for European private law.

Beginning with the impulses behind the ERPL perspective, I wish to highlight at least three. Again, I reiterate that these views are offered to some extent as an outsider or at least latecomer, and to that extent they ought to be taken with a few grains of salt, even if an outside perspective can often be useful for clarification purposes.

The first (in light of the 'private law' focus) might be described as an impulse towards a bottom up view of EU legal integration, including an interest in how it affects actors in managing their affairs, structuring relationships and resolving problems and disputes. This may even be seen as a Hayekian impulse, favouring an approach that sometimes gets obscured in the top-down inter-institutional focus that EU lawyers typically adopt. It is Hayekian in its bottom-up focus and its emphasis on the importance of tacit local knowledge as encoded in local law, rather than due to a faith in the price mechanism as a mechanism for economic or social organisation. In fact, it seems that this impulse is simultaneously coupled with some degree of agnosticism as between liberal and paternalist views of individual actors and their proper relationship with the state.[44]

A second impulse appears to stem from scepticism towards the untested claims of specialist communities that their tools work well and are effective, even the most effective (and perhaps no less legitimate than others), at achieving the public policy objectives assigned to them explicitly or implicitly. Thus, EU lawyers and officials might become accustomed to think that EU action is necessary for the achievement of integration goals and moreover that such action also promotes other aspects of the public good. Similarly, national private lawyers might view EU interventions as intrusions that disrupt a coherent legal regime that works well within its ambit.[45] Self-regulatory or standard-setting bodies might also harbour similar views, independent of any evidence about the effects of their activities.[46] This is yet another version of a familiar blending of means and ends, whereby the means of action for specialised groups—sometimes even imperceptibly—become final goals supported by a black-box theory of a link to the various dimensions of the public interest that we truly care for.[47] By way of a minor digression, given that legal or regulatory regimes generally have not developed means for evaluating their own contribution to the public good, one important challenge for ERPL as a scholarly effort is whether or not a socio-legal method focused on in-depth study of individual instantiations

[44] see S Frerichs, 'False Promises? A Sociological Critique of the Behavioural Turn in Law and Economics' (2011) 34 *Journal of Consumer Policy* 289.

[45] Y Svetiev, 'W(h)ither private law in face of the regulatory deluge' in Micklitz and Svetiev (eds), *Self-Sufficient European regulatory private law*.

[46] van Gestel and Micklitz, 'European Integration through Standardisation', 149 f.; B van Leeuwen, 'European Standardisation in Healthcare: Towards Convergence Through Self-Regulation' in Micklitz and Svetiev (eds), *Self-Sufficient European regulatory private law*.

[47] Compare C Lindblom, 'The Science of "Muddling Through"' (1959) 19 *Public Administration Review* 79.

can provide the kind of evidence needed for evaluation. One risk is that the evidence would be insufficient or inconclusive, with the possible tendency to slip into over-emphasis of traditional conceptions of legitimacy as promoted by traditional instruments.

A third impulse could even be characterised as a sentimental or nostalgic one, rooted in a belief of the continued relevance of both law as an instrument and national private law as its specific embodiment or institution. This impulse is animated further by the idea of embededdness of law into national legal or societal cultures.[48] After all, often enough we all fall prey to the givens of the communities that have given shape to who we are, personally or scientifically. To some extent, such an impulse is faced with the difficulty of the state's intervention in law-making for its own specific objectives, often divorcing law wholly from the forces of societal self-organization.[49] Nonetheless, perhaps the intuition is that there are some underlying values, even shared ideas of justice, that shape not only national culture and legal culture, but also the modalities of state-building[50] and law-making. If such varieties exist, they should be taken into account in any process of legal integration or scholarly effort to understand and evaluate it. There is a further claim associated with this impulse, namely that there may be some value in retention of such diversity. It is not clear, and remains a true open question, whether such diversity is valuable to be preserved in and of itself or whether it is also valuable for the promotion of some other goals of the public interest.[51]

8.4 The Shape of ERPL

If I am right so far in the identification of the problems and the driving impulses behind the ERPL perspective on European legal integration, one remaining question is precisely the one of the normative design of European private law. In particular, in the remainder of the essay I offer some observations about the shape that ERPL might take as a normative order of EU integration in its private law dimension.

For this purpose, a useful departure point might be the conflicts perspective on EU legal integration, as supplemented and to some extent even inspired by systems theoretic contributions on transnational private law. In particular, this perspective allows us to paint a much richer picture of the landscape, including about the possible reasons and effects of the differentiation (or specialisation) of

[48] H-W Micklitz, 'The Unsystematics of a European legal culture' in G Helleringer and K Purnhagen (eds), *Towards a European Legal Culture* (Oxford, Hart, forthcoming).

[49] c.f. J Cohen and C Sabel, 'Extra Republicam Nulla Justitia?' (2005) 34 *Philosophy and Public Affairs* 147, 149.

[50] e.g. S Steinmo, *The Evolution of Modern States: Sweden, Japan and the United States* (Cambridge, Cambridge University Press, 2010).

[51] but see C Sabel and J Zeitlin, 'Learning from difference: The new architecture of experimentalist governance in the EU' (2008) 14 *European Law Journal* 271.

normative regimes and their reliance on new institutional forms. An open question that seems to be at the bottom of much scholarly inquiry, which is also captured in the conflicts perspective, is precisely that of the mutual interaction of different normative regimes and, for our purposes, the role—if any—of EU law in managing or guiding that interaction.

From the traditional private international law perspective, the identification of a "conflict" of laws leads to the need for making a "choice" of the applicable law on the basis of principled criteria (desirably *ex ante*, even if in reality typically *ex post*). Thus one model for the shape of ERPL is as a choice of law and/or institution regime. Note however that, as already indicated, the traditional private international law focus is on functionally equivalent legal rules of different jurisdictions and the legitimate selection of a rule from the perspective of both the sovereigns and the parties involved. But in the setting of horizontal, vertical and diagonal conflicts between EU, Member State public, semi-public and purely private normative regimes, each with their own rationalities (here interpreted as combinations of goals and habitually-relied upon instruments for achieving them), a pure focus on "choice" may necessarily entail a preference for some aspects of the public good over others. In the judicially-propelled precedent-driven process of integration, as Scharpf has suggested, such preference may tend to become encrusted and stable, encoded into the DNA of the integration process. Such persistently propagated preference of some policy goals might ultimately undermine the very foundations of the process of integration, to the extent that the relevant communities also value other goals (or conceptions of justice even).

An alternative response might be for EU law to seek to be the promoter of formal legitimacy for various norm-making, norm-enforcing or dispute resolution regimes so as to ensure that different publicly-oriented perspectives are better represented within them. We may already be able to identify some efforts in that direction on the part of the EU institutions, including EU rules on the creation of independent national sectoral regulatory authorities,[52] or recently promulgated EU legislative solutions for alternative dispute resolution and online dispute resolution schemes[53] or for the elaboration of an EU approach to standard setting.[54] Such efforts might be salutary, but may fall short of their promise for a number of different reasons. First, this is because formal legitimacy does not necessarily entail empirical legitimacy in the sense of wider social acceptance of a practice.[55] This reflects the fact that it is possible for formally or procedurally proper processes or decisions to nonetheless disguise substantial imbalances in input and access. Secondly, strengthening procedural formalities does not necessarily guarantee that regimes will be effective

[52] see SACM Lavrijssen and AT Ottow, 'Independent Supervisory Authorities: a Fragile Concept' (2012) 39 *Legal Issues of Economic Integration* 419.

[53] Dir 2013/11/EU on alternative dispute resolution for consumer disputes (Directive on consumer ADR); Reg (EU) No 524/2013 on online dispute resolution for consumer disputes (Regulation on consumer ODR).

[54] Reg (EU) No 1025/2012 on European standardisation.

[55] J Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2403, 2468.

in pursuing their mandate. Finally, and particularly important for present purposes, strengthening procedural formality requirements does not provide a normative model of interaction between different normative orders and institutions and might even strengthen their differentiation or self-sufficiency.

A yet further conception of a normative model of EU legal integration, and the last one that I consider here, is a more integrative one, perhaps reflecting the intuition of the original codification exercises: to identify commonalities (to use a relatively neutral term) that might supply the backbone of an effort of legal consolidation.

The most ambitious and all-encompassing version of an integrative model would be the idea of codification of EU private law, in a way that both consolidates and makes coherent its various sources (both autonomy promoting and instrumentalist). Thus, in the face of CJEU caselaw which appears to sacrifice the public interest of justice between the parties to the public interest of EU integration,[56] Schmid suggests that an all-encompassing code would "almost inevitably have to follow the European tradition" of a "justice-oriented non-instrumental private law". The potential to integrate various dimensions of the public interest in a code that incorporates not only the instrumentalist rules of current EU private law, but also puts "autonomy and solidarity" as core private law principles on equal footing as market integration, would be further enhanced by committing such a code to the new EU fundamental rights charter.[57] The desirable result would be to deliver rules, principles and practices that balance as between these various worthy public goals, currently ambient in various normative orders.

There are some obvious reasons for caution, which have been explored at length elsewhere. It adds nothing new to the debate to say that such a task seems quite daunting both from a practical and from a conceptual point of view. From a practical point of view, it is quite doubtful that the profound normative diversity can be subsumed under a single roof, unless this is to be a mere collection and pruning exercise (as is the case with the so called "US Code" for example), which does not seem to be not what proponents envisage.[58] Even more fundamentally, the diversity of goals and instruments make this task conceptually daunting as well. As Wilhelmsson points out, there can even be different views about what the best market-promoting private law measures are. If we expand the view also to interventions that are meant to pursue different substantive welfare ideals, "there is no coherent system of values behind the present welfarism of the contract laws of the EC and

[56] CU Schmid, 'The Instrumentalist Conception of the *Acquis Communautaire* in Consumer Law and its Implications on a European Contract Law Code' (2005) 1 *European Review of Contract Law* 211, 225 ("the *effet utile* of market integration is placed above all—including above justice among the parties").

[57] *ibid* 225 f.

[58] Given the dynamism of normative change in many of the relevant law-producing settings, it seems even mere collection and pruning would be quite difficult, if not meaningless.

the Member States" nor is it in his view "possible to combine the varieties of welfarism" in one coherent whole at one point in time, let alone over time.[59]

Interestingly, we see that in the practical instantiations of such codification attempts, both academics and law-makers immediately strive to carve off separate chunks of the problem so as to make it practically more manageable and perhaps also to cabin off protests from different specialised communities with vested interests in their existing instruments. The proposed sales instrument as the only concrete output so far on the table,[60] given its optional nature, only adds to the fragmentation rather than achieving consolidation or integration. By itself, this is neither here nor there, but unless such an instrument carries other benefits[61] the mere fact that it increases legal complexity seems to be a negative.

An integrative model of fragmented normativities and resulting conflicts that is neither mere choice of law nor codification might be that of a platform. The concept of a platform is used both in technology and in economics[62] and is proposed here in the rather ecumenical sense of a mechanism that creates value by bringing together and allowing for the interaction of various relatively separate units, without purporting to encompass or unify them under a common roof. A platform solution might allow the different normative orders to exist separately, while at the same time providing for mutual interaction in a way that, on an optimistic scenario, promotes various dimensions of the public interest, while also controlling some of the dysfunctions that can arise within relatively isolated specialised groups. Given this rather functional conception, it is little surprise that such a platform can have different kinds of practical instantiations. In light of the exploratory nature of this essay, I suggest three examples that offer possible prototypes for such platform integration, to identify circumstances that give rise to them, as well as canvass some possible advantages and problems. I do not suggest that this is an exhaustive menu and acknowledge that there are probably others not canvassed here. Nor do I propose to express a preference for any one of these prototypes, not least because it is quite likely that different types of integrative platforms could subsist at any one time in different contexts.

[59] T Wilhelmsson, 'Varieties of Welfarism in European Contract Law' (2004) 10 *European Law Journal* 712, 732 f. Both national and sectoral variability is a relevant obstacle. To take an example at random, tenants might require very different contractual protections depending on the current state of the housing market and leasing practices typical in different settings.

[60] Proposal for a Regulation on a Common European Sales Law, COM(2011) 635 final.

[61] e.g. S Grundmann and W Kerber, 'An Optional European Contract Law Code—Advantages and disadvantages' (2005) 21 *European Journal of Law and Economics* 215.

[62] A Hagiu and J Wright, 'Multi-Sided Platforms' (2011) *HBS Working Paper* 12-024 http://www.hbs.edu/faculty/Publication%20Files/12-024.pdf.

8.4.1 Judicial Platforms: Mutual Monitoring

The first example is that of a judicial platform which is quite familiar to EU lawyers and made possible by the fact that the various judicial regimes (national and EU) are structured hierarchically with the apex court in each regime sometimes declaring to be the master of their own domain having the right to review even the actions of other apex courts.[63] This has produced the famous "so long as" formula of the German Bundesverfassungsgericht from the *Solange* line of cases[64] for the avoidance (or management) of possible conflicts with the EU legal order whereby one normative regime invites another one to consider and promote values (or dimensions of the public interest) that the first one is tasked with or holds particularly dear, but which may otherwise be sacrificed by the pursuit of other (also worthy) goals by the second normative order. The formulation "I will defer to your decisions in pursuit of goal X (e.g., market integration), so long as at the same time you do not sacrifice goal Y (e.g., fundamental rights)", has the advantage of allowing deliberative interaction over time between the two orders through mutual monitoring, a model that could be extended to other contexts. EU integration is the platform that creates the mutual interdependence between the two normative orders, which in turn means that they cannot simply ignore each other and thus might engage in mutual monitoring and even conversation that could result in an "overlapping consensus" in the promotion of relevant shared goals of public policy.[65]

The foregoing description both suggests some conditions that may be necessary for such interaction between two orders to take place as well as possible concerns and limitations. For this type of mutual monitoring platform to emerge, one condition seems to be that a body which is part of one normative order can credibly threaten to interfere or interrupt the activities of another legal order if a particular objective is sacrificed, yet at the same time it seems that there also needs to be some uncertainty as to its ability to interfere effectively. Thus, a court which sits at the top of the judicial hierarchy within its own domain, such as the Bundesverfassungsgericht or the EU judiciary in cases like *Solange* or *Kadi*, could make such a threat vis-à-vis normative orders to which they were not in a clear hierarchical relationship, even if the efficacy of such a volley is quite uncertain. The absence of a clear hierarchical relationship between the orders is what may ensure that one normative order will neither be able nor tempted to simply assign the promotion of all dimensions of the public interest to itself and will pay due respect to the specialisation of the other normative order. Where a public authority delegates a task to a private standard-setting organisation, this condition may not be satisfied: the

[63] De Búrca, 'The ECJ and the International Legal Order', 43 f.

[64] BVerfG, 29/5/1974, 37 *Entscheidungen des Bundesverfassungsgerichts* 271; BVerfG, 22/10/1986, 73 *Entscheidungen des Bundesverfassungsgerichts* 339.

[65] CF Sabel and O Gerstenberg, 'Constitutionalising an Overlapping Consensus: The ECJ and the Emergence of a Coordinate Constitutional Order' (2010) 16 *European Law Journal* 511.

public authority would at least formally be able to take over the task and even if it is not capable of performing the task itself, it might at least be tempted to do so.[66]

In addition, a potential limitation stems from constraints on the efficacy of the monitoring regime due to two related considerations, including (i) the type of right or public goal that is to be protected, and (ii) the infrastructure and capacity of the relevant bodies to monitor each other's activities *and* their effects on different goals. Thus in the standard cases in which such formulations arose, the nature of the public goal to be protected were fundamental rights defined principally by their procedural character, so that whether the goal was promoted or not could to a large extent be determined on a case-by-case basis and a simple observation of the case file. There are many types of public goals, namely ones which entail substantive positive obligations of action, such as the promotion of competition or the sustainable exploitation of energy resources, where case by case monitoring is inadequate precisely because even if there is a restriction (say on competition) in a single case, it might be necessary to promote another goal (say sustainable energy use or technology interoperability). Yet the restriction might be implemented and adjusted over time in a way that ameliorates the initial restriction on competition. To validate such claims, however, may require a more elaborate monitoring infrastructure, particularly compared to what courts are ordinarily equipped with.[67]

8.4.2 Agency Platforms: Reflexivity or Merger

A second model for the platform integration of normative orders that promote different aspects of the public interest would be to exploit the EU push for the establishment of independent regulatory agencies. Such agencies are themselves specialised in certain sectors or tasks, but they could also build more elaborate and flexible mechanisms for interaction with other relevant actors, as well as for monitoring within their domain of expertise. Thus, Brousseau and Glachant have envisaged the work of regulatory agencies as "reflexive governance platforms",[68] allowing for the continuous interaction of relevant stakeholders to a specific regulatory problem, in a way which might promote different policy goals. In network industries such goals could include competition and access, consumer protection, universal service,

[66] See for example the relationship between the Dutch competition authority and the Dutch Association of Travel Agents and Tour Operators (ANVR). NMa, Dutch travel trade association must amend its General Agency Conditions (1 May, 2012).

[67] see B Kas, 'Reshaping the Boundaries of the Enforcement of European Social Regulation: Unitas in Diversitate—the Construction of a Hybrid Relationship' (in particular the reconstruction of the case of C-237/07 *Janecek v Freistaat Bayern* [2008] ECR I-6221); Guido Comparato, 'Behind Judicial Resistance to European Private Law', both in Micklitz and Svetiev (eds), *Self-Sufficient European regulatory private law: A viable concept?*

[68] E Brousseau and JM Glachant, 'Regulators as Reflexive Governance Platforms' (2011) 12 *Competition and Regulation in Network Industries* 194.

investment in infrastructure, environmental protection and so on. Thus, because the "relevant information and knowledge are dispersed and permanently evolving, regulators have to organize fora in which the stakeholders have incentives to reveal information".[69] The model for such reflexive governance platforms appear to be the Florence Electricity Forum and the Madrid Gas Forum, which were created as mechanisms that "permit and indeed encourage industry input into the legal architecture."[70] They are precisely aimed at bringing together various market participants, including associations of transmission operators, producers, consumers, users, traders so as to shape legal measures and regulatory action.[71]

Again, without proposing to fully evaluate such an approach of integrating specialised regimes, I mention three immediate potential concerns. First, to the extent that this model is built on the quasi-corporatist principle of representation, it faces the usual problem of determining the adequate level and diversity of representation, including by less well-resourced or organised actors and associations.[72] Secondly, to the extent that the model depends on repeated interactions between the same organisations and individuals, for the purpose of building shared perspectives on the underlying problems and an epistemic community, it leads to concerns about scrutability and capture. To take just one example, it might be easy for all participating actors to come to share the view that it is precisely the fact that they are shielded from public scrutiny that enables frank and open discussion and sharing of views that promotes an environment of reflexivity.[73] Such a view could be buttressed by a distinct position that discussions involve sensitive commercial information of private operators in an industry, furthering a bias against scrutiny and openness.[74] Repeated behind closed doors informal interactions[75] could produce stability, shared perspectives, and a cohesive if reflexive epistemic community, but given its inscrutability, its activities in the creation and enforcement of norms would both be vulnerable to capture and very difficult to evaluate.

Another form of integration of different dimensions of public policy implemented by administrative agencies has been observed in some EU Member States, through the merger of different if allied policy mandates under the single roof of

[69] Ibid.

[70] P Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (Oxford, Oxford University Press, 2007) 101.

[71] Ibid, 102.

[72] E Bohne, 'Conflicts between national regulatory cultures and EU energy regulations' (2011) 19 *Utilities Policy* 255, 260, 264 (regulatory complexity itself can foreclose participation by certain groups).

[73] Ibid, 265 f.

[74] The mere presence of public authorities does not in itself guarantee that an alternative attitude to transparency would prevail. E.g., CJEU, judgment of 6/6/2013, Case C-536/11 *Bundeswettbewerbsbehörde v Donau Chemie AG*, not yet reported.

[75] Bohne, 'Conflicts between national regulatory cultures', 264 f., highlights the importance of informal negotiations in the energy sector.

one agency as opposed to the more usual sectoral models of specialised agencies.[76] Germany, for instance, always relied on an integrated agency, the Bundesnetzagentur, for the regulation of the networked industries, including electricity and gas, telecommunications, post and rail. More recently, the Netherlands has undertaken a prominent merger of its communications, consumer and competition authorities[77] (with the latter already having the responsibility for the energy market) into the new Dutch Authority for Consumers and Markets (ACM), with Spain and other EU Member States apparently undergoing or considering similar agency mergers.

Such mergers could offer various possibilities for reinforcement across different policy mandates, including their private law and regulatory dimensions.[78] Thus, to the extent that consumer and competition law are both transversal policies and are both concerned with the interest of consumers as market participants, merging the authorities could enable them to exploit policy complementarities. Agency mergers across sectors or mandates might also enable different agencies to disrupt their habits as to how they typically employ their usual instruments of implementation or how they define their goals, as well as to try new instruments or even reformulate their goals. At least with respect to the Dutch merger, it seems that an explicit goal of the process was to produce cross-fertilisation, as well as disruption of policy habits and cultures in a way that might lead to institutional and policy innovation.[79]

One risk of such an attempt at integration is that it occurs only formally, while the different component parts of the new institution continue to focus on narrowly defined policy mandates through habitual patterns of decision-making and analysis.[80] A more significant risk is that given the mode of integration or the organisational and personnel make-up of the new institution, one policy mandate becomes dominant, in the sense that the others become subordinate to it. Thus, for instance, consumer welfare may be pursued exclusively through the promotion of the typical intermediate goals of competition or liberalisation, without the more active mandatory tools that might otherwise be used by a consumer agency. In a recent case, the Dutch ACM investigated a decision of the trade association of the Dutch energy industry, Energie Nederlandplan to close down coal power plants built in the 1980s, made in conjunction with a broader accord (SER Energieakkoord) of the Social and Economic Council of the Netherlands, including "employers' associations, unions, environmental organizations, central, regional and local government, and other so-

[76] AT Ottow, *Erosion or Innovation? The Institutional Design of Competition Agencies—A Dutch Case Study* (unpublished manuscript, 2013).

[77] A move that apparently was contrary to the experts' advice offered to the Dutch Ministry. K Yesilkagit, 'To Merge or Not to Merge: The Institutional Re-design of Telecoms Regulation in the Netherlands' in D Aubin and K Verhoest (eds), *Multilevel Regulation in Telecommunications: Adaptive Regulatory Arrangements in Belgium, Ireland, the Netherlands, and Switzerland* (Palgrave Macmillan, Basingstoke, forthcoming).

[78] c.f. Y Svetiev, 'Antitrust Law and Development Policy: Subordination, Self-Sufficiency or Integration?' (2013) 4 *European Yearbook of International Economic Law* 223.

[79] Ottow, 'Erosion or Innovation'.

[80] DA Hyman and WE Kovacic, 'Competition Agencies with Complex Policy Portfolios; Divide or Conquer?' (2013) *GWU Law School Public Law Research Paper* No 2012-70 http://ssrn.com/abstract=2110351.

cial organizations" aiming to make the supply of energy more sustainable.[81] The ACM came to the conclusion that the association agreement was contrary to Dutch and EU competition law, based on its assessment that on balance it harms consumers, and offers too few environmental benefits.[82]

My aim again is not to examine the merits of such cases or the approach of the ACM in making such an assessment. It is simply to highlight the possibility that a unification of mandates could result in subordination of policy goals and instruments. In many instances, looking at a problem in a single case instance can involve a trade-off between goals such as competition or access versus energy sustainability or consumer protection. There may be different ways to achieve alternative public goals that do not involve a restriction of competition, such as through public financing or legislation instead of a private association agreement, but one might question whether a markets authority is capable of evaluating them or the likelihood that they would be adopted or that they would be even more restrictive of competition. Moreover, the implementation of a planned action or an association standard over time can oftentimes be shaped in a way that minimises anticompetitive or exclusionary effects. At the same time, an integrated authority is more likely to have the monitoring and adjustment capacities that could ensure the achievement of synergies as opposed to mere trade-offs in policy mandates.

8.4.3 Problem-based Platforms

The final model for ERPL as an integrative platform is neither purely judicial nor purely administrative, but problem-based. An example comes from the growing use by the European Commission and national competition authorities of a contractual tool for resolving cases[83] through negotiated remedies with undertakings *pace* the competition law rules and precedents.[84] While typically this tool is interpreted as a settlement agreement between authority and defendant,[85] an alternative view is that it provides a platform that can take into account various policy goals that are at issue in the underlying problem, including access, consumer protection, innova-

[81] Analysis by the Netherlands Authority for Consumers and Markets (ACM) of the planned agreement on closing down coal power plants from the 1980s as part of the Social and Economic Council of the Netherlands' SER Energieakkoord.

[82] see also above n. 66.

[83] Thus, it may be viewed as an example of 'regulatory private law' in its instruments, as well as its goals.

[84] In fact, the tool has been frequently used in the context of private standard-setting efforts, including sports leagues and technology standard-setting. S Rab et al, 'Commitments in EU Competition Cases' (2010) 1 *Journal of European Competition Law and Practice* 171, 176–180.

[85] e.g. F Wagner-von Papp, 'Best and Even Better Practices in Commitment Procedures After *Alrosa*: The Dangers of Abandoning the "Struggle for Competition Law"' (2012) 49 *Common Market Law Review* 929.

tion or even environmental goals.[86] As such, it can also provide a platform to brings together various specialisations that could ensure both the intervention's efficacy along various public interest dimensions and its accountability. Before the implementation of the negotiated remedies, both third parties[87] and national competition authorities[88] are given an opportunity to provide input on the proposed remedies. Following the formal decision, such a mechanism allows further opportunities for institutional innovation in the monitoring of implementation, where both private expert monitors but also national sectoral authorities have been used.[89]

Again the foregoing is just one example that provides a possible platform format. The fact that it also comes from competition law is not meant to privilege a particular perspective, but it is likely also not accidental. Like traditional private law, competition law is transversal (as it applies across sectors), and yet in the EU the view that it has heterodox goals and can be used to advance various aspects of the public interest is part of the law's DNA[90] and continues to hold sway.[91] As with the other examples, I avoid an attempt at a complete evaluation of the merits of this tool as a platform model. The literature points to numerous potential concerns about the use of such mechanisms, which must be carefully considered. One such concern is about the abandonment of the "struggle for law"[92], even if it is possible to view this practice as a source of remedial law rather than a law of prohibitions.[93] Compared to the other prototypes, it may offer more scope for institutional innovation precisely because different problems may call for different specialties and this platform format avoids both the stability of the merged agency and the repeated interactions that may be inherent in the "reflexive governance" forum.

8.5 Conclusion

As is now generally recognised, the plurality of normative orders is not necessarily a new phenomenon, though it was perhaps somewhat obscured from view by a dominant focus on State-law and legal institutions.[94] It is little surprise then that such a perspective has also come to be prevalent in EU law scholarship, focusing

[86] Y Svetiev, 'Settling or Learning Through Commitments?', *EUI Law Working Paper* (forthcoming).

[87] See Art 27(4) of Reg 1/2003 (publication for market testing).

[88] See Art 14(1) of Reg 1/2003 (review of decisions by the Advisory Committee on Restrictive Practices and Dominant Positions).

[89] COMP/39.386– Contrats Long Terme France (EDF) (17.03.2010) par. 51.

[90] See Art 101(3) TFEU.

[91] e.g. M Motta, *Competition Policy* (Cambridge, Cambridge University Press, 2004) 15–17.

[92] see Wagner-von Papp, 'Best and Even Better'.

[93] Svetiev, 'Settling or Learning'.

[94] E.g., B Tamanaha, 'Understanding Legal Pluralism: Past to Present, Local to Global' (2008) 30 *Sydney Law Review* 375.

on EU legal instruments and emanations in the form of regulations or directives, or doctrinal innovations for the interaction of EU and national law, such as supremacy and direct effect. Due to valuable contributions of many scholars, increasing attention has been paid to the bottom up perspective on EU integration, including its private law dimension, revealing perhaps unsurprisingly that there can also be a diversity of bottom-up perspectives. Relying on the contribution of the conflicts perspective on EU integration, one way to represent the fragmentation of legal orders is through the lens of specialisation and in particular the narrowing of goals as well as the usual instruments (including institutions) for the achievement of such goals. As such, even in the absence of complete rationalities or coherence, different normative orders might develop habitual ways to pursue seemingly well-defined goals. We might say that they pursue different aspects or dimensions of the public interest, even if at the same time they may be subject to blind spots or path-dependent suboptimal trajectories or overt capture.

Yet even cases where we might identify conflicts between normative orders in the 'true conflicts' sense—so that they seem to point to different outcomes in a specific instance—such conflicts can be handled either through choice or some attempt at integration. Choice privileges a particular perspective, and given some legal, structural or institutional constraints, that perspective may become systematically privileged within a transnational legal integration regime, which can lead to both efficacy and legitimacy concerns. A more integrative conception for European Regulatory Private Law is as platform law, which seeks to bring together various normativities and the dimension of the public interest that they habitually pursue, while at the same time allowing for instrument innovation via blending, hybridisation or even the outright borrowing of instruments from one realm into another. The essay offers some examples from somewhat disparate areas that can provide avenues for the pursuit of consilience –even across perspectives—and that seem to have arisen precisely out of the structures or interactions created by EU integration (at the very least EU integration may both have hastened their creation and provided the infrastructure for their realisation[95]). While some possible advantages and concerns of each of these models have been canvassed, I leave the full evaluation of their promise or viability as the question for another day.

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[95] c.f. L Azoulai 'The Court of Justice and the Social Market Economy. The emergence of an ideal and the conditions for its realization' (2009) 45 *Common Market Review* 1335.

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Chapter 9
On Law and Sorrow

Joseph H.H. Weiler

Abstract The distinction between law and spirit has had an enduring impact in Western culture, where the law, whatever virtues it may or may not have, however necessary it may be for order or even justice, is perceived as 'cold' and in tension with the warmth of love and mercy, oblivious to sorrow and pain. I will shine some light on the edges and interconnections of these distinctions by putting them into the context by contrasting the religious law on mourning with the actual spirit of sorrow.

The attitude and teaching of Paul on the 'law' are complex, in the eyes of some contradictory and still the subject of scholarly disagreement. And yet in a myriad of ways and places he introduces a fundamental distinction between law and spirit, law and grace, law and righteousness, and most poignantly between the '…tablets of stone' and 'tablets of flesh, that is, of the heart'. (2 Cor 3:3)

This distinction has had an enduring impact in Western culture where the law, whatever virtues it may or may not have, however necessary it may be for order or even justice, is perceived as 'cold' and in tension with the warmth of love and mercy, oblivious to sorrow and pain.

Judaism is correctly perceived as a religion in which the law, Nomos, plays a huge even constitutive role. In Rabbinic Judaism, which developed alongside Christianity, the enduring presence of God is to be found through Nomos, his Law. In many ways the Pauline message is an offer of an alternative to this legalistic way of understanding the relationship of God to and with humans.

Nowhere is the seeming tension between the cold tablets of stone and the tablets of flesh, the heart, more apparent in the way Rabbinic Judaism deals with death and bereavement. As in so many other areas, the response to the shock of death and the subsequent loss and pain are laden with a formidable matrix of law and custom. When to mourn, who is to mourn, who is to be mourned, how long to mourn, indeed, how to mourn are all minutely regulated by law.

Here is a sample of some of the laws and customs of bereavement and mourning.

The paradigm for bereavement and mourning is that of children whose parents had died. Burial is to follow swiftly after death, ideally on the day of death. The bereaved rend their garments and the funeral, as will be explained below, is swift and

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_9,

austere. However, full mourning may only begin after the burial. In the first seven days, the bereaved 'sit' at home, on the floor or close to the floor. Food is brought in. Various customs of mourning are observed such as not shaving, abstaining from intimacy, washing in tepid water, not changing ones clothes, abstaining from wearing leather shoes and the like. There is a duty to make within those seven days condolence visits to the bereaved and there are prescribed forms of offering condolences. Forms of greeting are prescribed as are forms of departure. Certain expressions are forbidden. Work is forbidden. After seven days the mourners 'rise' but until the end of the first 30 days several of the customs of mourning remain, including visible signs such as non-shaving for men. Children are expected to recite the Kadish (a prayer for the dead) for their parents three times a day in the presence of a community of at least ten. This duty endures for the year of mourning. During that year of mourning certain festive activities are proscribed. Mourning ends 11 months after the death after which special prayers will be said once a year on the day of the death.

It is hard to imagine a sharper, more poignant example of the two types of tablets, cold and formal rules—one suit fits all, oblivious to the contingency of emotions, pain and sorrow, the tenderness of the heart.

My interest here, I should emphasize, is not to 'defend' these practices and the world view they represent—it is certainly not everyone's cup of tea. I am, instead, interested in illustrating two interlinked notions. One, relating to the content of the legal matrix, is to show that what at first blush might appear to be dry, or empty, or 'formal' or even arbitrary ritualistic rules represent in fact psychologically and sociologically a fairly sophisticated and sensitive approach to the drama of death. The second, at the meta level, is to reflect in similar fashion not on the specific content of the legal matrix but on the fact of using law, and so much of it, in this circumstance. The two notions are interlinked and my treatment will enmesh them together.

I first want to set out what I consider as four important teloi of the elaborate legal matrix surrounding death, burial and mourning. The law is designed to mediate a complex quadrality of desiderata which in an ideal world would not only all be attained but would naturally cohere. But we do not live in an ideal world and a hallmark of Jewish law is precisely that—it caters for the world we actually live in with all its flaws and for human beings as we know them, imperfect and invariably falling short of their professed ideals. Above all it caters for a world of complexity with conflicting and contradictory expectations and desires, demands and values.

What are these desiderata?

Honoring the Deceased What is meant by this is not the kind of honor which may or may not be bestowed on an individual in longer or shorter eulogies as a reflection of the respect (and affection) earned during his or her lifetime. It is, instead, a reflection at the moment of death of the essential and inherent dignity of each and every living individual as such, a unique human being created in the image of his or her Creator. Folded into this is the fundamental equality which inheres in that status. It is, if you wish, an extension to the moment of passing of that most fundamental of 'rights', the inviolability of human dignity. At its simplest this could be understood as standing for the proposition that the dignity of the living may be compromised if denigrated

at death. But one does not have to adopt any belief in life-after-death to accept that at least the identity of an individual transcends his or her physical existence and that the dignity of that identity might well be compromised even after death.

The Gravity of Death Related, but yet distinct, is the desideratum of acknowledging the gravity of death as a signal non-trivial moment of the human condition. Death is never trivial in this account and should never be treated as such. It is not simply, though it is this too, a reflection that birth and life are not trivial and may not be treated as such. The gravity of death is a reflection of the very ontology of the human condition. To be human means we are destined to die. We will no longer exist in this world as living volitional beings. Marking the gravity of death is, on this reading, an act of important self-recognition and humility of who and what we are.

Attending to the Psychological Condition (and needs) of the Bereaved and Others Death can, and often does, leave survivors—typically family and other loved ones—in a state of distress, sorrow and sadness. When death of a loved one is untimely through, say, accident or violence rather than old age, it can be traumatic. Losing one's parents or siblings disrupts what is often a fundamental relationship and anchor in one's life. Losing a child turns the world on its head. One may, cognitively and philosophically, understand the inevitability of death yet psychologically find it difficult to accept. For the living it is often hard to recover from 'death' of a beloved one.

A concomitant set of feelings is often experienced by the friends of the bereaved who understandably wish to console and comfort the bereaved, the form for which, however, is not always 'natural'. For many it is far easier to express (sincerely or otherwise) feelings of congratulations in moments of happiness and joy than it is to express condolences in the face of fatal loss. The same kind of contrast between the cognitive and the experiential is present for those faced by the bereavement of others.

Sorrow and sense of loss do not exhaust, even minimally, the kind of emotional reaction which death can evoke. Even the death of close ones is often accompanied by feelings ranging from relief to satisfaction and even glee. One cannot at times control such feelings and, consequently, they are often associated with varying degrees of guilt which complicate even further the emotional, behavioural and normative challenge to those affected directly or indirectly by the death.

Family, Community Jewish law and civilization assumes (at times even oppressively according to modern sensibilities) the embeddedness of the individual in family and (Jewish) community. The two are inextricably linked: Upon birth it is the duty of parents through the ceremony of circumcision of boys, and in recent times naming of girls, to introduce the newly born into the Covenant. Family and (covenantal) community are thus inextricably linked and mark the notion of life itself—they give it its teleological meaning as well as the expectation of its sociological meaning. It should not surprise us that the same metaphysics will attend death. Man and woman die as part of family and community. In this worldview, man and woman are never quite alone—for good and for bad.

Some of what I have stated is recognizable in other cultures, especially those associated with communitarian world views, religious and otherwise. What is distinct is that dealing and mediating these complex values and emotions is achieved through a dense matrix of laws and customs a sample of which I outlined above.

Let me start with that interesting period between death and burial—which I find emblematic. The rule forbids the bereaved family member to begin his or her full mourning until after the burial has taken place, forbids condolence visits et cetera. A rule such as this may indeed appear both inhuman and unrealistic. What could be the aim and effect of such a rule?

At the meta-level it is a sharp reminder of one of the defining traits of *homo religiosus*, the Kantian/non-Kantian interplay of autonomy and heteronomy. Homo religiosus is Kantian in that in exercise of free will he or she accepts the bond (age) of the religious normativity. It is an internalized autonomous act. The content of the normativity is, however, heteronomous. It forces him or her at every step to submit to the will (and wisdom) of the Creator. This submission is most apparent and protein when there is a cleavage between the 'natural' inclination of homo religiosus and the heteronomous norm. What might seem as enslavement to some, may be experienced as liberation to others, liberations from our natural inclinations. Unbounded human freedom may be understood as no freedom at all. Letting one be driven entirely by our desires may be thought of allowing us to be enslaved to them. In Jewish law this is manifest day in day out for example, in dietary laws, Sabbath rules and the like. This particular rule, is most poignant since even at this moment of extreme grief one finds one's self-subjected to this form of bondage/rational liberty.

But if we move from the meta-level to the actual content of the rule, we find what is, in my view, an exquisite inflection. For the rule which forbids all the accoutrements of formal mourning goes further: It absolves in this period of time the individual from almost the entire range of ritual obligations. It is a period of time when one is absolved from the duty of daily prayer, of learning and similar obligations. (Moral and other interdictions remain of course in force). It is a rule the content of which is to suspend rules. Psychologically, it allows the individual to be concentrated on his or her loss and (practical as ever) to make all arrangements for the burial. It suspends many of the normal duties to God in the face of personal grief and duties to the deceased. It acknowledges the disorientation of death and accords through the suspension of those duties huge gravitas to the circumstance of death.

The Jewish funeral is earthy and elemental. The corpse is cleaned meticulously by attendants and bound in burial cloth—the same for rich and poor. There is no embalmment or beautification. The immediate family, one by one, approach the corpse, in private, and touch the eyes of the deceased and pour some dust into them: 'For dust thou art, and unto dust shall thou return.' (Gen. 3:19). It is not just a farewell, but a shocking confrontation with the reality and finality of death. The communal part of the funeral then begins. The traditional funeral resembles the traditional circumcision and wedding—other grave moments of life. The public gathers around, typically standing, the deceased. A short prayer and eulogy is intoned. There will always be 'community'—for it is a very central obligation to attend a funeral. The famous Kadish can only be said in the presence of a 'Minyan' of ten.

If someone dies with no family it is a communal obligation to appoint mourners. No one is buried in solitude. Nobody leaves this world without mourners. The body, wrapped in its linens is then carried from the mortuary to the cemetery. The service is equally austere and uncharacteristically short. When the traditional forms are followed there is considerable 'sameness', The size of the crowd may differ, but rich and poor, kings and paupers are treated in precisely the same manner, underscoring that basic equality of dignity—it is precisely the blindness of law which takes care of that.

Much has been written about the self evident psychological and normative significance of the sequencing of mourning—the first seven days after the funeral, the first 30 days and the first year (in reality 11 months) during which the mourners are bound by certain duties gradually lifted until the end of formal mourning. Psychologically it is a way gradually to ease the bereaved from acute distress slowly back to normality. Normatively it is a way to force the mourner to return to normality over a period of 11 months, not to allow mourning to become a permanent way of life. The rigidity of the rule is both its strength and weakness. One strength is that it caters both to the 'over mourner' and the 'under mourner'. It does not allow excessive wallowing, but it also does not allow perfunctory mourning inconsistent with the dignity of the deceased and the gravity of death. It also underscores the fundamental filial parent relationship. By contrast, mourning for other relationships—spouse, sibling and, most shockingly, children is limited to 30 days. Various explanations may be given to this disparity but they cannot mask the psychological and normative autism inherent in the disparity.

Be that as it may, the content of the rules of mourning within the prescribed periods repay some reflection. At the meta level two features are striking. First, they are a sharp reminder of a legal system which is duty and responsibility oriented rather than rights oriented. There is a very powerful set of norms—legal or customary—of offering succor to the mourners by visitation, condolences and acknowledgement. Consoling the bereaved and acknowledging their status of mourners is both an individual duty and a communal responsibility. The wisdom of the American legal aphorism—the life of the law is not logic but experience—is particularly apt: The fact that consoling, condoling and acknowledging is rooted in obligation does not detract from the psychological comfort which such provides and, again, underscores that fundamental dignitarian notion of equality in death. The powerful, rich and important rise in the same manner to recite Kadish throughout the year and are acknowledged in equal measure by the community as the meek and the poor.

Second, they mediate between the vagaries of emotional states, of mourners and consolers, and the duty of respect towards the dead which should not depend on such. Regardless of feelings (!) and perhaps even despite feelings, the memory of the dead is honored.

When the period of mourning after 11 months comes to an end, the pain may have long passed, or may persist even acutely. But in looking back, there is a measure of serenity in the knowledge, that dead were honored, that the gravity of death (and life) was powerfully acknowledged, that the embeddedness of identity in family and community had been preserved and even strengthened and for most, that healing had at a minimum begun. The Law serves.

Chapter 10
Free Movement of Legal Sources: The Use of Foreign Sources in Private Law in Europe

Thomas Wilhelmsson

Abstract In this essay, I focus on what kind of legal reasoning and what arguments one may use to legitimate references to foreign sources. Such legitimation is needed when the foreign source is used as an argument with some degree of authority. The typology of arguments that emerges includes reasoning of three kinds. Firstly, the authoritative status of the foreign source may be based on some meta-level authority, for example legislation or conventions that prescribe the use of foreign sources. This, however, is seldom the case. Secondly, the authority of the foreign source can be based on a particular trust in the expertise of those that have created the source. This trust can already be embedded in tradition—then the reasoning lies near the first case—or on substantively based reasons for assuming a superior expertise in the foreign court, foreign author or foreign legal order more generally. And thirdly, the authority of the foreign source may be based on meta-level substantive arguments mainly related to the value of harmonisation of legal orders. Depending on which arguments one uses to support harmonisation—the needs of cross-border trade, the importance of equal conditions of competition, the striving for a European identity or the requirements of justice for and equal treatment of all Europeans—the circumstances in which a free movement of sources seems particularly well-founded are bound to vary. This typology is based on the assumption that not only foreseeability of outcome, but also foreseeability of reasoning matters. A line of reasoning expressly based on an analysis of this type is obviously more transparent than a pure use of foreign sources without any express justification. Transparency of arguments—an open and honest presentation of the arguments used—is a way to enhance equality and foreseeability in a legal world where the ideal of coherent and relatively stable national legal orders is no longer convincing. In today's complicated and fragmented legal structures this is probably the most one can hope for.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*, Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_10,

10.1 Introduction[1]

Hans-W. Micklitz has been one of the leading figures in the debate on Europeanisation of private law, a process which has been going on for a few decades already. His scepticism concerning the way in which the great harmonisation projects have been conducted is well known.[2] But his thoughtful analysis of European judicial co-operation[3] as well as his interest in comparative discourse and co-operation across European borders[4] shows his strong engagement in the European project as such.

In celebrating the great work of Hans-W. Micklitz, one should therefore not discuss harmonisation from above as the method for creating a Europeanised private law, but rather look at more horizontal and practice-based forms of harmonisation. Passing over the more obvious alternative, how we all are used to learn from the experience of others in the national processes of legislation, I will look at the use of 'foreign' legal materials in the practice of the national courts and in the argumentative structures of legal dogmatics.[5] I will discuss the use of comparative law as a source of law, an issue that may be associated with catchphrases like 'learning law'[6] or 'free movement of legal ideas'[7] or 'international marketplace for judgments'[8]. Hans-W. Micklitz has used the illustrative metaphor of the 'Laboratory of the European Union'.[9]

As the last phrase suggests, the particular perspective is that of European private law. It is to be assumed that the movement of law across borders appears and should

[1] I thank Geraint Howells and Ellen Eftestøl-Wilhelmsson for very useful comments on an earlier draft of the paper.

[2] H-W Micklitz, 'Failure or Ideological Preconceptions—Thoughts on Two Grand Projects: The European Constitution and the European Civil Code', *EUI Working Papers Law* 2010/04 (Florence, European University Institute, 2010).

[3] H-W Micklitz, *The Politics of Judicial Co-operation in the EU* (Cambridge, Cambridge University Press, 2005).

[4] An impressive example is the volume R Brownsword, H-W Micklitz, L Niglia and S Weatherill (eds), *The Foundations of European Private Law* (Oxford, Hart Publishing, 2011).

[5] What K Riedl, *Vereinheitlichung des Privatrechts in Europa* (Baden-Baden, Nomos, 2002) 45 counts as 'spontaneous' harmonisation.

[6] For example, BS Markesinis, 'Learning from Europe and Learning in Europe' in BS Markesinis (ed), *Gradual Convergence: Foreign Ideas, Foreign Influences, and English Law on the Eve of the 21st Century* (Oxford, Oxford University Press, 1994) 1.

[7] J Smits, *The Making of European Contract Law* (Antwerp, Intersentia, 2002) 63; T Wilhelmsson, 'The Design of an Optional (Re)statement of European Contract Law—Real Life Instead of Dead Concepts' in S Grundmann and J Stuyck (eds), *An Academic Green Paper on European Contract Law* (The Hague, Kluwer Law International, 2002) 353, 354; id, 'The Ethical Pluralism of Late Modern Europe and Codification of European Contract Law' in J Smits (ed), *The Need for a European Contract Law* (Groningen, Europa Law Publishing, 2005) 121.

[8] M Andenas and D Fairgrieve, 'Introduction: Finding a Common Language for Open Legal Systems' in G Canivet, M Andenas and D Fairgrieve (eds), *Comparative Law before the Courts* (London, BIICL, 2004) xxvii, xxviii.

[9] Speaking at a conference on Coherence and Fragmentation organised by the Center of Excellence in Foundations of European Law and Polity in Helsinki 19/9/2013.

appear with some particular features within the European Union, being constantly involved in discussions concerning and implementation of measures for harmonisation and unification of law.

As such the issue is much discussed. One need only recall the extensive debate following the English landmark case, *White v Jones*,[10] as well as many other similar discourses. Often the focus has been on the evolving tendency to use foreign source material, both globally and in a European context, and on the analysis of the normative implications of such practice. Many have detected a growing openness towards such learning processes across the borders in various jurisdictions.[11] In this paper I will not question these claims, but rather take them as a starting point. I will not discuss whether and to what extent there indeed is a tendency towards more frequent use of foreign materials in private law legal reasoning in Europe. Instead I will analyse how such use is justified and indeed justifiable.

It is easy to agree with the claim that comparative sources are 'useful'. But why are they considered useful? What does usefulness mean in this context? And how are the cases and sources deemed to be useful chosen? Sometimes it seems that scholars and courts are using the materials just 'because it's there'.[12] But that is obviously not a satisfactory answer. One should take a step further and ask for what express or implied reasons such materials are used in a given situation. Even though the true heuristic explanation for the use of foreign materials might well be 'because it's there', there certainly is or ought to be some further reason for the use, making it legally legitimate. The question addressed here, in the European context, is in other words the following: why is the use of sources from other European countries in court practice or in legal dogmatics (black letter law) analysing national law considered legitimate and how can it be so considered?

By referring to the legitimate use of sources, I set the focus primarily on more or less hard cases, in which it seems relevant to discuss the issue of sources at all. In so-called easy cases, which for example are clearly covered by the wording of a democratically legitimate national legislation, the possibility of using foreign sources does not necessarily arise at all. Democracy should not be overrun by lawyers, neither domestic nor foreign. At the same time it should be remembered that the line between hard and easy cases is by no means clear, and that convincing foreign materials may be used to bring a previously established domestic rule into question.

[10] [1995] 2 AC 207.

[11] See eg many of the papers in Canivet et al., *Comparative Law*. This book offers much of the 'empirical' basis of my paper. A detailed analysis of case-law in several countries is presented by J Smits, 'Comparative Law and its Influence on National Legal Systems' in M Reimann and R Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford, Oxford University Press, 2006) 477. See earlier also U Drobnig and S van Erp (eds), *The Use of Foreign Law by Courts* (The Hague, Kluwer Law International, 1999).

[12] A Scalia, 'Keynote Address: Foreign Legal Authority in the federal Courts' (2004) *Proceedings of the 98th Annual Meeting of the American Society of International Law* 305, 308.

Comparative law is (also) a subversive discipline[13] that contributes to enlarging the horizon of the decision-makers.[14]

This is not a purely analytical exercise, for the fun of it, but it has a purpose. I do think, and I have stated my case in greater detail elsewhere,[15] that a kind of free movement of legal sources is a valuable contribution to the processes of Europeanisation of private law. If used properly, the 'laboratory of the European Union' can help improve national legal orders. At the same time, however, such use of foreign sources in practice necessarily involves a certain degree of arbitrariness which might be difficult—at least in principle—to reconcile with fundamental legal principles of foreseeability and equality (between the subjects of a certain national order). By knowing more exactly why the comparative material is used and legitimised in a certain situation we may at least somewhat mitigate these drawbacks. We might at least in a more transparent way be able to face the question as to the grounds on which the use of foreign sources and the selection of certain sources may appear as a legitimate part of legal reasoning.

In what follows I will look at some ways to approach the question, why foreign sources might be considered relevant in legal decision-making. I will look at patterns of thinking or reasoning that can be derived from practice or from judges' and others' account of practice in various countries. Obviously the qualitative and diffuse character of the materials does not allow any empirical generalisations on the frequency of use of the different patterns of thinking. Nor do I aim to make any such claims.

Before continuing the analysis, I have to make clear what I mean by '*foreign source*' in this context. In today's multi-level governance of the European legal sphere, non-national materials are regularly flowing across the borders in great quantities. However, in order to focus the argument I will not discuss the use of supra-national (European or global) sources, but only the use of sources concerning national law (typically case-law or black-letter analysis of a question of national law). And I will only discuss the direct use of foreign sources by national courts and in national doctrine. The indirect import through the case-law of the European Court of Justice as well as of the European Court of Human Rights is a separate issue. In cases where these Courts have based their decisions on comparative national materials, the national sources gain indirect influence across the borders, as the decisions of the Courts have authoritative status in the national settings. However, the analysis of such indirect influence falls outside the scope of this paper.

[13] H Muir Watt, 'Of Transcultural Borrowing, Hybrids, and the Complexity of Legal Knowledge: An Example of Comparative Law Before the French Courts' in Canivet et al., *Comparative Law* 33.

[14] G Canivet, 'The Use of Comparative Law Before the French Private Law Courts' in Canivet et al., *Comparative Law* 181, 188.

[15] Above, n 7.

10.2 Degrees of Foreignness

As a phenomenon, the use of 'foreign' sources is not new. It is well known how common law cases, and in particular cases from the English leading courts, travel around the common law world. French materials concerning *Code Civil* are more or less widely used in countries that have followed this codification; French law is said not to be considered foreign for example by Italian lawyers.[16] A similar movement of sources concerning the great German codification, the *Bürgerliches Gesetzbuch*, can be spotted in relation to countries in which a reception of the *BGB* has taken place.

However, as mentioned in the example, these cases are often not experienced as a use of real 'foreign' sources. The sources are somehow rather treated as some kind of '*quasi-domestic*' materials. They appear as a 'giveaway', a benefit that the receiving country gets, when having bought the basic product (common law, *Code civil*, *BGB*). The way of reasoning in these examples is therefore not necessarily applicable as such when discussing the free movement of legal sources in a broader European context.

There are other well-known examples of movement of sources as well. Within the Nordic countries there is a strong tradition, particularly in private law, of leaning on materials from other Nordic countries. This is due in part to a shared legal tradition, between Sweden and Finland on the one hand, and Denmark and Norway on the other, but the cross-fertilisation is not restricted to these pairs. Neither is it restricted to the application of the joint legislation, such as the more or less identical Contracts Acts and Sale of Goods Acts that are in force in the Nordic countries. However, these factors, together with tradition, make the Nordic material appear almost domestic as well. In spite of this, the way in which the 'quasi-domestic' Nordic sources are used in legal reasoning may offer some insight into the various reasons for using materials from other countries in the EU setting.[17]

It would be tempting to solve the issue of the legitimate use of sources from other EU Member States by using the concept of 'quasi-domestic' in this context as well. As all the Member States are part of the Union, their laws are part of the Union as well. As members of the European family we should therefore in some way feel at home with the laws of all the Union member states and understand all our laws to be part of a larger legal home. We could look at the use of sources from other Member States as a natural part of legal reasoning in the same way as American courts from different states are ready to learn from each other. And indeed in comparative law

[16] G Alpa, 'Foreign Law in International Legal Practice' in Canivet et al., *Comparative Law* 195, 196.

[17] Decades ago I have analysed the use of Nordic sources in a way similar to this paper, T Wilhelmsson, 'Den nordiska rättsgemenskapen och rättskälleläran' (1985) 98 *Tidsskrift for Rettsvitenskap* 181.

discourse the use of comparative law in the European setting is considered to be different from the use of comparative law in general.[18]

But this is too easy a way out, at least for the time being. Obviously our legal cultures are not there yet, and a culture in which a large-scale adoption of materials from all over the Union is commonplace does not even seem a target worth striving for. We need to be able to learn from the law of other Member States, but when and in what circumstances? We cannot just be content with a general claim that within the Union, every source should be considered—now or in a possible future scenario—at least 'quasi-domestic'. We have to analyse further the grounds for the legitimate use of the materials of other Member States in national legal decision-making.

I will in what follows look at such grounds, or patterns of justification, from a relatively general private law perspective. One should, however, bear in mind that the issue of legitimate use of foreign sources is not an on-off issue. Several factors bear on the likelihood of a certain source from outside the national collection of sources being used and being considered legitimate in its particular context.

Most certainly the *degree of Europeanisation* of a certain area legitimately affects the way in which sources from other Member States are used. If the field is wholly or partially harmonised, like for example the field of product liability, it is certainly easier to defend the use of cases and materials from other European jurisdictions than if it were not. If the harmonisation measure is based on the law of certain model countries, like the Commercial Agents Directive and Germany, then there is obviously a pressure towards using examples from that country in particular. The Dutch experience that 'a foreign background' of the legislation to be applied lowers the threshold for considering foreign sources[19] can probably be attested in many other jurisdictions as well. Some areas of private law again may seem so strongly embedded in the national context—like perhaps some parts of real estate law—that any learning processes may have to take place in the area of legislation rather than in the courts or in legal dogmatics.

The use of foreign sources is also dependent on the general *theory and practice of legal sources* pertaining to the national setting in which the decision or legal analysis is made. The more similar the theory of legal reasoning and legal sources is in two countries, the easier it is to exchange sources between these countries. And this relates to the type of sources used as well. For example, if national legal dogmatics (living legal writers) is not considered a source in a certain legal order, foreign dogmatics will most likely not be cited either. German courts might prefer to cite textbooks from other countries,[20] whilst English courts rather cite cases.

Theorising about the legitimacy of using foreign sources is one thing, the *practical opportunities* to make such use is another. Of course such practical matters as availability, access and linguistic comprehensability of sources, as well as pro-

[18] M Freedland, 'Introduction: Comparative and International Law in the Courts' in Canivet et al., *Comparative Law* xv, xviii.

[19] AS Hartkamp, 'Comparative Law Before the Dutch Courts' in Canivet et al., *Comparative Law* 229, 231.

[20] H Unberath, 'Comparative Law in the German Courts' in Canivet et al., *Comparative Law* 307, 308.

cedural rules on presenting and reliance on foreign materials, are of paramount importance. Sources available in English, French and German[21]—and among the Nordic countries sources written in a Scandinavian language—certainly are more likely to be used outside their own jurisdiction. A variety of measures have been taken to improve the practical opportunities to make use of materials from other EU-jurisdictions,[22] but their impact probably remains rather small. Another way to overcome the problem is the development of 'principles' based on comparative materials, such as the Principles of European Contracts Law (PECL) and the Draft Common Frame of Reference (DCFR). The growth of trans-border law firms may in practice have some impact on the increasing use of materials from other countries as well.[23]

Anyway, at this moment in time there is little reason to focus heavily on the practical dimension. The rapid development of the electronic means both to find and to access, and eventually even to translate, legal source material from other countries has already to some extent and will undoubtedly in the future in a much deeper way greatly increase our practical opportunities to make use of a free movement of legal sources. In fact, this development makes it particularly germane to discuss in more 'theoretical' terms, why and in what way these opportunities should be used in legal reasoning.

10.3 Degrees of Support

Foreign sources may be used in a multitude of ways in actual decision-making. Their status as arguments can vary and the legitimation of the use of such sources varies accordingly.

One way of approaching the issue is to start the analysis from the traditional distinction between *substantive arguments* and *authoritative arguments*. Substantive arguments relate to the substance of the issue in question. They may refer to empirical facts, statements on consequences, claims about moral principles etc. Their value as arguments is directly dependent on how convincing they are as to their content. Authoritative arguments, on the other hand, derive their value not primarily from their substance, but from the institutionalised position of the source, like acts of legislation, court cases, in many countries the *travaux préparatoires* and in some

[21] Typically German courts, in the relatively few cases where foreign materials are used, very much tend to use Austrian and Swiss materials, see A Janssen and R Schulze, 'Legal Cultures and Legal Transplants in Germany' (2011) 19 *European Review of Private Law* 225, 249.

[22] See in particular the Ius Commune Casebooks on the Common Law of Europe. For example H Beale, A Hartkamp, H Kötz and D Talon (eds), *Cases, Materials and Text on Contract Law* (Oxford, Hart Publishing, 2002). Another measure of this kind is the European database on unfair terms, see on this H-W Micklitz and M Radeideh, *'CLAB Europa*—The European Database on Unfair Terms in Consumer Contracts' (2005) 28 *Journal of Consumer Policy* 325.

[23] HP Glenn, 'Comparative Legal Reasoning and the Courts: A View from the Americas' in Canivet et al., *Comparative Law* 217, 226.

statements in legal literature (*Stand der Lehre*). What is expressed in these sources has source value primarily because it is stated in such a source.

In practice this is not a clear-cut distinction, and the use of a certain source is often considered legitimate for both authoritative and substantive reasons. A court case is not only relevant because it contains a statement from a legal authority; it might be considered even more relevant if the reasoning in the case is considered substantively justified. As regards the use of foreign law in legal reasoning, obviously substantive and authoritative perspectives are regularly intertwined, as we can see in the analysis to follow later in the paper. In practice, one may assume there to be at least a minimum of substantive assessment attached to more or less all use of foreign legal sources: it is hardly conceivable that a decision-maker would use a foreign source that according to the views of the decision-maker would result in a substantively 'bad' decision. However, this does not remove the analytical usefulness of the distinction. When a certain source is used, it rather has to be analysed, whether and to what extent its use is based on authoritative value in addition to the substantive value attached to it. The possibility of recognising some authoritative value in a foreign source is the central issue when discussing the legitimacy of using foreign legal sources in legal decision-making.

It is of course conceivable that foreign legal materials are used exclusively as sources of substantive arguments. If this is the case, there is, in principle, nothing special in the use of such materials. The decision-maker can learn good substantive reasons from whatever source available. In such a case the issue is not so much one of 'use of foreign sources in decision-making', but only the practical issue of finding and learning good arguments. The substantive arguments imported just happen to be in a foreign legal source. They could equally well have been found in some other source of non-legal character.

I believe that some cross-border references to black letter legal research are best understood in this way. Legal writers cite foreign authors, not because of their authority, but because of the arguments these authors offer. The citation is made, not because it would increase the value of the argument, but because it is demanded by the ethical rules of science. It is a tribute to the expectations of the community of researchers rather than to the expectations of legal argumentation.

Such a 'scientific' rather than 'legal' movement of sources is particularly obvious in relation to legal concepts and constructions. An important part of the idea of a free movement of legal sources is indeed the movement of legal concepts and constructions. Such a movement is strongly facilitated by the comparative work done in PECL and DCFR to establish a shared European conceptuality. The main gist of the idea of a free movement of legal sources, however, is rather to improve the instruments for breaking up petrified national conceptual structures rather than to import new ones. Europeanised law has moved towards pragmatism rather than dogmatism.[24] I will here not look more closely into the particular challenges related to movement of legal constructions.

[24] MW Hesselink, *The New European Legal Culture* (Deventer, Kluwer, 2001). However, for a postscript on the return of neo-formalist tendencies, see MW Hesselink, *The New European Legal Culture: Ten Years On* (Rochester, Social Science Electronic Publishing, 2009).

But to be clear: even though some of the foreign references in legal dogmatics are made primarily for 'scientific' reasons and not because of the legal authority of the source, in many cases such references are clearly used with an authoritative flavour as well.

The accounts of the supposedly increasing use of comparative sources in the practice of the courts are often couched in a language implying that the use is motivated by the substantive knowledge those sources contain or express.[25] For example, foreign sources are said to be used to 'cast an empirical light on the consequences of different solutions to a common legal problem',[26] 'to ascertain whether a rule has successfully fulfilled its function'[27] or to see whether a concept or institution 'had been successfully tested in other legal systems.'[28] However, in most cases the foreign source cited does not convey such empirical and functional knowledge or such an extensive presentation of its arguments of substance that one convincingly could claim that only the substance was of importance. Obviously in most cases when a foreign source, for example a foreign case, is cited there is something more to it. The reference achieves some additional (not necessarily decisive) value, or even its sole value, by being a 'legal' source. It is felt more convincing to cite the case than just the substantive arguments of the case. So, in most cases there seems to be an added authoritative value attached to the foreign legal source. In this paper I discuss why and on what grounds such additional value can move across the borders.

Needless to say, a source may have various *degrees of authoritative value* in a given case. The argument may in more or less decisive ways affect the outcome of the case. A foreign source may have just weak authority, somehow contributing to giving the substantive arguments used a 'legal' flavour.[29] As has been said, a judge might 'in the end, be inspired more by the mechanisms of interpretative decoding he will find in a legal culture that is not his own than by ready-made solutions'[30]. The source may also be needed just to convince the reader that a certain solution, which is preferred on other grounds, can be considered 'legally possible'. In other cases the foreign source may acquire stronger authority, being a positive or even a decisive argument for the adopted solution.

In the following I will discuss in general the grounds according to which foreign sources may be given authoritative value (i.e. value emanating from the position of the source itself and not exclusively from its substantive arguments). I include both weaker and stronger forms of authoritative value, without pursuing this distinction further.

[25] See also B Markesinis and J Fedtke, *Judicial Recourse to Foreign Law. A New Source of Inspiration?* (Abingdon, Routledge, 2006) ch 3.

[26] *Printz v United States* 521 US 898, 921 (1997).

[27] Canivet, 'The Use of Comparative Law', 187.

[28] Unberath, 'Comparative Law', 312.

[29] A kind of *Kontrollfunktion*, Janssen and Schulze, 'Legal Cultures and Legal Transplants', 249.

[30] Canivet, 'The Use of Comparative Law', 189.

10.4 Authority Based on Legal Authority

The authoritative status of foreign materials may be based on a *meta-level authoritative source* that assigns such status to the materials. An enactment or some other authoritative source may normatively assert, explicitly or implicitly, that (some) foreign sources should be given authoritative value. In constitutional law, there are examples of constitutions expressly stating that foreign law may be taken into account when interpreting the constitution.[31]

In private law, a possible example would be the Nordic so-called Helsinki Treaty (the Treaty of Co-operation between Denmark, Finland, Iceland, Norway and Sweden).[32] According to Article 4 of the Treaty, 'The High Contracting Parties shall continue their co-operation in the field of law with the aim of attaining the greatest possible uniformity in the field of private law.' One would imagine that such a clear harmonisation order would be experienced as a valuable normative ground for using materials from other Nordic countries. However, this seems to be pure theory. In practice, the Treaty is never explicitly referred to as justification for the use of Nordic sources, nor does private law legal dogmatics make this move either. The opportunity to attach meta-level authority to Nordic cross-border references is not made use of.

A similar example at a global level is Article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods (CISG), according to which in the interpretation of the Convention, 'regard is to be had to its international character and to the need to promote uniformity in its application'. This Article alerts the courts to look beyond the national borders when applying the Convention. Certainly this lowers the threshold to rely on sources from other CISG countries, and this is probably reflected in the case-law of many countries concerning CISG. However, a similar tendency to look at the materials from foreign countries can obviously be recorded in the interpretation of other international conventions as well, for example in the area of transport law,[33] so it is debatable whether the express command of CISG Article 7(1) in practice adds much to the status of foreign sources. One may assume that for international conventions in general there is at least an implicit authority for attempts to harmonise interpretation through the use of foreign sources.

International conventions are a special case, however. The authoritatively justifiable cross-border movement of sources concerning such conventions does not confer authority on the movement of sources with respect to other issues. In addition, it seems that even in connection with international conventions there is a need for additional legitimation related to the choice of sources deemed relevant. It is very

[31] For example the South African Constitution of 1996, Art 39(c). See eg C Rautenbach and L du Plessis, 'In the Name of Comparative Constitutional Jurisprudence: The Consideration of German Precedents by South African Constitutional Court Judges' (2013) 14 *German Law Journal* 1539.

[32] The Treaty was signed on 23 March 1962 and entered into force on 1 July 1962.

[33] Unberath, 'Comparative Law', 308; Janssen and Schulze, 'Legal Cultures and Legal Transplants', 249.

rare, if ever, that one encounters claims that all possible sources from all countries which are party to the convention should be considered.

As this paper discusses the free movement of sources within the EU, the obvious question here is whether EU law contains any authoritative support for the free movement of legal sources within the Union. The Treaties do not seem to do so, at least not in any direct and express form. The Treaty on the Functioning of the European Union does not foresee legal harmonisation as a task in itself. Article 81 on judicial cooperation in civil matters, for example, only foresees that such cooperation 'may include the adoption of measures for the approximation of the laws and regulations'. In fact the idea of a Union which is 'united in diversity'[34] is reflected in the Treaty on European Union, Article 3(3), according to which the Union 'shall respect its rich cultural and linguistic diversity'. It is difficult to extract any clear general command towards legal harmonisation from the basic normative documents of the Union.

When looking at the interpretation of statutes based on directives intended to harmonise the law on particular subjects, the situation may be somewhat different. Then the situation resembles the interpretation of international conventions,[35] mentioned above. However, the implied normative authority for using foreign sources often seems to be less convincing when discussing directives than conventions. The directives are, in line with the wording of Articles 114–115 of the Treaty on the Functioning of the European Union, expressly aiming only at 'approximation', not unification of the law within their field of application. In addition, there is a mechanism in place for achieving uniformity when such uniformity is required, through preliminary rulings of the European Court of Justice, and this shrinks the normative legitimation for the parallel mechanism of direct import of interpretations from other Member States. Clearly such import can be useful, in particular with regard to detailed harmonisation directives like the Products Liability and Commercial Agents Directives, but it is difficult to find any direct authoritative meta-legitimation for the import. One rather has to use the same kinds of substantive reasons for using foreign materials, as when dealing with the free movement of legal sources in general. Such substantive reasons will be analysed later.

In most legal systems the doctrine of legal sources is not expressly enacted or defined in some other legal document with similar authority. It develops through case-law and legal theory and could normatively rather be defined as a part of *customary law*. Through a development of the traditionally nationally oriented legal custom towards the establishment of a custom that prefers a more international outlook on the sources, the meta-authority for using foreign sources could be derived from a renewed customary law.

However, although one can 'discover signs evidencing the progressive development of a specifically European way of looking at things'[36], we are not there yet, and

[34] This phrase is nowadays presented as the motto of the EU, see http://europa.eu/about-eu/basic-information/symbols/motto.

[35] Hartkamp, 'Comparative Law', 230 claims the situation to be 'practically identical'.

[36] Canivet, 'The Use of Comparative Law', 190.

we will not be there in the near future either. A customary view on legal sources may begin to develop, which contains some rules on how and under what circumstances the use of sources from other Member States would be considered legitimate and even normatively required. As long as such a more elaborate understanding of the source-value of foreign law in various situations has not emerged and has not been shared as a part of the common culture of a certain legal community, any claim that the use of foreign sources could be given meta-authoritative legitimation by customary law fails to convince. Nor, in fact, have I seen anybody try to use such language of legitimation either.

Hence it is difficult to offer any strong meta-authoritative legitimation for a free movement of legal sources within the European Union. There is no convention or statute and no developed customary law that would be sufficient to attribute to the use of foreign materials a self-evidently legitimate normative status, without the need to ask further questions. Therefore, if one believes in the value of the movement of legal sources across borders, one needs to keep asking. Without sufficient authoritative reasons, one has to turn to other possible reasons for using foreign sources. In the following parts of the paper such reasons are analysed. Are there reasons of a more substantive character, again at the meta-level, for such an extension of the legal source materials?

10.5 Authority Based on Trust, Status and Tradition

One way to approach the issue of possible substantive legitimation is to confront the metaphor of a learning law with a few critical questions. The idea, also taken as a starting point of this paper, that the use of foreign sources can be understood as part of a legal learning process across the borders means, in other words, that one is thought to be able to improve national law by using legal knowledge produced in other countries. This gives rise to the following questions: what makes the legal materials from other countries expected to improve national law any better than the reasoning of national courts and legal dogmatics? And why are the legal experiences of other countries more valuable as sources than other non-legal experiences?

As to the last question I wish to recall the scope of the analysis, as defined at the end of Sect. 3. I am looking at situations where the source is recognised to have some (additional) authoritative value, because it is a legal source, and not only functions as a bearer of substantive arguments. I do believe that in most cases when foreign legal sources are used, some additional authoritative value is indeed attached to them. The question is why.

A quick answer to the question why a foreign source is used instead of substantive reasoning of the decision-making court or researcher is intellectual laziness. It is more comfortable to resort to a readymade foreign solution than to make the difficult analysis of the issue oneself. But normatively at least this is of course not a satisfactory answer. Few would admit to using foreign materials for this reason alone. One needs to go further and look why certain sources are deemed valuable,

perhaps more valuable than others. Only in this way is it possible to unveil the substantive reasons for using foreign materials.

When speaking about a learning law, the core issue is how to find a good 'teacher'. We recognise as such a teacher only a person in whose level of knowledge and intellectual ability we trust. Legal recognition of foreign sources may rely on the same kind of reasoning. Authority is recognised in such sources that we believe to be capable of teaching us something that improves our legal order, in sources that we trust. Such authority may be attached to particular legal orders, to particular courts and legal decision-makers or to certain persons or groups of persons. This status may for various reasons emerge and disappear, but often it has some link to legal tradition in the receiving country.

Materials from certain foreign legal orders may be used as sources because these orders enjoy a particular prestige in the minds of the decision-makers. Italians find the French and German systems particularly prestigious,[37] whilst others again very easily turn to common law. Many other examples could be mentioned. In addition to linguistic access, such prestige may follow from a variety of factors, such as perceived power and cultural dominance. However, from the point of view of a learning law, the key factor is, or ought to be, the perception of quality of the legal order to be cited.

Quality of law is a concept which cannot be defined as such. The substantive reasons to search for help in a certain legal order rather relate to *perceptions of quality.* Such perceptions may stem from tradition and reflect various ideas of what good quality of law is all about. Some may use German law as a model, because of its systematic rigour and conceptual consistency, others rather prefer common law because of its perceived well-developed pragmatic approach to problem-solving. Some large jurisdictions may also be considered to be of high quality mainly by virtue of their size: the amount of case-law and black letter research as such create the expectation that many issues have been thought through more deeply in such jurisdictions. Be that as it may, the reasons for understanding a certain legal order as being particularly valuable must be analysed and discussed when advocating a free movement of legal sources within the EU.

Sometimes the perceived expertise might relate to particular issues or fields. A good example is the high status of English law in the area of maritime law.[38] When certain legislation is transplanted to another country, the courts of the model country again may be considered to possess useful expertise in the interpretation of this enactment.[39] In the context of free movement within the EU this may be particularly important with regard to directives that are predominantly based on the experiences of one or a few Member States.

The 'high quality' or 'good teacher' argument normally relates to a particular legal order. However, it is at least conceivable that a certain court or institution may

[37] G Alpa, 'Foreign Law', 209.

[38] On German practice in this respect, see Unberath, 'Comparative Law', 308.

[39] As mentioned above, in Sect. 2, the import of a whole Code easily confers on the courts of the model country such authority. This particular situation is not analysed here.

develop such a reputation that its decisions are considered particularly valuable in some field. The reputation of a court that has produced many highly-regarded judgments may confer particular authoritative value on its decisions more generally.

Even the perceived quality of individual foreign cases may lead the decision-maker to use them as a legal source. In the emerging 'international market place for judgments' the quality and form of a judgment may determine its persuasiveness.[40] In such a case, however, it is questionable to what extent, if any, the source is used as an authoritative legal source in the meaning defined in this paper, or whether it is used only as a device for presenting the substantive reasons for reaching the decisions.

In jurisdictions in which legal research formally or practically is considered to be an important source of law, some legal writers might enjoy a particularly good reputation and be more often cited than others. Such a reputation, which at least in principle should be derived from the quality of the writings, may also extend across borders. In Nordic law some highly-regarded legal scholars have been cited regularly throughout the whole region.[41] However, scholarly reputation is often tied to the jurisdiction about which the scholar is writing. When speaking about scholarship on national law—and not about scholarship focusing, for example, directly on EU law—it is not (yet) so easy to come up with household names that are cited across the EU.

Anyway, in the European setting there is one good example of scholarly work being used across the Union because of its perceived quality. That is, of course, the collections of 'principles' (rather rules) for European private law, made by experienced groups of scholars, such as the PECL and DCFR. The growing status of these collections is so far, before any formal enacting decisions are taken, based on the assumption that they are made by extremely competent experts and therefore represent the best possible way to arrive at a more harmonised private law. However, a discussion of the learning input offered by such informal collections of rules made to be used all over Europe falls outside the scope of this paper. The Principles do not represent a view on national law, but an expressly European view on the field. As mentioned in the Introduction, I am here looking at the direct movement of national legal sources across borders, not at various indirect roads such as the one running through a European collection of principles.

To sum up: Clearly one of the substantive reasons offering meta-legitimation for the use of foreign sources is related to learning through materials perceived to be of high quality. Foreign sources are in this case used, because the use of such sources is thought to improve the quality of domestic law. This again gives rise to questions like: How do we define quality? From what kind of environment is quality derived, from experience or from particular approaches to legal issues? How do we find and

[40] Andenas and Fairgrieve, 'Introduction', xxxv.

[41] Scholars like Jan Hellner (Sweden), Carl Jacob Arnholm (Norway) and Henry Ussing (Denmark)—not to mention many living scholars—have gained great respect across the Nordic countries.

delimit the sources that supposedly fulfil the possible criteria? Should we speak about the quality of particular legal orders or of particular courts or institutions?

Obviously, in the EU today, it would be impossible to reach agreement on particular questions such as those above. It is, however, important that they are raised, both in general and in relation to specific situations. Only by openly discussing such issues can legal decision-making avoid the trap of choosing sources in a completely arbitrary way. The more sources that become available through technical and linguistic development, the more the decision-makers need to be transparent as to their reasons for choosing particular sources.

An exciting question for future discussions concerning this theme is whether there could be some kind of division of labour within the EU. In the same way as the English courts are considered leading experts in maritime law, could others be recognised as having other particular fields of expertise? Could the Nordic countries be seen as leading experts in, for example, consumer law, whilst some other fields of law would be better cultivated in more depth within some other jurisdiction? Obviously, such a forerunner position requires not only well-founded national creativity, but also sensitivity with regard to what can be considered acceptable in other Member States.

10.6 Authority Based on Substantive Reasons

Even though a certain source is used as an authoritative argument, the meta-legitimation for the authority may be based on substantive reasons. Such reasons may be used to attach positive value to the principle that legal orders should attempt to follow the content of each other. In its most general form, this argument may hold that the use of foreign sources is a value in itself: 'In a shrinking world … there must be some virtue in uniformity of outcome….'[42]

In more concrete form, substantive reasoning of this kind is familiar from the debates on the value of harmonisation of European private law. Various kinds of substantive arguments have been used to justify the claim that harmonisation of legal orders in Europe is useful and worth pursuing. This claim again may be referred to as an argument for the use of foreign legal sources in the national context, as one instrument for reaching a higher degree of harmonisation.

As such substantive arguments for harmonisation for example the need to facilitate cross-border transactions and to create equal conditions of competition, the value of building a European identity and the support for joint feelings of justice in Europe have been mentioned. I will not discuss the weight and accuracy of these arguments in this paper; many have done so elsewhere.[43] I just wish to show that

[42] *Fairchild v Glenhaven Funeral Services Ltd* [2003] 1 AC 32, para 32.

[43] One of the best early compilations of views regarding this issue is Grundmann and Stuyck (eds), *An Academic Green Paper*. For an interesting analysis of the arguments from a multidisciplinary perspective, see Smits (ed), *The Need for a European Contract Law.* See also the comprehensive

different substantive arguments for giving foreign sources authority have different weight in different circumstances. Whilst one of the arguments may seem relevant in one type of situation, another may gain more force in another type of case.

The practical needs of those working in the internal market are often in the private law and commercial law setting cited as a primary reason for harmonisation. Common rules, according to this view, mean the facilitation of *cross-border transactions*. Obviously this argument has its main force and is mainly used when discussing the legislative harmonisation of larger areas of law. However, it is less clear how much weight this argument carries when referring to the free movement of legal sources relating to detailed issues only. At least concerning some private law issues one may assume that joint approaches and detailed learning may be very important with regard to the smooth running of cross-border transactions. These are the issues that Hugh Beale has called 'traps'[44]. Rules that can easily cause hidden traps for traders who wrongly presume the rules to be similar are, for example, rules on giving notice and limitation periods as well as rules on securities in movables.

Other substantive arguments, familiar from the harmonisation debate, could be mentioned in this context. In some areas, for example, harmonisation is defended with reference to the need to create *equal conditions of competition*. This argument has been used with regard to the legislative harmonisation of mandatory rules on protecting market participants such as consumers. Again, however, it is debatable to what extent equal conditions of competition require harmonisation in details with minor general economic impact on the actors. In other words this argument seems most useful with regard to issues in which the economic consequences at stake are considerable. For example, in cases that might require the change of economically relevant behavior in relation to a large number of customers or where the value of the case is high for some other reason, a look across the borders could gain some support from the argument that conditions of competition should be equal on both sides of the border.

Another strong line of argument behind the larger harmonisation projects relates to the building of a *European identity*. A joint code or private law system, according to this view, would in a valuable way strengthen the common and shared identity of Europeans as Europeans. Whatever value one attaches to this argument, it rather seems to belong to the sphere of larger codification projects, with less relevance for the micro-level movement of legal sources. Admittedly, in particular situations, i.e. in cases with strong emotional appeal and broad media coverage, express learning processes across the borders may contribute to a shared feeling of Europeanness. For example, similar reactions to widely-observed and contested Europe-wide marketing and commercial practices might bring a sense of togetherness to the European legal discourse.

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analysis by H Collins, *The European Civil Code. The Way Forward* (Cambridge, Cambridge University Press, 2008), as well as H Collins, 'Does 'Fragmented Europeanisation' Require a European Civil Code?' (2009) 145 *Tidskrift utgiven av Juridiska Föreningen i Finland* 213.

[44] H Beale, 'Finding the Remaining Traps Instead of Unifying Contract Law' in Grundmann and Stuyck (eds), *An Academic Green Paper,* 67.

One may also refer to feelings of *justice and equality* in this context. It may hurt the sense of justice of the citizens of the Union, if they experience citizens being treated differently in different Member States. Obviously, again, this argument seems to have little force in most cases, as the Europeans are used to and cherish the idea of being united in diversity, of having their own legal orders in each Member State. But in particular in cases that are felt important for the position and protection of individuals and their rights, the harmonization-as-justice argument may have some force. The field of privacy law has been mentioned in this context.[45] Strongly differing rules protecting weaker parties may also cause dissent among parties coming from a Member State with less stringent standards, at least in cases with a strong public appeal. For example, it would seem natural that breast implant and hip replacement liability cases should be solved in a similar manner across the Union. A harmonised approach could be argued for also in tobacco liability cases; however, different views about risk taking, socialisation of risk and smoking as a habit might lead to differing conclusions.[46]

Other arguments concerning harmonisation of European private law could be mentioned here as well. But I will not explore the variety of possible substantive reasons further in this context since it is not required with regard to the perspective of the present analysis.

Many of the above arguments are most forceful in the context of a general discussion on harmonisation of private law. In relation to the free movement of legal sources in particular cases their weight obviously varies depending on the situation. As mentioned, certain arguments seem forceful in some fields of private law and in some particular situations, others in other fields and situations. The practical argument that similar rules are required to facilitate cross-border trade seems particularly strong in situations that could be described as hidden traps, whilst the common identity argument primarily could be used in cases with strong emotional appeal and large media coverage. Also arguments related to justice and equality could come to the fore in the latter situations, in particular when the rights and protection of individuals are at stake. In cases with considerable economic impact it might also be possible to refer to the need to create equal conditions of competition.

Again, as in the previous section of the paper, it is easy to claim that no agreement concerning the weight of the above arguments can be reached in the European legal discourse. This is certainly true, but it does not eliminate the need for the analysis. Only by making explicit reference to arguments of this kind can legal decision-making and legal analysis become transparent in a way that makes it possible to discuss and contest the solutions on rational grounds. A legal reasoning that expressly discusses the substantive arguments for attaching relevance to foreign sources becomes much more nuanced than a reasoning built on a 'blind' acceptance of foreign materials. And within such a transparent discourse the value of the for-

[45] Canivet, 'The Use of Comparative Law', 190.

[46] See G Howells, *The Tobacco Challenge. Legal Policy and Consumer Protection* (Farnham, Ashgate Publishing, 2011).

eign source—its substantively justified harmonisation value—can more openly be balanced against other substantive arguments related to the case.

This insistence on transparency not only relates to the legitimation of the use of foreign sources as such. It also relates to the issue of choice; what jurisdictions and what foreign sources to follow. The harmonisation-related arguments described above are often not very helpful in this regard. The needs of cross-border trade and the elimination of hidden traps probably to some extent favour a convergence dominated by the large jurisdictions, because those are anyway better known and linguistically accessible for the traders and their lawyers. Value-laden experience on the other hand might be sought in places that have succeeded in establishing themselves as value-leaders and frontrunners in some area of law. In such a case the argument is rather one of trust, as described in the previous section of the paper.

Of course, when a similar practice can be reported from several Member States, the harmonisation argument becomes more convincing and the national decision-maker is to some extent relieved of the burden of deciding what foreign sources to choose. This, however, is certainly not always the case.

10.7 Conclusion

The aim of this paper is not to contribute to yet another discussion about whether and where the use of foreign sources and comparative law is increasing in national legal decision-making and legal dogmatics. I have attempted to look beyond this question, discussing why such use is and could be considered legitimate. Instead of asking 'to what extent are foreign sources used?' and 'should such sources be used?' in a general fashion, I have focused on what kind of legal reasoning and what arguments one may use to legitimate references to foreign sources. Such legitimation is needed when the foreign source is used as an argument with some degree of authority.

The typology of arguments that emerges includes reasoning of three kinds. Firstly, the authoritative status of the foreign source may be based on some meta-level authority, for example legislation or conventions that prescribe the use of foreign sources. This, however, is seldom the case. Secondly, the authority of the foreign source can be based on a particular trust in the expertise of those that have created the source. This trust can already be embedded in tradition—then the reasoning lies near the first case—or on substantively based reasons for assuming a superior expertise in the foreign court, foreign author or foreign legal order more generally. And thirdly, the authority of the foreign source may be based on meta-level substantive arguments mainly related to the value of harmonisation of legal orders. Depending on which arguments one uses to support harmonisation—the needs of cross-border trade, the importance of equal conditions of competition, the striving for a European identity or the requirements of justice for and equal treatment of all Europeans—the circumstances in which a free movement of sources seems particularly well-founded are bound to vary.

This typology of reasoning then does not offer any readily applicable formula for the use of foreign sources in legal reasoning. The foreseeability with regard to the outcome of a case is probably not improved to any considerable extent by employing this kind of reasoning. However, not only foreseeability of outcome, but also foreseeability of reasoning matters. A line of reasoning expressly based on an analysis of this type is obviously more transparent than a pure use of foreign sources without any express justification. Transparency of arguments—an open and honest presentation of the arguments used—is a way to enhance equality and foreseeability in a legal world where the ideal of coherent and relatively stable national legal orders is no longer convincing.[47] In today's complicated and fragmented legal structures this is probably the most one can hope for.

The purpose of analysis has not been to advise against the use of foreign sources. On the contrary, as mentioned at the outset, I see the free movement of legal sources as an important element in building the European legal space. Foreign sources should not primarily be understood as an alien and intrusive element in the national legal landscape. At best they offer tools for breaking with petrified old structures and developing national law in accordance with European values.

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[47] Arguments instead of coherence is also advocated by J Smits, 'Plurality of Sources in European Private Law, or: How to Live With Legal Diversity' in Brownsword et al (eds), *The Foundations of European Private Law,* 323, 334.

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Part II
EU Internal Market Regulation

Chapter 11
New Economic Governance in the European Union: Another Constitutional Battleground?

Fabian Amtenbrink

Abstract The regulatory responses to the global economic and financial crisis and the subsequent euro area sovereign debt crisis raise serious constitutional questions not only at the supranational, European level, but mainly also at the level of the Member States; developments, fuel the long-standing debate on the relationship between the supranational legal order and the (constitutional) legal orders of the Member States, or as Micklitz and Schebesta (The European Court of Justice and the Autonomy of the Member States, 2012) put it 'the challenge […] to define the *limits* of European integration inward looking'. This may put the much referred to cooperation and dialogue between the national highest (constitutional) courts and the CJEU to the tested yet again, in particular when observing the trend with some national highest (constitutional) courts to 'not only perceive themselves as the ultimate guardian of fundamental rights, but increasingly also more broadly as defenders of a broader constitutional identity.' Hereafter, this contribution commences with a brief flashback to the beginnings of European economic and monetary union (EMU) highlighting that the current judicial discourse on European economic governance and its democratic credentials is anything but new, as it finds its roots in the Treaty on the European Union. This contribution provides an overview of the new legal framework pertaining to economic policy coordination in the euro area and its impact on the national policy sphere is offered, followed by an analysis of a selection of decisions by national highest (constitutional) courts, thereby focusing on their dealing with the constitutional impact of various aspects of the European regulatory response to the crisis. In the concluding section a preliminary answer to the question raised in the title of this contribution is given.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_11,

11.1 Prologue

The fallout in the European Union (EU) of the global economic and financial crisis and the subsequent euro area sovereign debt crisis has exposed fundamental flaws of the system of economic governance in the euro area and namely of the legal framework introduced into primary Union law by the 1992/1993 Treaty on European Union governing economic policy coordination.[1] In addition to the initial ad hoc crisis measures to prevent the collapse of the financial system and of several euro area Member States, the crisis has triggered a European regulatory response, the scope and swiftness of which is unprecedented in the 60 year history of European integration.[2]

These regulatory activities raise serious constitutional questions not only at the supranational, European level, but mainly also at the level of the Member States; developments, which may not only be "constitutional relevant, but maybe even alarming", as argued by Chiti and Teixeira,[3] but also fuel the long-standing debate on the relationship between the supranational legal order and the (constitutional) legal orders of the Member States, or as Micklitz and Schebesta put it 'the challenge […] to define the *limits* of European integration inward looking'.[4]

As the focus in the national sphere is increasingly on the impact of the European regulatory activities on core structural principles of the constitutional legal orders and namely the structural principle of parliamentary democracy, this debate has every potential to become even more entrenched. This could also put the much referred to cooperation and dialogue between the national highest (constitutional) courts and the Court of Justice of the European Union (CJEU) to the tested yet again, in particular when observing the trend with some national highest (constitutional) courts to "not only perceive themselves as the ultimate guardian of fundamental rights, but increasingly also more broadly as defenders of a broader constitutional identity."[5]

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[1] Throughout this contribution reference is made to Union law even when referring to events prior to the coming into force of the Treaty on European Union and, subsequently, the formal introduction of a single legal personality for the European Union by the Treaty of Lisbon. For a post-crisis analysis see D Adamski, 'National Power Games and Structural Failures in the European Macroeconomic Governance' (2012) 49 *Common Market Law Review* 1319, with further references.

[2] Throughout this contribution the term (new) economic governance is used as a placeholder for the various supranational and intergovernmental measures that are summarized in section 3.1.

[3] E Chiti and P G Teixeira, 'The Constitutional Implications of the European responses to the Financial and Public Debt Crisis' (2013) 50 *Common Market Law Review* 685 and 705. See also M Maduro, B De Witte and M Kumm, 'The Euro Crisis and the Democratic Governance of the Euro: Legal and Political Issues of a Fiscal Crisis' in M Maduro, B De Witte and M Kumm, 'The Democratic Governance of the Euro' (2012) *RSCAS Policy Papers 2012/08*, http://cadmus.eui.eu/handle/1814/23981; Editorial Comment, 'Debt and democracy: "United States then, Europe now"?' (2012) 49 *Common Market Law Review* 1833.

[4] H-W Micklitz and H Schebesta, 'Judge-Made Integration?' in H-W Micklitz and B De Witte (eds), *The European Court of Justice and the Autonomy of the Member States* (Cambridge-Antwerpen-Portland, Intersentia, 2012) 3.

[5] F Amtenbrink, 'The European Court of Justice's Approach to Primacy and European Constitutionalism—Preserving the European Constitutional Order?' in Micklitz and De Witte (eds), *The European Court of Justice* (Cambridge-Antwerpen-Portland, Intersentia, 2012) 47.

Hereafter Section 11.2 commences with a brief flashback to the beginnings of European economic and monetary union (EMU) highlighting that the current judicial discourse on European economic governance and its democratic credentials is anything but new, as it finds its roots in the Treaty on the European Union. Thereafter, Section 11.3 offers an overview of the new legal framework pertaining to economic policy coordination in the euro area and its impact on the national policy sphere, followed by an analysis of a selection of decisions by national highest (constitutional) courts, thereby focusing on their dealing with the constitutional impact of various aspects of the European regulatory response to the crisis. In the concluding section a preliminary answer to the question raised in the title of this contribution is given.

11.2 Pre-Crisis Judicial Review of the EMU Legal Framework

While this contribution focuses on the regulatory response to the euro area sovereign debt crisis this is not to suggest that this is also the first time that the European legal framework pertaining to economic and monetary policy has become subject to (judicial) scrutiny. In fact in a number of instances the primary Union law provisions on economic and monetary policy were at the very heart of challenges to the ratification of the Treaty on European Union (Maastricht Treaty) brought in national highest (constitutional) courts. Arguably the two most prominent examples linked to the impact on the principle of democracy enshrined in national constitutional law come from France and Germany. Moreover, in two cases provisions pertaining to EMU were also at the centre of proceedings before the CJEU.

11.2.1 The Maastricht Treaty Before the Highest Courts in France and Germany

In the case of France, the provisions on EMU included in the Treaty of European Union became subject to review by the Constitutional Council (*Conseil Constitutionnel*) that was asked, whether the ratification of said Treaty would require an amendment of the French Constitution of 4 October 1958.[6] In setting out the scope of review of the constitutionality of an international agreement in accordance with Article 54 French Constitution, the Constitutional Council referred to paragraph 3 of the Declaration of the Rights of Man and Citizens (*Déclaration des droits de*

[6] Hereafter French Constitution. Decision no 92-308 DC of 9/4/1992. The Court's own English translation is available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/case-law/sample-of-decisions-in-relevant-areas-dc/decision/decision-92-308-dc-of-9-april-1992.135427.html.

l'homme et du citoyen) of 1789 which essentially stipulates national sovereignty and the principle that this sovereignty rests with the people. This is reflected by Article 3 French Constitution, which states that "National sovereignty shall belong to the people, who shall exercise it through their representatives and by means of referendum." In reviewing the main legal framework underlying monetary policy as foreseen in EMU, the Constitutional Council came to the conclusion that "Constitution as it stands precludes France from joining the economic and monetary union provided for by the Treaty", as in its view the provisions on monetary policy resulted in "the conduct of single monetary and exchange-rate policies according to arrangements which deprive the Member States of their own powers in a matter which is vital to the exercise of national sovereignty."[7] In the opinion of the Constitutional Council the transfer of such powers required prior amendment of the French Constitution.

This resulted in a constitutional amendment and the introduction in June 1992 of Article 88(2), allowing for the transfer, subject to reciprocity, of powers necessary for the establishment of European economic and monetary union in accordance with the terms of the Treaty on European Union.

Interestingly, in its April 1992 decision the Constitutional Council did not engage in a substantive review of the effects of the Treaty provision on EMU on Article 3 1958 Constitution. This was different however in a subsequent decision dating from September 1992, where the authors of the referral—among other things—had argued that despite the introduction of Article 88(2), in its third and final stage EMU would infringe Article 3 and thus "jeopardizes the prerogatives of the representatives of the people".[8] Here the Constitutional Council implicitly considered the constitutional amendment sufficient, arguing that

> the constituent authority is sovereign; it has the power to repeal, amend or amplify constitutional provisions in such manner as it sees fit; there is accordingly no objection to insertion in the Constitution of new provisions which derogate from a constitutional rule or principle; the derogation may be express or implied.[9]

This approach was furthermore confirmed in the decision on the Treaty of Lisbon where the Constitutional Council stated that

> When […] undertakings entered into […] contain a clause running counter to the Constitution, call into question constitutionally guaranteed rights and freedoms or adversely affect the fundamental conditions of the exercising of national sovereignty, authorisation to ratify such measures requires prior revision of the Constitution;[10]

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[7] Decision no 92-308 DC, para 43.

[8] Decision no 92-312 DC of 2/9/1992. The Court's own English translation is available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/case-law/sample-of-decisions-in-relevant-areas-dc/decision/decision-92-312-dc-of-2-september-1992.137203.html.

[9] Ibid, para 35, brackets added.

[10] Para 9 of decision no 2007-560 DC of 20/12/2007, brackets added. The Court's own English translation is available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/case-law/sample-of-decisions-in-relevant-areas-dc/case-law.25743.html. Brackets added.

Such fundamental conditions in the view of the Constitutional Council include not only the transfer of new powers to the supranational level, new manners of exercising existing powers that have previously been transferred, namely in the sphere of decision-making procedures, and even the creation by supranational law of new rights for the national parliament.[11] Whether from these and other decisions it can be concluded that the French Constitution in principle does not recognise an inviolable constitutional core for instance in the sphere of parliamentary representation is subject of constitutional debate.[12]

The situation is different in the case of the German Basic Law (*Grundgesetz*). The German Federal Constitutional Court (*Bundesverfassungsgericht*)[13] has addressed the impact of the provisions on EMU prominently in its much-noted 1993 *Brunner* decision, reviewing the national the parliamentary act authorizing Germany's accession to the Treaty on European Union. The Court—among other things—had to evaluate the impact of the newly introduced provisions on EMU on the principle of democracy as guaranteed by Article 79(3) in conjunction with Article 20 German Basic Law.[14] The particular gravity of this question, which is also very relevant in the context of the most recent challenge of the European crisis measures before the BVerfG observed in section 3, derives from the fact that Article 79(3) German Basic Law explicitly precludes core components of the constitutional order from amendments, including the principle of democracy. In the case of the detection of a breach of this principle, different to what can be observed for the French Constitution, there is thus no flexibility to solve a (potential) conflict between the supranational European legal order and the national constitutional legal order by means of a constitutional amendment. Article 79(3) arguably defines the ultimate 'constitutional restraint'[15] not only for a transfer of competences onto the supranational European level, but also for the conditions under which such competences must be exercised at the European level and namely by the European institutions and bodies. Article 23(1) German Basic Law, which allows for the transfer of sovereign power by the Federation safeguards this line in two ways. Firstly, the provision refers to a EU "that is committed to democratic, social and federal principles, to the rule of law, and to the principle of subsidiarity, and that guarantees a level of protection of basic rights essentially comparable to that afforded by this Basic Law", thereby limiting the transfer of competences to a supranational organization that features these specific structural principles. Moreover, Article 23(1) explicitly calls for the adherence to the above-mentioned eternity clause of Article 79(3).

[11] Ibid, para 20 et al.

[12] See generally D Barranger, 'The Language of Eternity: Judicial Review of the Amending Power in France (or the absence thereof)' (2011) 44 *Israel Law Journal* 389.

[13] Hereafter also the abbreviation *BVerfG* is used.

[14] BVerfG 89, 155. Presently the English translation provided in 33 ILM 395 (1994) is used. See also M Herdegen, "Maastricht and the German Constitutional Court: Constitutional Restraints for an 'Ever Closer Union' and Document 'Extracts from: Brunner v. The European Union Treaty (w)'" (1994) 31 *Common Market Law Review* 235.

[15] To borrow a term used by Herdegen, 'Maastricht and the German Constitutional Court'.

In *Brunner* the German Federal Constitutional Court mainly had to address the question whether the ratification of the Treaty on European Union constituted a violation of the democratic participation and representation of every citizen, as enshrined in Articles 20 and 38, and protected by Article 79(3) German Basic Law. In this context the provisions on EMU and namely the attainment of a single currency area in three stages was condemned by the complainants for its automatism and for the fact that "In the monetary union, monetary policy would be removed from all parliamentary influence and other democratic legitimation."[16]

The Court emphasized that "The right granted by Art. 38 of the Basic Law to participate, by means of elections, in the legitimation of State power and to influence the implementation of that power, precludes, within the scope of application of Art. 23 of the GG, such right being weakened by reassignment of the functions and the authority of the Federal Parliament in such a way that the principle of democracy declared inviolable by Art. 79 para. 3 in conjunction with Art. 20 paras. 1 and 2 of the GG is infringed".[17] Turning to Article 79(3) German Basic Law the Court stressed that

> it is an inviolable element of the principle of democracy that the performance of State functions and the exercise of State power derive from the people of the State and that they must, in principle, be justified to that people. This sequence of responsibility may be created in various ways, not just in a single specific way. The crucial factor is that a sufficient proportion of democratic legitimation, a specific level of legitimation, is achieved.[18]

For the Court precondition of a membership in a supranational community is "that the legitimation and influence which derives from the people will be preserved within an alliance of States", whereby the "German Federal Parliament must retain functions and powers of substantial import". In the view of the Court this excludes a situation in which the competences assigned to the supranational level, as well as the "planned degree of integration" are not sufficiently precisely specified.[19]

The German Court concluded that the Treaty on European Union and thus Germany's ratification thereof could not be construed violating these conditions, emphasizing that Europe is granted "specific powers and responsibilities only, on the basis of the principle of limited individual powers", which "remain essentially the activities of an economic community."[20] In this context the Court explicitly refers to the coordination of Member States' economic policies and the development of monetary union. For the Court the constitutional rights of the German Federal Parliament are protected not only through the requirement of its consent in the transfer of competences, but also through its contribution to the "the process of forming the

[16] BVerfG, 'Brunner', section B.1.b.

[17] ibid, section C.I.1.

[18] ibid, section C.I.2.

[19] ibid, section C.I.2.b.

[20] ibid, section C.II.1.a.

Federal Government's political will" based on specific legislation strengthening the influence of the German Federal Parliament on EU matters.[21]

With regard monetary union the German Court concluded that despite the uncertainty—at the time—mainly of its future development in terms of economic significance and number of participants, the requirement of parliamentary responsibility was fulfilled, among other things referring to the parliament's right "to make its own evaluation on the transition to the third stage of economic and monetary union, and therefore to resist any relaxation of the criteria for stability, may be based in particular on Art. 6 of the Protocol on the Convergence Criteria."[22]

For the Court the ratification of the Maastricht Treaty did not mean that Germany was "subjecting itself to an uncontrollable, unforeseeable process which will lead inexorably towards monetary union".[23] In fact the Court even went so far as to state at the time that "Even after transition to the third stage, development of the monetary union is subject to foreseeable standards and thus to parliamentary accountability."

A subsequent case brought before the German Federal Constitutional Court against the actual participation of Germany in the single currency from 1 January 1999 was dismissed.[24] Mainly the argument by the complainant that the participatory rights deriving from Article 38 German Basic Law are infringed was considered unfounded.[25] In the view of the Court Germany's participatory rights in the European institutions is backed by the parliamentary participation rights of the German Federal Parliament, thereby allowing for a sufficient democratic legitimation of the entry into the third stage of monetary union. In this context the Court also emphasized that as far as the final decision on the start of the monetary union involves economic knowledge and policy-making that for which the executive government and parliament are responsible, whereby the federal government exercised the membership rights at the European level participatory rights executive at the European level, whereby the federal parliament participates in the formation of preferences at the federal level.[26]

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[21] Gesetz über die Zusammenarbeit von Bundesregierung und Deutschem Bundestag in Angelegenheiten der Europäischen Union vom 12. März 1993 (BGBl I, 311). Amended by BGBl II 2013, 2170.

[22] BVerfG, 'Brunner', section C.II.2.d (3). At the time critical of this suggestion of a parliamentary prerogative A Weber, 'Die Wirtschafts- und Währungsunion nach dem Maastricht-Urteil des BVerfG' (1994) *Juristenzeitung* 53, as cited in F Amtenbrink, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank* (Oxford, Hart, 1999) 183.

[23] BVerfG, 'Brunner', section C.II.2.d (5).

[24] BVerfG, 31/3/1998, 97 *Entscheidungen des Bundesverfassungsgerichts* 350—'Euro'.

[25] Ibid, section BI.

[26] BVerfG, 'Euro', section II. 2. c) bb).

11.2.2 EMU Before the European Court of Justice

When observing the role of the CJEU in the context of the EMU and namely the Maastricht legal framework on the economic policy coordination a number of factors need to be born in mind that until today restrict the jurisdiction of the CJEU considerably. Firstly, this concerns the nature of the obligations resting on the Union institutions, namely the Council, and the nature of the instruments foreseen in primary and secondary Union law. Rather than to foresee in automatism, important procedural steps have been introduced for economic policy coordination on qualified majority decision-making in the Council. Secondly, the main instrument available to address Member States with precarious budgetary positions was (and still is) recommendations. What is more, Article 126(10) TFEU explicitly excludes the application of the treaty infringement procedure in the context of the excessive deficit procedure, whether initiated by the European Commission or another Member State.[27] Thirdly, direct actions by natural and legal persons brought before the General Court against measures mainly by the Council and the ECB are largely precluded by the nature of the measures taken and the applicable standing requirements.[28] It may thus not be surprising that cases focusing on aspects of European economic and monetary policy are scarce.

Having said that, in two instances the CJEU did deal with provisions pertaining to EMU. While not as such addressing with the impact of EMU on European democracy, both cases are interesting for the fundamental questions they raise.

Relating to European economic policy, in *Commission v Council and European Parliament* the Court had to deal with the scope of the excessive deficit procedure laid down in Article 126 TFEU (ex 104 TEC) and Regulation 1467/1997.[29] In essence the CJEU did not follow the argument submitted by the Commission that the failure to reach the required qualified majority in the Council to advance a previously started excessive deficit procedures against France and Germany to the next phase of the procedure amounted to a decisions not to continue the procedures in breach of Article 126.[30] In doing so the Court verified what had long before been identified in the legal and economic literature as the major Achilles heel of the European system of economic coordination, namely the reliance on peer review and the lack of effective enforcement mechanisms. Moreover, the facts underlying this case can be seen as a prelude to the euro area sovereign debt crisis. Indeed, while not addressing the democratic credentials of economic policy coordination or its (potential) impact on fundamental rights, this decision does touch upon broader as-

[27] Arts 258 and 259 TFEU.

[28] Art 263 para. 4 TFEU.

[29] Case C-27/04 *Commission v Council and European Parliament* [2004] ECR I-6649.

[30] In procedural terms the CJEU considered this part of the application for annulment inadmissible, as an act by the Council that could have been annulled was considered absent. The Commission did achieve a partial win, as the Court annulled a Council Conclusion on France and Germany respectively effectively deciding to hold the excessive deficit procedure in abeyance and modifying recommendations adopted in a previous step of the excessive deficit procedure.

pects that can be linked to structural principles underlying EMU that have recently became subject to regulatory scrutiny.

In the area of European monetary policy, in *Commission v European Central Bank* the Court had to decide on the scope of the investigative powers of the European Antifraud Office (OLAF) vis-à-vis the European Central Bank (ECB).[31] The ECB had challenged the scope of these powers with reference to its independence as guaranteed by primary Union, whereas the CJEU concluded that the statutory independence did not shield the Bank from such investigations. From a constitutional point of view the significance of this decision lies primarily in the statement by the Court that "the ECB, pursuant to the EC Treaty, falls squarely within the Community framework", and to some extent is thus also subject to its system of checks and balances, a view not all commentators had previously shared.[32]

11.3 Constitutional Challenges to New Economic Governance

From the synopses of the constitutional challenges of the Maastricht system of EMU in France and Germany it could be concluded that the hypothesis offered at the outset of this contribution has been refuted, as the Maastricht system of economic policy coordination and even more so the pooling of monetary policy of those Member States has been a bone of contention from the start. Yet such a conclusion would be premature in that it would disregard the potential impact of the crisis measures both on the European and national constitutional legal orders and in particular the degree to which these measures (potentially) touch upon the structural principle of parliamentary democracy. As has been pointed out at the beginning of this contribution the euro area sovereign debt crisis has resulted in extensive regulatory activities with effects for economic policy coordination in EMU as laid down in primary and secondary Union law.[33] Before turning to concrete examples of judicial review of some of these measures a brief overview of the latter is called for.

[31] Case C-11/00 *Commission v European Central Bank* [2003] ECR I-7147.

[32] Ibid, para 92. See F Amtenbrink and J De Haan, 'The European Central Bank—An independent Specialized Organization of Community Law—A Comment' (2002) 39 *Common Market Law Review* 65, in response to C Zilidi and M Selmayr, 'The European Central Bank, An Independent Specialized Organization of Community Law' (2000) 37 *Common Market Law Review* 591.

[33] Excluding the many measures in preparation of the changeover to the single currency, the two main modifications have been the introduction through the Stability and Growth Pact of Reg 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, [1997] OJ L 209/1; Council Reg 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, [1997] OJ L 209/6. Subsequently both regulations were amended in 2005: Reg 1055/2005 amending Reg 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, [2005] OJ L 174/1; Reg 1056/2005 amending Reg 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, [2005] OJ L 174/5.

11.3.1 Ad Hoc and Structural EU Crisis Measures: An Overview

As the near fatal financial situation in Greece and shortly thereafter Ireland and Portugal became apparent, the EU could be seen scrambling for crisis measures. Rather than to be able to rely on a well-established set of legal instruments to provide financial assistance to euro area Member States, in the case of Greece Member States had to improvise by granting bilateral (so-called stability support loans), albeit centrally pooled by the European Commission, outside the Union framework. Moreover, these loans were accompanied by a Stand-By Arrangement with the International Monetary Fund (IMF).[34] What followed shortly thereafter was the establishment, on a temporary basis, of the European Financial Stabilization Mechanism (EFSM) under secondary Union law[35] and the European Financial Stability Facility (EFSF) as a *société anonyme* under Luxemburg law, backed by a Framework Agreement between the euro area Member States and the EFSF.[36] Aim of the EFSF and EFSM was to provide for a more structured facility for financial assistance to euro-area Member States in "exceptional circumstances beyond such Member States' control", so to preserve financial stability in the EU.[37] Both Ireland[38] and Portugal[39] have received assistance under this mechanism, followed by Spain[40] and Cyprus.[41]

In some instances financial assistance was also granted to Member States outside the euro area, thereby making use of an existing Union law instrument appli-

[34] IMF Reaches Staff-level Agreement with Greece on € 30 Billion Stand-By Arrangement, Press Release No. 10/176 of 2 May 2010.

[35] Based on Art 122(2) TFEU. See Reg 407/2010, [2010] OJ L 118/1.

[36] EFSF Framework Agreement between Belgium, Germany, Ireland, Spain, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia, Finland, Greece and European Financial Stability Facility, 7/6/2010 and the European Financial Stability Facility of 7/6/2010. See also Articles of Incorporation of 15/12/2010.

[37] See consideration recital (5) of Reg 407/2010.

[38] Details on the economic adjustment programmes for Ireland, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/ireland/index_en.htm.

[39] Details on the economic adjustment programmes for Portugal, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/portugal/index_en.htm.

[40] In the case of Spain assistance was specifically geared towards the recapitalisation of financial institutions. Details on the financial assistance programme, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/index_en.htm.

[41] Details on the economic adjustment programmes for Cyprus, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/cyprus/index_en.htm.

cable to non-euro area Member States only.[42] Hungary[43], Latvia[44] and Romania[45] have received balance-of-payment assistance. In fact in the case two of these three countries, Hungary and Latvia, financial assistance preceded that for the euro area Member States.[46]

Focusing on the euro area Member States, commencing with Greece the actual disbursement of financial assistance has been arranged in tranches and subject to strict conditionality in the shape of so-called Economic Adjustment Programmes[47] consisting of two main components. The first component is a Memorandum of Economic and Financial Policies,[48] laying down the main economic and financial policies that the Member State in question has to commit itself to, such as increasing taxes and reducing public investment and public salaries. Building on this memorandum is a Memorandum of Understanding on Specific Economic Policy Conditionality[49] that identifies concrete policy action linked mainly to fiscal consolidation measures and structural reform measures, such as the revision of private sector wage bargaining and contractual arrangements.

The pay out of tranches is subject to positive assessments in quarterly reviews mainly of the compliance with the terms of the Memorandum of Understanding on Specific Policy Conditionality.[50] The programme review missions are conducted by staff teams from the so-called Troika (European Commission, ECB and IMF), and

[42] Art 119 TFEU and Reg 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments, [2002] OJ L 53/1.

[43] Details on the Memorandum of Understanding and the reviews of the assistance programme for Hungary, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/hungary/index_en.htm.

[44] Details on the Memorandum of Understanding and the reviews of the assistance programme for Latvia, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/latvia/index_en.htm.

[45] Details on the Memorandum of Understanding and the reviews of the assistance programme for Romania, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/romania/index_en.htm.

[46] Decision 2009/102/EC providing Community medium-term financial assistance for Hungary, [2009] OJ L 37/5; Decision 2009/289/EC on granting mutual assistance for Latvia, [2009] OJ L 79/37; Decision 2009/290/EC providing Community medium-term financial assistance for Latvia, [2009] OJ L 79/39.

[47] See eg European Commission, The Economic Adjustment Programme for Portugal. Eight and Ninth Review, Occasional Papers 164, November 2013, http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op164_en.htm.

[48] See eg Memorandum of Economic and Financial Policies of 3/5/2010. See European Commission, The Economic Adjustment Programme for Greece, Attachement I. This includes specific quantitative performance criteria and indicative targets.

[49] Ibid, European Commission, The Economic Adjustment Programme for Greece, Attachment II.

[50] See eg European Commission, Economic Adjustment Programme for Ireland Autumn 2013 Review, European Economy. Occasional Papers. 167, December 2013. http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op167_en.htm.

may result in the periodical amendment of the above-mentioned memoranda of understanding, for example resulting from a change in the macroeconomic outlook.[51]

In parallel to these acute crisis measures that were primarily aimed at stabilizing the economies of euro area Member States in financial distress, evading contagion and, arguably, the destabilisation of the financial markets, the EU swiftly took measures aimed at improving the economic governance framework of EMU with the aim to learn from "Experience gained and mistakes made during the first decade of the economic and monetary union".[52] While leaving the main primary Union law provisions and mainly Articles 121 and 126 TFEU unchanged (with the exception of the amendment of Article 136 TFEU), the multilateral surveillance and excessive deficit procedures have nevertheless undergone major reforms. This has first and foremost taken the shape of two secondary Union law packages commonly referred to as the 'Six Pack' and 'Two Pack', consisting of no less than seven Regulations and one Directive.[53] Adding to these Union law measures, agreement was reached among 25 Member States on the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact), an intergovernmental treaty with the aim to "strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact."[54] Shortly before that the heads of state and government of the then 17 euro area Member States had also agreed on the establishment of a permanent mechanism to provide financial assistance to euro area Member States. To this end, the European Stability Mechanism (ESM) was established, which in the course of 2013 has taken over the tasks of the EFSM and EFSM as far as the distributing

[51] At the time of writing of this contribution, Ireland had announced to not request any further financial assistance and thus to become the first of the currently 5 € area Member States to exit the economic adjustment programme, which was immediately celebrated as by 'a living example that EU-IMF adjustment programmes are successful provided there is a strong ownership and genuine commitment to reforms.' See Statement by the Eurogroup on Ireland of 14/11/2013. Available at http://ec.europa.eu/economy_finance/assistance_eu_ms/ireland/index_en.htm.

[52] See recital 3 of Reg 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, [2011] OJ L 306/1.

[53] Six Pack: Reg 1173/2011 on the effective enforcement of budgetary surveillance in the euro area; Reg 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, [2011] OJ L 306/8; Reg 1175/2011 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, [2011] OJ L 306/12; Reg 1176/2011 on the prevention and correction of macroeconomic imbalances, [2011] OJ L 306/25; Reg 1177/2011 amending Reg (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, [2011] OJ L 306/33; Dir 2011/85/EU on requirements for budgetary frameworks of the Member States, [2011] OJ L 306/41. Two Pack: Reg 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, [2013] OJ L 140/1; Reg 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, [2013] OJ L 140/11.

[54] Article 1 Fiscal Compact. Signed on 2/3/2012, the Fiscal Compact entered into force on 1/1/2013. The Treaty was signed by all Member States except for the Czech Republic and the UK. At that time Croatia had not yet acceded to the EU.

of new loans is concerned.[55] The establishment of the ESM was preceded by an amendment of Article 136 TFEU on measures specific to the euro area Member States, introducing a new paragraph explicitly allowing for the establishment of a stability mechanism "to be activated if indispensable to safeguard the stability of the euro area as a whole" under the condition that its operationalization is subject to "strict conditionality".[56] Spain[57] and Cyprus[58] were the first two countries to received financial assistance by the ESM.

It would go beyond the scope of this contribution to discuss the substance of all these measures and their interrelationship in any detail.[59] What needs to be observed in the present context is that the new legal framework in practice arguably results in a restriction of national policy space and a substantive shift of economic policy decision-making power in the euro area. Vertically this shift can be observed for the relationship between the Member States and the supranational European level, calling into question the paradigm of *national* economic policy.[60] Horizontally this shift can be observed at the Union level were the role of the national governments represented in the Council of the European Union decreases in favour of the position of the European Commissioned.[61]

An overall appraisal of the Six and Two Pack, as well as the Fiscal Compact and even the ESM Treaty suggest that outside the framework of the Economic Adjustment Programmes applicable to euro area Member States that have been granted financial assistance under the EFSM/EFSF or ESM scheme, the room for the conduct of a self-determined economic policy is considerably restricted, if and to the extent that the

[55] T/ESM/2012/en. Signed on 2/2/2012.

[56] European Council Decision 2011/199/EU amending Art 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro, [2011] OJ L 91/1.

[57] In the case of Spain assistance was specifically geared towards the recapitalisation of financial institutions. Details on the financial assistance programme, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/index_en.htm.

[58] Details on the economic adjustment programmes for Cyprus, including the relevant documentation, can be found at http://ec.europa.eu/economy_finance/assistance_eu_ms/cyprus/index_en.htm.

[59] For a broader overview and debate of the impact and legality of these measures see eg M Ruffert, 'The European Debt Crisis and European Union Law' (2011) 48 *Common Market Law Review* 1777; A De Gregorio Merino, 'Legal Developments in the Economic and Monetary Union During the Debt Crisis: the Mechanisms of Financial Assistance' (2012) 49 *Common Market Law Review* 1613; See eg P Craig, 'The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism' (2012) 37 *European Law Review* 231; C Herrmann, 'Legal Aspects of the European Sovereign Debt Crisis' (2013) 41 *Hitotsubashi Journal of Law and Politics* 25; K Armstrong, 'The new governance of EU fiscal discipline' (2013) 38 *European Law Review* 601; F Amtenbrink, 'Legal Developments' (2012) 50 *Journal of Common Market Studies* 132; id, 'Legal Developments' (2013) 51 *Journal of Common Market Studies* 139.

[60] See Arts 5 and 120 TFEU.

[61] See already in this regard F. Amtenbrink, 'Some Reflections on the (Potential) Effects of the Euro Area Debt Crisis on the European Union Constitutional Order', in F Basaran Yavaslar (ed), Basaran Yavaslar Avrupa Birligi'nde Mali Kriz Ve Tuerkiye'YE Etkileri (The Economic Crisis in the European Union and its Effects on Turkey) (Istanbul/Ankara, seckin, 2013), 165–199, 169 ff.

new framework is fully applied in practice.[62] At the national level this does not only go at the expense of the room for manoeuvre of national governments, but potentially also the budgetary rights of national parliaments. Contributing to this is mainly the introduction of the European Semester, the macroeconomic imbalances procedure, and the (fiscal) rules introduced by the Fiscal Compact and the ESM Treaty.

The European Semester is aimed at the introduction at the Union level of a comprehensive economic and fiscal policy planning cycle as part of the previously existing economic policies coordination cycle based on supranational Broad Economic Policy Guidelines and national Stability and Convergence Programmes.[63] The 6-month surveillance cycle that starts with the publication by the European Commission of an Annual Growth Survey, including concrete policy recommendations and, thereafter, European Council policy guidelines, which the Member States are expected to include mainly in their Stability and Convergence Programs and national reform programs. Based on a review of the latter, the European Commission makes country-specific recommendations, to be endorsed by the European Council, which the Member States are expected to implement in their national economic policies.

Member States have to ensure that their budgetary procedures are consistent with this euro area economic policy cycle and namely with the economic policy guidelines and recommendations issued.[64] They are not only obliged to annually publish "national medium-term fiscal plans in accordance with their medium-term budgetary framework" that are "consistent with the framework for economic policy coordination in the context of the annual cycle of surveillance" before the end of April, but also publish their draft budgets for the next year by half October.[65] The draft budgets moreover have to be forwarded to the European Commission. If the European Commission concludes that the draft budget amounts to a "particularly serious non-compliance with the budgetary policy obligations laid down in the [Stability and Growth Pact]", it can request from the national parliament the submission of a revised draft budgetary plan.[66]

Technically speaking *Šefčovič* is correct in pointing out that in the new legal framework "national budgets will continue, quite rightly, to be agreed and adopted by national parliaments"[67] However, at the same time it can also be observed that national parliaments are restricted in their leeway not only with regard to the organization of the national budget cycle, but also in deciding on the substance of the

[62] Such a reservation is called for considering the experience with the application of the pre-crisis legal framework.

[63] See the new section 1-A of Reg 1466/97 (as amended) in conjunction with Reg 473/2013. With regard to the structure of the previous system see F Amtenbrink, A Geelhoed and S Kingston, 'Chapter X. Economic, Monetary and Social Policy' in AM Mcdonnell, PJG Kapteyn, K Mortelmans and CWA Timmermans (eds), *The Law of the European Union and the European Communities*, 4th ed (Alphen aan den Rijn, Kluwer Law International, 2008) 914.

[64] Art 3 Reg 473/2013.

[65] Art 4(1) and (2) Reg 473/2013.

[66] Art 6 Reg 473/2013. Brackets added.

[67] M Šefčovič, 'Democratic oversight for Europe's evolving economic governance: the role of national parliaments', Intervention at COSAC chairpersons' meeting, Copenhagen, 30/1/2012, at 3.

budget. *Hefftler and Wessels* observe in this context that "national parliaments have increasingly become aware of the impact of EU decisions on significant parliamentary prerogatives. In the domestic arena, the majority of national parliaments have increased their legal and political influence as a reaction to this."[68] This seems to underlined by the understandable fear of national parliaments that the European Semester may "undercut the budgetary powers of national parliaments".[69]

Next to the new European economic policy cycle it can also be observed that the review of planned economic policies and the monitoring of economic developments is broadened beyond budgetary surveillance and thus the government deficit and debt levels, to include "any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole".[70] As part of the multilateral surveillance procedure laid down in Article 121 TFEU, on a recommendation from the Commission the Council can address recommendations to a Member State for which an in depth-review by the Commission has revealed macroeconomic imbalances. The existence of an excessive imbalance can trigger an excessive imbalance procedure in the context of which Member States are subjected to specific policy recommendations and deadlines, which they have to follow up in a national corrective action plan that has to include specific policy actions to be approved by the Council.[71] Non-compliance results in sanctions, initially in the form of a non-interest bearing deposit, and in case of continuing non-compliance in the form of an annual fine.[72]

Both in the regular multilateral surveillance procedure and the macroeconomic imbalances procedures a subtle but important shift of power can be observed in the decision-making process in favour of the European Commission. Indeed, while in principle it is still presumed that the designated European institution to act based on a European Commission recommendation is the Council, different than in the past, indecision in this forum does not inevitably result in inaction. Instead decision on the absence of effective action of a significant deviation from the adjustment path towards the medium-term budgetary objective in the multilateral surveillance procedure and on the application of sanctions in the macroeconomic imbalances procedure are subject to a new reversed voting procedure. The Commission recommendation is under certain conditions "deemed to be adopted by the Council unless it decides, by simple majority, to reject the recommendation within 10 days of its adoption by the Commission. "[73]

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[68] C Hefftler and W Wessels, 'The Democratic Legitimacy of the EU's Economic Governance and National Parliaments' (2013) *IAI Working Papers 13*, 11, http://www.jmc.uoa.gr/fileadmin/jmc.pspa.uoa.gr/uploads/PDFs/iaiwp1313.pdf.

[69] Ibid, 9.

[70] Art 2(1) Reg 1176/2011.

[71] Arts 7–9 Reg 1176/2011.

[72] Art 10(4) Reg 1176/2013 in conjunction with Art 3 Reg 1174/2011.

[73] Art 6(2) Reg 1466/97 (as amended) and Art 3(3) Reg 1174/2011.

Interestingly the Fiscal Compact foresees in a similar reversing of voting in the context of the excessive deficit procedure.[74] More importantly, this Treaty commits the signatory Member States[75] to a balanced or surplus budgetary position,[76] a rule that has to be implemented in the national legal order "through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes."[77] Even if the debt level of a country stays significantly below the excessive deficit threshold of 60 % of GDP laid down in primary Union law,[78] Member States are not allowed to have a structural deficit of more than 1 % of GDP. What is more the Fiscal Compact requires Member States to provide for an automatic correction mechanism, based on European Commission principles, to be triggered "in the event of significant observed deviations from the medium-term objective or the adjustment path towards it".[79] Failure to comply with the requirement to introduce a debt break and automatic correction mechanism can result in a infringement-like procedure before the CJEU and the application of sanctions.[80] Interestingly, Article 3(2) Fiscal Compact explicitly states that "Such correction mechanism shall fully respect the prerogatives of national Parliaments." Yet, whether this is actually possible considering the extent of the requirements set out in Article 3(1) seems to depend both on the definition of the scope of European influence and its impact on national parliamentary prerogatives.[81]

The Fiscal Compact also forms part of the broader strategy implemented with the ESM to make financial assistance to euro area Member States subject to strict conditionality. In fact, the preamble to the ESM Treaty explicitly states that the granting of financial assistance is conditional on the ratification of the Fiscal Compact and the compliance with Article 3(2) of the latter Treaty.[82] The aim of the ESM Treaty is to "provide stability support to an ESM Member when its regular access to market financing is impaired or is at risk of being impaired."[83] For this purpose, backed by the authorized capital stock of the participating Member States, the ESM raises funds "by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third

[74] Art 7 Fiscal Compact.

[75] While the Fiscal Compact is primarily geared towards euro area Member States, it is open for participation by non-euro area Member States.

[76] Measured as an annual structural deficit below 0.5 % GDP.

[77] Art 3(2) Fiscal Compact.

[78] Art 126(1) TFEU in conjunction with Art 1 of the Protocol on the excessive deficit, [2008] OJ C 115/279.

[79] Art 3(1) (e) and (2) Fiscal Compact.

[80] The jurisdiction of the CJEU derives from Art 8 Fiscal Compact in conjunction with Art 273 TFEU.

[81] See also section 11.3.2.

[82] Preamble no 5 ESM Treaty. Similar to the Fiscal Compact, non-euro area Member States are free to join the ESM Treaty.

[83] Ibid, preamble no 13.

parties", which are thereafter utilized to grant financial assistance to ESM Member States.[84] Financial assistance may come in various forms,[85] but in any event is limited to situations in which a ESM Member State experiences, or is threatened by, severe financing problems, whereby financial assistance is "indispensable to safeguard the financial stability of the euro area as a whole and of its Member States".[86] In principle the decision to grant financial assistance is taken by unanimity by representatives of the ESM Member States on the Board of Governors of the ESM, as a result of which no decisions can be taken against the will of a national government. However, an emergency voting procedure applies in case that the European Commission and the ECB both conclude that a failure to urgently adopt a decision to grant or implement financial assistance "would threaten the economic and financial sustainability of the euro area".[87] In such a case decisions by the ESM Board of Governors, which are normally adopted by mutual agreement, require only a qualified majority of 85 % of the votes cast, whereby the voting rights of the members are equal to the number of shares allocated to the respective Member States in the authorised capital stock of the ESM. Considering their capital subscriptions this effectively gives France, Germany and Italy a veto right, whereas other Member States may be outvoted.

Of the capital stock of the ESM of EUR 700,000 million, initially only the EUR 80,000 million has to be paid-in by the Member States, The majority part of EUR 620,000 million, the so-called callable shares, can be called upon by Board of Governors ESM by unanimity.[88] Finally, the ESM Treaty limits the liability of the ESM Member States "in all circumstances, to their share in the authorised capital stock at its issue price, as "no ESM Member shall be liable, by reason of its membership, for obligations of the ESM.[89]

Overall, as has been observed elsewhere, the new legal framework governing economic policy coordination in the euro area results in "a further technocratization of economic policy at the national level".[90] For euro area Member States that are subject to an Economic Adjustment Programme the strict conditionality applicable to the loans granted goes at the expense of the national policy space, as it can be argued that the principle constitutional actors, i.e. governments and parliament, in practice have little choice but to implement the measures necessary to meet the concrete targets laid down in the Memorandum of Understanding on Specific Economic Policy Conditionality. Otherwise they risk the pay out of the next trench of the loan granted and a further loss of credibility on the financial markets. Yet, this intrusion on the national policy space is not restricted to euro area Member States in financial distress, as the new European legal framework provides for the early in-

[84] Art 3 ESM Treaty.

[85] See Arts 14–18 ESM Treaty.

[86] Art 12(1) ESM Treaty.

[87] Art 4(4) ESM Treaty.

[88] Arts 8 and 9 ESM Treaty.

[89] Art 8(5) ESM Treaty.

[90] Amtenbrink, 'Legal Developments' (2012) 144.

volvement of Union institutions in national budgetary planning and Member States unbalanced budget and macroeconomic imbalances are supposed to subject themselves to automated corrective measures. Thus arguably a vertical shift of policy making power takes place from the national to the supranational European level. Moreover also an inter-institutional shift of power can be observed at the European level to the advantage namely of the European Commission.

Bertoncini and Kreilinger have rightly observed in the context of the Economic Adjustment Programmes that: "Composed by experts from the IMF, the Commission and the ECB, the Troika symbolises the exercise of enormous powers by technocratic actors and, as such, perfectly echoes the traditional critic of the EU's 'democracy deficit'. The emergence of this new body must lead not only to a better assessment of the real nature and scope of the EU powers regarding its member states, but also to identify more clearly the way EU decisions are made and the 'input legitimacy' they are based on." The brief overview of the measures highlights that the same observation can also be extended to the structural reform of the legal framework for economic policy coordination. These reforms too have consequences for the delicate system of democratic legitimation of public power in the multidimensional legal order of the EU and the role that national and EU institutions play in this regard.

In fact the impact of the new economic governance framework on national parliaments has also been acknowledged by the main EU institutions, which in the December 2012 report stress the need for strong democratic legitimacy and accountability mechanisms. While recognising that 'Decisions on national budgets are at the heart of Member States' parliamentary democracies', the authors of the report also draw the somewhat provoking conclusion that 'the provisions for democratic legitimacy and accountability should ensure that the common interest of the union is duly taken into account; yet national parliaments are not in the best position to take it into account fully'.[91] This seems to be a plea for a greater role for the European Parliament in European economic governance than is currently foreseen.

11.3.2 Constitutional Challenges[92]

From the previous section it has emerged that the legal framework pertaining to economic policy coordination in EMU has been altered substantially. This reform is not limited to the amendment of existing Union law, but actually involves a substantial extension of the scope of economic policy coordination. Rather than to make use of existing Union competences only, mainly for reasons of political disagreement on the amendment of the existing Treaties, in the course of the reform recourse

[91] 'Towards a Genuine Economic and Monetary Union', report of 5/12/2012 by the President of the European Council in close collaboration with the Presidents of the European Commission, the Eurogroup and the European Central Bank.

[92] The assessment included in this section of the decision of the CJEU in case C-370/12 *Pringle*, as well as the decisions by the Estonian Supreme Court of 12/7/2012 and by the German Federal Constitutional Court of 12/9/2012 draw on Amtenbrink, 'Legal Developments' (2013) 140–149.

was also taken to intergovernmental instruments. Overall the new legal framework does not only affect the economic policy decision-making processes at the level of the Member States and namely the role of national parliaments, but in the case of Member States subjected to Economic Adjustment Programms, also in a much more direct way the the legal position of individuals. As the examples of Greece and Portugal show, they are the one that are actually affected by the far-reaching national austerity measures.

The extent and scope of measures taken as a response to the euro area sovereign debt crisis are thus predetermined to become subject to review both in national highest (constitutional) courts and before the CJEU.

What emerges from a preliminary and thus by no means exhaustive scan of relevant cases is first of all that until now judicial proceedings take place primarily in the national domain before national (highest) (constitutional) courts and tribunals and with the exception of the amendment of Article 136 TFEU focus mainly on the intergovernmental instruments outside the Treaty framework. This is hardly surprising considering that the reform measures within the Union framework have taken the shape of generally applicable secondary law instruments, which are much less suited target for constitutional challenges before national courts or before the CJEU.

In the sphere of the acute crisis measures, the focus was on national measures allowing for the bilateral loans granted to Greece and the establishment of the EFSF and EFSM. With regard to the structural reform of the legal framework of European economic governance, next to the compatibility of such measures with existing Union law, and with the exception of the amendment of Article 136 TFEU, cases focus on the compatibility with national constitutional provisions of the ratification of the Fiscal Compact and the ESM Treaty and thus two central elements of the new European economic governance framework. Until now this has only in one instance resulted in a referral to the CJEU. Focusing in the present contribution on the challenge of the new legal framework for a breach of national (constitutional) law, it can moreover be observed that all of the cases discussed below have in common that the impact of the European measures on the national constitutional legal orders and namely parliamentary democracy take centre stage.

The French Constitutional Council in its decision on the constitutionality of the ratification of the Fiscal Compact focused on the impact of said Treaty on the rights of parliament namely with regard to the balanced budget rule and the obligation created by Article 3(2).[93] The Constitutional Council concluded that "the direct introduction of provisions of binding force and permanent character mandating compliance with rules on balanced public finances requires that these constitutional provisions be amended", as it would otherwise infringe the constitutional prerogatives not only of government but also of parliament "in the elaboration and enactment of finance laws and social security financing laws" and moreover "the principle that finance laws are to be enacted annually".[94] On the contrary, the second alternative

[93] See section 11.3.1 above.

[94] Decision no. 2012-653 DC of 9/8/2012, consideration no 21. The Court's own English translation is available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/

provided in Article 3(2) was considered compatible with the French Constitution, as this would "leave the States with the freedom to determine the provisions the full respect for and adherence to which 'otherwise' guarantees that the rules on balanced public finances will take effect under national law".[95]

While recognizing that the automatic correction mechanism provided for in Article 3(1) (e) in conjunction with Article 3(2) Fiscal Compact implies "measures regarding all public administrations, especially the State, local government and social security bodies", the Constitutional Council nevertheless did not consider this obligation in conflict with the French Constitution. In its view neither the prerogatives of the national parliaments nor the principle of freedom in the administration of local government bodies is infringed, as "the procedures according to which this mechanism must be triggered or the measures which must be implemented as a result" are not defined, leaving "the States free to determine these procedures and measures in accordance with their constitutional law".[96] Finally also the requirement for Member States with an excessive deficit to put in place and implement budgetary and economic partnership programmes, to be endorsed by the Council and the Commission, was considered compatible with the prerogatives of parliament. Interestingly, rather than to emphasize the freedom of government and parliament with regard to the procedure and measures that are applied, the Constitutional Council somewhat laconically states that "the existence of such a programme does not have any binding consequences under national law".[97] Whether this interpretation of the budgetary and economic partnership programmes as soft-law is shared by the main actors in economic governance at the Union level and mainly the European Commission is questionable.

In its decisions of September 2012 concerning an application for interim relief against several German Federal laws effectively implementing the ESM and the Fiscal Compact, the German Federal Constitutional Court also emphasized the constitutional requirement that national parliament must retain control over fundamental budgetary decisions, thereby repeating the position it expressed in its 2011 decision on the constitutionality of the bilateral loan to Greece.[98] For the Court "As representatives of the people, the elected Members of the German Bundestag must retain control of fundamental budgetary decisions even in a system of intergovernmental governing."[99] The fact that Germany has committed itself "not only legally,

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case-law/sample-of-decisions-in-relevant-areas-dc/decision/decision-no-2012-653-dc-of-9-august-2012.115501.html.

[95] Ibid, consideration no 22.

[96] Ibid, consideration no 25. Note the broad wording of the decision, referring generally to the impact on national parliaments and thus not only the French situation. This is somewhat odd as this suggests that the judges have made a study of the constitutional situation in all signatory Member States.

[97] Ibid, consideration no 32.

[98] BVerfG, 12/9/2012, 132 *Entscheidungen des Bundesverfassungsgerichts* 195. See also already the 2011 decision: BVerfG, 7/9/2011, 129 *Entscheidungen des Bundesverfassungsgerichts* 124—'Greece', para 124.

[99] Ibid, para 211.

but also with regard to fiscal policy" does not as such, in the view of the Court, result in an infringement of the budgetary rights of parliament contrary to Article 38(1) German Basic Law. At the same time the Court does identify constitutional boundaries when noting that:

> the relevant factor for adherence to the principles of democracy is whether the German Bundestag remains the place in which autonomous decisions on revenue and expenditure are made, including those with regard to international and European liabilities […] If essential budget questions relating to revenue and expenditure were decided without the mandatory approval of the German Bundestag, or if supranational legal obligations were created without a corresponding decision by free will of the Bundestag, parliament would find itself in the role of mere subsequent enforcement and could no longer exercise its overall budgetary responsibility as part of its right to decide on the budget […].[100]

As has been pointed out elsewhere, the Courts "more general reflections on the role of a national parliament can be interpreted as a word of caution against any further stripping of the rights of national parliaments for as long as the current constitutional structure of the EU has not been replaced by a more federal structure in which the rights of national parliaments and of the European Parliament are redefined accordingly."[101] Indeed, once more referring to its 2011 decision the German Court reasons that

> the German Bundestag may not transfer its budgetary responsibility to other entities by means of imprecise budgetary authorisations. The larger the financial amount of the commitments to accept liability or of commitment appropriations is, the more effectively must the German Bundestag's rights to approve and to refuse and its right of monitoring be elaborated. In particular, the German Bundestag may not deliver itself up to any mechanisms with financial effect which—whether by reason of their overall conception or by reason of an overall evaluation of the individual measures—may result in incalculable burdens with budget significance without prior mandatory consent, whether these are expenses or losses of revenue.[102]

Interpreting the ESM rules on the authorized capital stock and the limited liability of the ESM Member States itself the Court concluded that the ESM Treaty does not result in such an incalculable burden.

The Court moreover also considered the scope of the Fiscal Compact concluding that "It grants the bodies of the European Union no powers which affect the overall budgetary responsibility of the German Bundestag […] and does not force the Federal Republic of Germany to lay down its economic policy permanently in a way that can no longer be reversed".[103] In this context the Court first of all referred to the debt break provided for in the German Basic Law, which is "essentially similar in structure" and also aims at "preventing the development of indebtedness".[104] Moreover, the Court also took the view that the Fiscal Compact actually amounts to a concretization of primary Union law provisions pertaining to economic policy coordi-

[100] Ibid, para 211. Brackets added.

[101] Amtenbrink, 'Legal Developments' (2013) 148.

[102] Ibid, para 212, with reference to BVerfG, 'Greece'.

[103] Ibid, para 300. Brackets added.

[104] Ibid, para 302. Namely Arts 109, 109a, 115 and 143d German Basic Law.

nation in EMU. Even the obligation included in Article 3 Fiscal Compact to provide for automatic correction mechanisms was not considered problematic. For the Court the reference in the very same provision to the national parliamentary prerogatives can only mean that this provision "is restricted to the institutional provisions and gives the European Commission no authority to impose specific substantive requirements for the structuring of the budgets".[105] Interestingly, in its decision the German Federal Constitutional Court explicitly referred to the interpretation of Article 3 by the French Constitutional Council in its decision on the Fiscal Compact.[106]

What remains unclear however is why the European Commission's right to lay down common principles for the corrective mechanism, which also in the view of the German Court entails the specifying of "the nature, size and time-frame of the corrective action to be taken" can under no circumstances affect the overall budgetary responsibility of the parliament in a constitutionality relevant way.[107] This is even more so the case as the Court in the paragraph of the decision itself implicitly seems to recognise that the Fiscal Compact can commit Member States to a particular budget policy, stating that Germany is not "*irreversibly* bound by these requirements".[108]

One can only speculate what the German Federal Constitutional Court would have made of the emergency voting procedure provided for in Article 4(4) ESM Treaty that abrogates the unanimity requirement for granting financial assistance.[109] Considering that the German share in the capital of the ESM effectively secures the German government a veto right the German Court had no reason to deal with this provision. However, Article 4(4) did take centre stage in the constitutional challenge of the ESM Treaty before the Estonian Supreme Court (*Riigikohus*).[110] In fact as a preliminary finding the Court stated that the emergency voting procedure "interferes with the financial competence of the Riigikogu provided for in § 65 (6) of the Constitution in conjunction with § 115 (1) of the Constitution and in § 65 (10) of the Constitution in conjunction with § 121 (4) of the Constitution, and is related to the principle of a democratic state subject to the rule of law and with the state's financial sovereignty."[111] However, rather than to therefore conclude that a ratification of the ESM Treaty would be unconstitutional, the Court *en banc* considers the interference of Article 4 (4) ESM Treaty with the Estonian Constitution "justified by substantial constitutional values—obligation arising from the preamble to and § 14 of the Constitution to guarantee the protection of fundamental rights and freedoms". In this context the majority of presiding judges considered that "Article 4 (4) […] provides for an appropriate, necessary and reasonable measure for the

[105] Ibid, para 315.

[106] Ibid, para 311.

[107] Ibid, para 315.

[108] Ibid, para 319. Emphasise added.

[109] See section 3.1 above.

[110] Estonian Supreme Court, decision no. 3-4-10-6-12 of 12/7/2012, para 159. An English language version of the decision is available at http://www.riigikohus.ee.

[111] Ibid, para. 159. Brackets added.

achievement of the objective", being "to guarantee the efficiency of the ESM also in case the states are unable to make a unanimous decision to eliminate a threat to the economic and financial sustainability of the euro area."[112]

The number of descending opinions attached to this decision and the rather astonishingly frank language applied therein highlight the degree of disagreement among the judges as to the constitutionality of the ESM Treaty. In one major descending opinion six judges question the application of the principle of proportionality as a yardstick to assess the constitutionality of the ESM Treaty stating that instead

> it should have been assessed whether the contested emergency procedure which leaves the state of Estonia out of the decision-making outweighs the sovereignty of the state of Estonia, including the financial competence of the *Riigikogu* and the principle of a state subject to the rule of law which are one of the most substantial principles. The answer to that question is negative in our opinion.[113]

In the case of Poland, a Member State outside the euro area, only the Polish act of ratification of the European Council Decision amending Article 136 TFEU was subject to a constitutional challenge before the Polish Constitutional Tribunal (*Trybunał Konstytucyjny*).[114] The decision does not explicitly address the impact of the establishment of a European Stability Mechanism on parliamentary prerogatives. Nevertheless, the effects of said Treaty in the national constitutional order did stand at the centre of the judicial review, as the applicants claimed that the ratification of the Council decision required the application of Article 90 of the Polish Constitution of 1997, according to which the delegation to an international organization of competences of "organs of state authority in relation to certain matters" requires a two-third majority in both houses of parliament (*Sejm* and Senate) or a nationwide referendum ratification had actually taken place. Yet, based on Article 89, which foresees in a simple majority vote. In essence the Tribunal had to determine whether the inclusion of paragraph 3 in Article 136 TFEU amounts to the conferral of new competences onto the EU. The Tribunal answered this to the negative thereby notably referring to the reasoning of not only of the CJEU in *Pringle*, briefly discussed hereafter, of but also the German Federal Constitutional Court in the above mentioned 2012 decision and, albeit briefly, the Austrian Constitutional Court in its decisions on the same principle issue.[115]

Almost as an afterthought in the conclusions to its decision the Polish Constitutional Tribunal also reflected on the ESM Treaty, which Poland as a non-euro area Member State as not (yet) signed. The Tribunal noted that "the ESM has actually changed the architecture of the Economic and Monetary Union", with serious consequences not only for the Member States that have to subject themselves to strict conditionality in order to receive financial aid, but for all signatory Member States,

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[112] Ibid, paras 169, 209, 179.

[113] Ibid, dissenting opinion of the justices Henn Jõks, Ott Järvesaar, Eerik Kergandberg, Lea Kivi, Ants Kull and Lea Laarmaa, para 8.

[114] Polish Constitutional Tribunal, decision of 26/6/2013, Ref No K 33/12. The Court's own translation can be found at http://www.trybunal.gov.pl/eng/summaries/documents/K_33_12_en.pdf.

[115] Ibid, section 7.4.

as they "accept an obligation […] to cover their share of capital in that institution, as well as to provide—upon fulfilment of further premises—funds to cover the subscribed capital, or even to cover the shares of any insolvent signatories to the Treaty [which] implies a substantial burden for the budgets of the Member States involved."[116] The Tribunal leaves no doubt as what its own role may be in the future: "Statutes aimed at adjusting Polish law to the requirements of the euro area, as well as a possible statute grating consent to the ratification of the ESM Treaty, will be potential subjects of constitutional reviews to be carried out by the Constitutional Tribunal".[117]

In a case brought on appeal from the Irish High Court to the Irish Supreme Court, a member of the Irish lower House of Parliament challenged the ratifications of the European Council Decision amending Article 136 TFEU and the ESM Treaty.[118] The applicant claimed both an infringement of the Irish Constitution and the incompatibility of these measures with Union law.

With regard to the former the main question dealt with by the Supreme Court was whether "the ESM Treaty involves a transfer of sovereignty to a degree that makes it incompatible with the Constitution, when one applies the principles" set out in previous case law. The applicant had namely argued that "the open-ended and imprecise powers and functions conferred on the ESM institution, and its degree of autonomy, the proposed Treaty constitutes a degree of delegation of sovereignty that is incompatible with the Constitution and is required to be the subject of a referendum" and moreover, that said Treaty "entails the transfer by [parliament] of an impermissible degree of monetary and budgetary power to the executive branch of the State and, in particular, to the Minister of Finance […] contrary to Articles 5, 6 and 17 of the Constitution."[119] The Supreme Court did not follow this argument in a nutshell pointing out that the two main functions of the ESM Treaty, namely "to raise funds, by subscriptions from the states and to borrow money, and [to] support member states in financial difficulties" will not affect the economic or monetary sovereignty of Ireland.[120] Even the possibility of being overruled in the context of the emergency procedure in accordance with Article 4(4) ESM Treaty was not considered to constitute such an abrogation of sovereignty as, in the view of the Court, this and other decisions in the ESM Treaty implement "a specific policy of the ESM Treaty, through a specified mechanism, within the limits of the specified maximum financial contribution."[121]

On the issue of the compatibility with Union law of the amendment of Article 136 TFEU and the ESM Treaty with Union law, the Supreme Court decided to stay the proceedings and make a preliminary reference to the CJEU. This has resulted in

[116] Ibid, section 7.6.1. Brackets added.

[117] Ibid, section 7.6.1.

[118] The Supreme Court, Appeal No. 339/2012, judgment of 19/10/2012.

[119] Ibid, section 6.xvii. According to Art 5 of the Irish Constitution 'Ireland is a sovereign, independent, democratic State.'

[120] Ibid, section 17 iv and vi.

[121] Ibid, section 17xi.

the CJEU's only decision so far in the sphere of new legal framework and namely the compatibility of amendment of Article 136 TFEU and the ESM Treaty with primary Union law.[122] While arguably providing "valuable insights into the distribution of competences in EMU and the scope of central provisions of Title VIII TFEU relating to economic and monetary policy governing the euro area"[123] the decision does not include any more general reflections on the impact of the ESM on the Union's own structural principle of representative democracy.

Completing the picture on the challenges of the structural reform measures, the ratification of the European Council Decision to amendment Article 136(3) TFEU and the ESM Treaty in the Netherlands in summary proceedings before the District Court 's-Gravenhage was also unsuccessfully challenged by a member of the Dutch House of Representatives (*Tweede Kamer der Staten-Generaal*). The aim was to hold the legislative procedures geared towards ratification of the European Council decision to amend Article 136 TFEU and the ESM Treaty.[124] The plaintiff had claimed the unlawfulness of the ESM Treaty inter alia resulting from a lack of judicial control, the absence of democratic control, the violation of the budget rights laid down in Article 105 of the Dutch Constitution and the ministerial duty to inform parliament. The Court rejected a substantive review of the claim on procedural grounds with reference to the constitutional principle of separation of powers in the view of the Court this principle implies that the judiciary in principle cannot intervene in the legislative procedure and thus the political decision-making process. The Court did briefly engage with the argument submitted by the plaintiff that the introduction of Article 136(3) TFEU would amount to a breach of Union law and namely Article 125 TFEU. However the Court followed the arguments submitted by the government during the proceedings that primary Union law provided sufficient space for the introduction of the provisions of the ESM Treaty and that the latter did not contain any provisions aimed at derogating from the TFEU.[125]

Next to constitutional challenges of the acute crisis and structural reform measures two decisions from by the Portuguese Constitutional Tribunal (*Tribunal Constitucional*) highlight that also national austerity measures can become subject to constitutional review. While falling outside the main scope of this contribution the facts of the cases proof the point made in section 11.3.2 above that the strict conditionality applied in the context of financial assistance granted to Member States also rather directly affects the the legal position of individuals. In the first case various provisions of the Portuguese State Budget Law for 2012 providing "for 'suspension of the Christmas and holiday payment' (non-payment, in principle for a number of years, with no prospect of payment of the lost amounts at any time in the future), while simultaneously maintaining the measures involving 'remuneratory reduc-

[122] Judgment of 27 November 2012, Case C-370/12 *Thomas Pringle v Governement of Ireland, Ireland and The Attorney General*, not yet reported.

[123] Amtenbrink, (2013) (supra, n. 64).

[124] District court 's-Gravenhage, decision of 1/6/2012, case no 419556/ KG ZA 12-523.

[125] Ibid, section 3.6.

tions' contained in the [State Budget Law] for 2011 were challenged."[126] Addressee of these measures that were taken in order to comply with the budget deficit limits imposed by the European Economic Adjustment Programme were all public sector workers and retirees. While recognizing public debt reduction and the sustainability of the public finances as a public interest, the Tribunal considered these measures unconstitutional, pointing out that "the [constitutional] principle of equality with regard to the just distribution of public costs, as a specific manifestation of the principle of equality, is a necessary legislative parameter which the legislator must consider when it decides to reduce the public deficit in order to safeguard the state's solvency." In the headnote to the decision the Tribunal also reflects in a more generally, but very noteworthy way on the role of the constitution in the severe economic crisis: "The Constitution clearly cannot distance itself from economic and financial reality, but it does possess a specific normative autonomy that prevents economic or financial objectives from prevailing in an unlimited way over parameters such as that of equality, which the Constitution defends and with which it must ensure compliance."[127] The Constitutional Court came to a similar conclusion for the suspension or reduction of various work and pension-related benefits for public administration staff and pensioners in the State Budget Law for 2013.[128]

11.4 Epilogue

The present contribution has highlighted that from the very outset the impact of the legal framework governing EMU on the national constitutional systems was subject of debate in national highest (constitutional) courts and tribunals. The acute crisis and structural reform measures that have been taken as a response to the European financial and sovereign debt crisis have arguably altered this framework considerably, thereby rather profoundly challenging the concept of *national* economic policy still upheld in primary Union law. Arguably Six Pack, Two Pack, Fiscal Compact and ESM Treaty, but also the European Economic Adjustment Programmes that are at the heart of the strict conditionality that is applied to euro area Member States that receive financial assistance restrict the national policy space and namely the role of government and parliament in unreservedly formulating and implementing economic policy in the national domain.

To be sure, this may be desirable from an integrationist perspective or even an economic necessity considering the existence of a single currency area and the asymmetric integration of economic and monetary policy foresee in the Maastricht Treaty that has been rightly criticized from the start. Yet, it is questionable whether the present state of the European legal order, in which the national and supranational

[126] Constitutional Tribunal, decision of 5/7/2012, Ruling No 353/12. The Court's own English summary can be found at http://www.tribunalconstitucional.pt/tc/en/acordaos/20120353s.html.

[127] Ibid, headnotes.

[128] Constitutional Tribunal, decision of 5/4/2013, Ruling No 187/13. The Court's own English translation can be found at http://www.tribunalconstitucional.pt/tc/en/acordaos/20130187s.html.

(constitutional) systems are still intertwined and complementary, is sufficiently robust to support the current shift in economic policy from the national to the European level. It is readily admitted that this contribution raises more questions in this regard than its answers.

The decisions by national (highest) (constitutional) courts and tribunals show the extent to which the new legal framework of economic governance can touch upon structural principles of the national constitutional order and namely parliamentary democracy. Nevertheless, for the time being national highest (constitutional) courts by and large seem to take a pro-European stands even when in some instances calling for constitutional amendments, such as in the case of France. Some national highest (constitutional) courts can even be seen seeking support for their arguments in the decisions by courts of other countries and the CJEU, providing evidence for the much-vaunted judicial cooperation in the EU.

However, before drawing the conclusion from these observations that the new legal framework for economic policy coordination in EMU is unlikely to be the next constitutional battleground, some words of caution are called for. In none of the cases referred to in the previous section has a court has undertaken a comprehensive analysis of the new legal framework applying to economic policy coordination in the euro area. As the subject matter of the individual proceedings naturally determines the scope of the judicial review, an overall assessment of the impact of the new economic governance, thereby not only considering those intergovernmental instruments that require ratification in the national constitutional order, has not taken place. Thus, the combined legal and practical effects not only of the Fiscal Compact and the ESM Treaty, but also the Six Pack and Two Pack, on the national policy space and namely the constitutional functions of government and parliament have yet to be thoroughly analysed. The same arguably also applies to the CJEU, which in its decision in *Pringle* did not reflect on the compatibility of the new legal framework with the Union's own structural principle of representative democracy.[129] Yet, as the policy space for national parliaments decreases the still limited role of the European Parliament in economic policy decision-making should receive more attention.[130] As far as national courts are concerned, as hinted to by the Polish Constitutional Tribunal in its decision on the ratification of the European Council decision to amend Article 136 TFEU, the accession of new Member States to the euro area may bring with it the opportunity of a more comprehensive review of the consequences on the national policy space of the joining of the euro area.

What is more, the two decisions by the Portuguese Constitutional Tribunal point to another constitutional dimension that has not been the main focus of this contribution, namely the impact of the new legal framework on fundamental rights. Indeed, national constitutions may limit the scope of austerity measures geared towards meeting European economic policy prerogatives, impeding national government's efforts to comply with European duties.

[129] Art 10 TEU: 'The functioning of the Union shall be founded on representative democracy.'

[130] Even when considering the increased role of the European Parliament in the adoption of secondary legislation through the amendment of Art' 121(6) TFEU and the introduction of the so-called economic dialogue.

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Chapter 12
Regulatory Coherence—A European Challenge

Roger Brownsword

Abstract This paper concerns the ideal of regulatory coherence, with particular reference to Europeanpatent law, and with the spotlight on the controversial decision of the CJEU in *Oliver Brüstle v Greenpeace* (interpreting Directive 98/44/EC on the Legal Protection of Biotechnological Inventions). The *Brüstle* decision invites the objection that it is incoherent, both *formally* (because the Court rules that the products of a permitted and innovative research activity are excluded from patentability) and *substantively* (because its strong protection of human embryos is not supported by the jurisprudence of the European Court of Human Rights). The thrust of the paper is that, while these particular objections can be answered, it is arguable that the decision of the CJEU is not the appropriate target for the critics; rather, if there is a serious incoherence in European patent law, it is in the 1998 Directive itself.

12.1 Introduction

The development of a multi-level regulatory regime in Europe is a test-case not only for our understanding of the ideal of legal coherence but also, of course, for its practical realisation. This is an ideal that is particularly strong in private law circles where 'coherentists' expect courts to respect the precedents and to keep faith with the seminal values that shape the law. Hence, to take an example from English contract law, we are critical of the disjunction between (i) the long-standing rule that A (a creditor) is not bound by a promise freely given to B (a debtor) to accept a lesser sum in full settlement of the debt and (ii) the modern rule that, where there is a practical benefit to A in so doing, then A is bound by a promise freely given to B to pay additional sums, over and above the agreed price, for the performance of the contract—and we are critical of this doctrinal state of affairs because we think

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_12,

that it lacks 'coherence'.[1] Rule (i), seemingly ignoring the practical benefit to A in at least recovering some of the debt, is not coherent alongside rule (ii) where the practical benefit to A is recognised, and vice versa. As national private law regimes in Europe are increasingly drawn into the regional regulatory enterprise, one of the many questions raised is precisely about the implications for the ideal of coherence in the law.[2]

In this paper, although there will be some occasions to make passing references to contract law, my principal focus is on the ideal of coherence relative to European patent law. For some time, national patent law regimes have operated under the umbrella of the European Patent Convention, 1973 (the EPC). However, following the enactment of Directive 98/44/EC on the Legal Protection of Biotechnological Inventions, one major sector of innovation falls to be regulated under both the EPC and EU law. For most purposes, this is not problematic. However, the exclusion against patentability on moral grounds that is provided for in both regimes has given rise to major questions concerning the patentability of innovative stem-cell research—questions that have been raised for determination both at the European Patent Office (in relation to the EPC) and before the European Court of Justice (CJEU). The two leading cases, *Wisconsin Alumni Research Foundation* (*WARF*) at the European Patent Office,[3] and *Brüstle* at the CJEU,[4] have generated a storm of controversy about both the substance of the decisions and the coherence of the patent regime. My focus in this paper is on the *Brüstle* decision, its supposed lack of coherence, and what we can learn from it about regulatory coherence in Europe.

Briefly, in October 2011, the CJEU, responding to a reference from the German Federal Court of Justice, ruled that innovative stem cell research conducted by Oliver Brüstle was excluded from patentability by Article 6(2)(c) of Directive 98/44/EC on the Legal Protection of Biotechnological Inventions—or, at any rate,

[1] Rule (i) is supported by *Foakes v Beer* (1884) 9 App Cas 605; rule (ii) by *Williams v Roffey Bros and Nicholls (Contractors) Ltd.* [1991] 1 QB 1.

[2] Some of these questions are raised in R Brownsword, H-W Micklitz, L Niglia and S Weatherill (eds), *The Foundations of European Private Law* (Oxford, Hart, 2011).

[3] Case G 0002/06, November 25, 2008. Here, the Enlarged Board of Appeal at the EPO was asked by the Technical Board of Appeal (T 1374/04 ([2007] OJ EPO 313)) to rule on four questions of law – one of which was whether Article 6(2)(c), as incorporated in the EPC Rules, forbids the patenting of a human embryonic stem cell culture which, at the time of filing, could be prepared only by a method that necessarily involved the destruction of human embryos (even though the method in question is not part of the claim). Treating this as an exercise in the interpretation of a particular rule, rather than a more general essay in European morality, the EBA said (at para 18):

'On its face, the provision (…) is straightforward and prohibits the patenting if a human embryo is used for industrial or commercial purposes. Such a reading is also in line with the concern of the legislator to prevent a misuse in the sense of a commodification of human embryos (…) and with one of the essential objectives of the whole Directive to protect human dignity.'

Rejecting the argument that human embryos were not actually being used for commercial or industrial purposes, the EBA held that, where the method of producing the claimed product necessarily involved the destruction of human embryos, then such destruction was 'an integral and essential part of the industrial or commercial exploitation of the claimed invention' (para 25); and, thus, the prohibition applied and precluded the patent.

[4] Case C-34/10 *Oliver Brüstle v Greenpeace e.V*. [2011] ECR I-9821.

it was so excluded to the extent that Brüstle's research relied on the use of materials derived from human embryos which were, in the process, necessarily terminated. Although this judgment was, broadly speaking, in line with the decision of the Enlarged Board of Appeals at the European Patent Office in the *WARF* case (where, once again, the products of pioneering human embryonic stem cell research were excluded from patentability), the decision in *Brüstle* (like the decision in *WARF*) has attracted widespread criticism.[5]

Stated shortly, the basis of the CJEU's decision is that Brüstle's research crosses one of the moral red lines provided for by the Directive—in this case, a 'dignitarian' line[6], set out in Article 6(2)(c), that protects human embryos against instrumentalisation, commodification, and commercialisation by researchers (or, in the words, of Article 6(2)(c), that protects human embryos against use for 'industrial or commercial purposes'). For many IP lawyers, the very idea of moral lines being embedded in European patent law is unacceptable[7]: such lines are not drawn in other major regional patent regimes; and decisions such as those in *WARF* and *Brüstle* serve to underline both the limited moral competence of patent examiners and the uncertainty created once courts engage in moral deliberations. For others, especially for utilitarian consequentialists, the *Brüstle* decision is misguided because, not only does it make the European regulatory environment less attractive to leading-edge biotechnology companies, it impedes the prospects of developing stem-cell based therapies for major human diseases (such as Parkinson's disease which was the target of Brüstle's research). Moreover, these sentiments will be echoed by secularists who will see the *Brüstle* decision as an example of European courts being captured by conservative religious dogmas that stand in the way of the progressive improvement of the human condition.[8]

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[5] On the *WARF* case, see e.g. P Torremans, 'The Construction of the Directive's Moral Exclusions under the EPC' in A Plomer and P Torremans (eds), *Embryonic Stem Cell Patents* (Oxford, Oxford University Press, 2009) 141. There is also the question of how coherently the *WARF* reading of the exclusion fits with other EC legal measures that license human embryonic stem cell research: see A Plomer, 'Towards Systemic Legal Conflict: Article 6(2)(c) of the EU Directive on Biotechnological Inventions' in Plomer and Torremans, *Embryonic Stem Cell Patents*, 173. Nevertheless, this broad interpretation was foreshadowed in EDINBURGH/Animal Transgenic Stem Cells (Patent App No 94 913 174.2, July 21, 2002, Opposition Division), on which see SHE Harmon, 'From Engagement to Re-engagement: the Expression of Moral Values in European Patent Proceedings, Past and Future' (2006) 31 *EL Rev* 642.

[6] Here, I use the term 'dignitarian' to capture a range of duty-based ethics, both secular and non-secular, that highlight the importance of not compromising human dignity. See, further, R Brownsword, 'Bioethics Today, Bioethics Tomorrow: Stem Cell Research and the "Dignitarian Alliance"' (2003) 17 *University of Notre Dame Journal of Law, Ethics and Public Policy* 15; id, 'Stem Cells and Cloning: Where the Regulatory Consensus Fails' (2005) 39 *New England Law Review* 535.

[7] However, Art 27(2) of the TRIPs Agreement permits members to exclude inventions from patentability on grounds of *ordre public* or morality. In other words, the international view is that provisions such as Art 53(a) of the EPC and Art 6 of Dir 98/44/EC are optional.

[8] Notably the views associated with the Catholic Church (compare my remarks in n 6). But, for a view defending the 'deontological' approach of the CJEU against the general 'consequentialism' of patent courts, see J Giles, 'The *Brüstle* and *Eli Lilly* Cases: Creation—God or Humankind' (2012) 1 *Oxford Journal of Law and Religion* 518.

As I have already indicated, my interest in *Brüstle* and the background Directive is rather different, being provoked by the thought that the CJEU's decision might lack 'coherence'. This thought has two strands: one strand is that *Brüstle* lacks *formal* coherence; the other is that the decision lacks *substantive* coherence.

The charge that *Brüstle* lacks *formal* coherence runs as follows: German law is highly sensitised to dignitarian concerns about the instrumentalisation of human embryos—indeed, German embryo protection laws are amongst the strongest in Europe; yet, even governed by these strict national standards, Brüstle's research was perfectly lawful in Germany; how, then, can it be coherent for the CJEU to exclude this same lawful research from patentability? In other words, if research is permitted by the background law and regulation, how can it be formally coherent for the patent regime to treat such research as excluded?

Even if this charge can be satisfactorily answered, there is also the claim that *Brüstle* lacks *substantive* coherence. The thrust of this charge is that the CJEU, being bound by the provisions of the European Convention on Human Rights, should always decide in terms that are compatible with the jurisprudence of the European Court of Human Rights[9]; in that jurisprudence, it is clear that human embryos are not treated as bearers of human rights; and, in particular, it is clear that the treatment (including destruction) of human embryos does not directly engage the Convention right to life. It follows that there is no support in European human rights law for the dignitarian moral concerns that underpin Article 6(2)(c) of the Directive; and, thus, no good reason for the exclusion of patentability in relation to Brüstle's research.

While I will suggest that it is possible to defend the *Brüstle* decision against both these charges of incoherence, my discussion invites the articulation of further charges of incoherence—for example, that the CJEU violates a Rule of Law standard of impartiality, that its prescriptive approach fails to cohere with the margin of appreciation typically accorded by the Strasbourg court to Contracting States where moral consensus is lacking, and that it fails to cohere with a certain vision of a regional association of communities of rights. It also invites some clarification of the very idea that legal and regulatory decision-making should be 'coherent'. After all, one very obvious thought is that the best defence of the CJEU is that the Court was simply articulating the agreed terms of the Directive and that such incoherence as there might be resides in the Directive itself. In the real world, we know that the political branch will generate legislation that will often involve compromises and accommodations that indicate a lack of coherent purpose. Indeed, in the case of the Directive, we know that it was all but lost in 1995 and that it was only because of compromise and accommodation that it was rescued—from a political perspective, perhaps an incoherent agreed Directive would seem better than no Directive at all. In any event, if we are to assess the activities of courts and legislators by reference to a standard of coherence, in the context of the pluralistic nation state democracies that collectively comprise the European Union, we need to work out just how much, and what kind of coherence, we can insist upon.

[9] See, most explicitly, Art 6 TEU. Generally, see S Douglas-Scott, 'The European Union and Human Rights after the Treaty of Lisbon' (2011) 11 *Human Rights Law Review* 645.

The paper is in five main parts. First the central provisions of the Directive and the ruling in *Brüstle* are laid out. Secondly, the charge made against the *Brüstle* decision that it is formally incoherent is reviewed and rejected. Thirdly, the charge that *Brüstle* is substantively incoherent relative to the European jurisprudence of human rights is considered; and one particular version of the charge is again rejected. Fourthly, three further charges of incoherence are suggested and very briefly reviewed. Finally, the aspiration of 'coherence' in legal and regulatory decision-making is itself analysed in an attempt to identify the types of coherence that we can plausibly use to evaluate the work of legislators, regulators and judges.

My overall conclusion is that, while there are some charges of incoherence that do not stick against the decision in *Brüstle*, there are others that might fare better. Nevertheless, the more that we search for a charge of incoherence that might stick against *Brüstle*, the more it seems that the decision of the CJEU is not the appropriate target. If there is serious incoherence in European patent law, it is in the Directive itself.

12.2 The Directive and the Ruling in *Brüstle*

For present purposes, we need not review the full range of the Directive.[10] So far as the dispute in *Brüstle* is concerned, the core provisions of the Directive are those in Article 6—comprising, in Article 6(1), a general moral exclusion and then, in Article 6(2), four specific exclusions—together with the underlying guidance given by Recital 38.

Article 6(1) of the Directive (in language that very closely resembles that of Article 53(a) of the European Patent Convention) provides:

'Inventions shall be considered unpatentable where their commercial exploitation would be contrary to *ordre public* or morality; however, exploitation shall not be deemed to be so contrary merely because it is prohibited by law or regulation.'

Article 6(2) then provides for four specific exclusions that follow from the general exclusion in Article 6(1). Thus:

'On the basis of paragraph 1 [i.e. Article 6(1)], the following, in particular, shall be considered unpatentable:

a. processes for cloning human beings;
b. processes for modifying the germ line genetic identity of human beings;
c. uses of human embryos for industrial or commercial purposes;
d. processes for modifying the genetic identity of animals which are likely to cause them suffering without any substantial medical benefit to man or animal, and also animals resulting from such processes.'

[10] For such a review, see D Beyleveld, R Brownsword and M Llewelyn 'The Morality Clauses of the Directive on the Legal Protection of Biotechnological Inventions: Conflict, Compromise, and the Patent Community' in R Goldberg and J Lonbay (eds), *Pharmaceutical Medicine, Biotechnology and European Law* (Cambridge, Cambridge University Press, 2000) 157.

It is clear from the jurisprudence, and especially from *Commission v Italy*,[11] that there must be strict and unequivocal implementation of the exclusions in Article 6(2). It is also clear from Recital 38 of the Directive that the four particular exclusions listed are not exhaustive. According to Recital 38:

'Whereas the operative part of this Directive should also include an illustrative list of inventions excluded from patentability so as to provide referring courts and patent offices with a general guide to interpreting the reference to *ordre public* and morality; whereas this list obviously cannot presume to be exhaustive; whereas processes, the use of which offend against human dignity, such as processes to produce chimeras from germ cells or totipotent cells of humans and animals, are obviously also excluded from patentability.'

Although the third clause of this Recital invites more than one interpretation, it certainly implies that human dignity is the key underlying value in both Article 6(1) and Article 6(2).

The several questions referred by the Bundesgerichtshof (Germany) to the CJEU focus in particular on the interpretation of Article 6(2)(c). For present purposes, the key ruling handed down by the CJEU is expressed (at the conclusion of the judgment) as follows:

'Article 6(2)(c) of Directive 98/44 excludes an invention from patentability where the technical teaching which is the subject-matter of the patent application requires the prior destruction of human embryos or their use as base material, whatever the stage at which that takes place and even if the description of the technical teaching claimed does not refer to the use of human embryos.'

Accordingly, even though Brüstle was not responsible for the destruction of human embryos, even though there was some distance between the destruction of the embryos and Brüstle's use of the embryonic (base) materials, the invention was still seemingly excluded from patentability.[12]

While there was no doubt that Brüstle's base materials were derived from human embryos, the Bundesgerichtshof also sought guidance on the interpretation

[11] Case C-456/03 *Commission v Italy* [2005] ECR I-5335, para 78 ff. Interestingly, in para 82, the Court draws on the obscure proviso in Art 6(1), first, to underline the point that prohibition of commercial exploitation by law or regulation does not entail exclusion from patentability, and then to insist that any possible uncertainty is removed by legislating for the Art 6(2) exclusions. However, the first of these points invites clarification because, on the face of it, it is formally incoherent for a regulator to prohibit the commercial exploitation of x but, at the same time, to permit the patenting of x: that is, in the ordinary way of things, prohibition of commercial exploitation of x does entail exclusion of x from patentability. Nevertheless, there might be contextual factors that resolve the apparent contradiction—for example, if the prohibition is in the nature of a moratorium for a limited period, then, in the particular setting, regulatees might understand that the red prohibitory signal in conjunction with the green patentability signal actually amounts to an amber signal (to proceed cautiously).

[12] However, the Federal Court of Justice has subsequently ruled that Brüstle's patent does not involve the destruction of human embryos and that, in an amended form, the patent is valid. See Bundesgerichtshof (BGH), 27/11/2012, 195 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 364; on which see A Blackburn-Starza, 'German court upholds Brüstle patent as valid' *BioNews* 684, www.bionews.org.uk/page_222080.asp.

of 'human embryos' in Article 6(2)(c). Stated simply, how far does the definition of a 'human embryo' extend into the kinds of cells created and used by stem-cell researchers? Addressing this question, the CJEU ruled (at the conclusion of the judgment) that 'any human ovum after fertilisation, any non-fertilised human ovum into which the cell nucleus from a mature human cell has been transplanted, and any non-fertilised human ovum whose division and further development have been stimulated by parthenogenesis constitute a "human embryo".' Finally, in a further ruling, the CJEU referred back to the national court the question of whether, in the light of scientific developments, 'a stem cell obtained from a human embryo at the blastocyst stage constitutes a "human embryo" within the meaning of Article 6(2)(c) of [the Directive].'[13]

12.3 Is the *Brüstle* Decision Formally Incoherent?

The charge of formal incoherence starts by observing that the research into Parkinson's disease undertaken by Oliver Brüstle was perfectly lawful in Germany; and, we need no reminding that German law takes the protection of human embryos more seriously than almost anywhere else in Europe. Assuming that German law and EU law are sufficiently connected to be viewed as parts of one regional regulatory regime, the question posed by the objectors is this: how can it be coherent to permit Brüstle to carry out research that uses materials derived from human embryos and yet to deny a patent on the products of that research for just the reason that human embryonic materials were utilised? At first blush, it looks as though German regulators are showing Brüstle a green light while, at the same time, the CJEU is holding up a red light. Is this not a case of formal incoherence?

It is a good question but, as a first step, we need to specify the ways in which a regulatory or legal regime might suffer from formal incoherence. Then, we can cross-check this against the supposed incoherence of permitting research, the resulting processes or products of which are excluded from patentability; or, excluding patentability where the research is already permitted.

Minimally, the idea of a coherent legal or regulatory enterprise presupposes that the signals given to regulatees should not be formally contradictory.[14] If the signals take the form of prohibitions, permissions and requirements, then regulatory coherence entails that the signals should not indicate, for example, that x is both prohibited and permitted or that x is both prohibited and required. To be sure, at different levels within the hierarchies of a legal or regulatory order, ostensibly contradictory signals may be given—for example, a higher court may overrule an old precedent

[13] The Federal Court of Justice has now ruled that, on their own, human embryonic stem cells are not capable of developing into a born human and, thus, should not be treated as a 'human embryo', see Blackburn-Starza, ibid.

[14] Compare the seminal analysis in LL Fuller, *The Morality of Law* (New Haven, Yale University Press, 1969) (revised edition).

or reverse the decision of a lower court, or a legislature may enact a statute to repeal an earlier statute or to change the effect of a court decision. Within the legal order's own hierarchical rules, these apparent contradictions are resolved; the later signals are understood to supersede and replace the earlier ones. Similarly, the context might make it clear what a potentially conflicting combination of signals actually means. For example, in the particular context, regulatees might understand perfectly well that a combination of red and green lights is actually signalling a prohibition (the green light is to be ignored, being treated as misleading or mistaken or even a trap); or that the lights are signalling a permission (the red light is to be ignored, perhaps because it is attached to a law that is now, so to speak, a 'dead letter'); or that the conjunction of red and green lights amounts to some kind of cautionary amber signal.[15] What is clearly formally incoherent is the co-existence of red lights in competition with green lights.

That said, without contradiction, the law may signal that x is both permitted and encouraged; or that x is permitted but neither encouraged nor discouraged; or even that x is permitted but discouraged (for example, as with the regulation of smoking). For present purposes, the key point is that permission does not entail encouragement. In other words, it is not formally incoherent to signal permission but without also signalling encouragement.

While patent lawyers might pause over this proposition, it will surely seem plausible to Contract lawyers. In the common law, there are many transactions that are perfectly permissible under the background law but which are nevertheless not treated as enforceable on grounds of good morals or the public interest. For example, in English law, although it is nowadays perfectly lawful to place a bet on a horserace or some other sporting event in one of the thousands of betting offices that open their doors to the public, gaming and wagering contracts continue to be treated as unenforceable. In this way, Victorian morals cast a long shadow over the regulation of this class of transactions; but, in the present century, the shadow does not amount to a prohibition so much as a refusal to encourage what is now permitted. The same story applies to transactions that violate Victorian sexual mores as well as more modern arrangements such as surrogacy and pre-nuptial agreements. In all cases, background permissions are conjoined with a refusal to signal encouragement.[16]

Pulling this together, and mindful of the contextual considerations and caveats already mentioned, I suggest that the two general rules of formal coherence and incoherence are: (i) if x is prohibited, it is not coherent to signal that x is permitted or required, or that x is encouraged[17]; but (ii) if x is permitted, it is coherent to signal

[15] For one such amber signal, in the context of a moratorium, see n 11. For further combinations that signal both prohibition and encouragement but the formal incoherence of which is more apparent than real, see M Schellekens and P Vantsiouri, 'Patentability of Human Enhancements' (2013) 5 *Law, Innovation and Technology* 190.

[16] Away from the law, whether contracts or patents, we can find common examples of regulators signalling that an action is permitted but not encouraged, or even that it is discouraged. Moreover, I suspect that liberal-minded parents often signal something rather similar to their teenage children.

[17] It is worth emphasising that this is subject to the various caveats in the text above and at n 15.

at the same time that x is (a) encouraged, or (b) neither encouraged nor discouraged, or (c) discouraged.

Applying this analysis to patent law, we must start by clarifying how patenting fits into the regulatory array. What is the function of making patents available for inventive work? Once patents have been granted, their function (as property entitlements) is to put the proprietor in a position to control the use of the invention (for a limited period of time). However, the pre-grant, and primary, function of patent law is not to control access to the invention so much as (i) to incentivise and encourage innovation that is in the public interest and (ii) to incentivise innovators putting their knowledge into the public domain.[18] It follows that, when patents are available, their intended (if not always their actual) role is to encourage innovators[19]; and when patents are excluded, as in *Brüstle*, the signal is one of either discouraging a particular kind of innovation or at least not encouraging it (neither encouraging nor discouraging it).[20]

Where the background regulatory position is one of prohibition (if, for example, Brüstle's research work had been prohibited in Germany) it would be formally incoherent for regulators to treat the products of the prohibited activity as patentable. That would be signalling prohibition with encouragement; and, applying the first of the above rules of formal coherence, that is not formally coherent. However, it does not follow (as some critics seem to imply) that, unless the background regulatory position is one of prohibition, the only coherent position for patent law is to encour-

[18] The extent to which patent and other IP rights operate in the public interest is, of course, a moot point: compare the critique in J Boyle, *The Public Domain* (New Haven, Yale University Press, 2008).

[19] One of many problems with patents in practice is that a liberal policy on granting patents can lead to blockages for downstream researchers. Famously, see MA Heller and R Eisenberg, 'Can Patents Deter Innovation? The Anticommons in Biomedical Research' (1998) 280 *Science* 698.

[20] If the proprietary characteristics of post-grant patents are treated as focal, this can bear on the question of coherence. For example, A Plomer, 'Patents, Human Dignity and Human Rights' in C Geiger (ed), *Research Handbook on Human Rights and Intellectual Property* (Cheltenham, Edward Elgar, 2014 forthcoming) Ch 25 (on file with author) sets up the incoherence of *Brüstle* in the following terms:

'A legal system cannot logically and consistently permit X and deny property rights over X on the grounds that X violates human rights/human dignity otherwise X could not be permissible. Thus, the supposed incompatibility of property rights or patents on X with human rights/human dignity have, in reality nothing to do with *ownership* of X but relate instead to the permissibility of X. (…) The glaring contradiction would not normally materialize within a national legal order because prohibitions on patents would normally be aligned to prohibitions on research reflecting the particular national moral and religious culture.'

While it is right to suggest that no legal system could rationally permit X where it judges that X violates human rights or human dignity, care needs to be taken that there is no shift in the reference of X. For example, it might be perfectly rational to permit the research and development of a life-saving diagnostic test and treatment (X1), and yet to exclude the patentability of the test or treatment on the grounds that the commercial exploitation of such a life-saving invention (X2) is not compatible with human rights or human dignity. At all events, none of this affects the claim that formal coherence allows for permitting X while denying patentability of X.

age the activity.[21] To repeat, applying the second of the above rules of formal coherence, it is formally coherent to conjoin a background permission with something other than encouragement. On this analysis, there is no formal incoherence between the background German legal permission in relation to Brüstle's research work and the CJEU's refusal to encourage such research.

We can summarise the key points in this analysis of formal coherence, leading to the claim that the first charge of incoherence against the *Brüstle* decision is not sustained. First, as the CJEU rightly emphasises in *Brüstle*, 'the purpose of the Directive is not to regulate the use of human embryos in the context of scientific research. It is limited to the patentability of biotechnological inventions.'[22] Patent law is a gloss on the background regulatory scheme of prohibitions, permissions, and requirements. Secondly, the distinctive role of patent law is to incentivise or encourage research that promises to be of public benefit. Thirdly, to exclude a patent is not to prohibit the underlying research activity; rather, it is to decline to encourage it. Fourthly, although prohibitions are undoubtedly incoherent alongside permissions or requirements, there is no formal incoherence in conjoining permissions with non-encouragement. It follows, therefore, that the *Brüstle* decision, because it does not prohibit (but merely does not encourage) an activity that is permitted elsewhere in the regulatory regime, is not contradictory or incoherent in a formal sense.

12.4 Is the *Brüstle* decision substantively incoherent?

Even if *Brüstle* does not suffer from formal incoherence, can it withstand scrutiny substantively—and specifically in relation to the European jurisprudence of human rights?[23] After all, even if non-encouragement is formally coherent alongside a permission, it calls for explanation. Why not encourage potentially beneficial research that is permitted?

Defenders of *Brüstle* will have to concede that in the key cases at Strasbourg, the Court has held that human embryos (and fetuses) do not have rights under the Convention.[24] However, the inference that the European jurisprudence of human rights gives no support for discouraging research that makes use of human embryos is much more questionable. For example, defenders might point to Article 18 of the Convention on Human Rights and Biomedicine[25] as a signal that any use of human

[21] See the range of criticisms of the *Wisconsin Alumni Research Foundation* case in Plomer and Torremans (eds), *Embryonic Stem Cell Patents*.

[22] *Brüstle* (n 4) para 40.

[23] Compare the reading of moral exclusions in D Beyleveld and R Brownsword, *Mice, Morality and Patents* (London, Common Law Institute of Intellectual Property, 1993).

[24] *Evans v United Kingdom* (Application no 6339/05) Grand Chamber, 10/4/2007; *Vo v France* (Application no 53924/00) Grand Chamber, 8/7/2004.

[25] Art 18(1) provides that 'Where the law allows research on [human] embryos in vitro, it shall ensure adequate protection of the embryo'; and Art 18(2) prohibits the 'creation of human embryos for research purposes'.

embryos as research tools should never be encouraged and that some uses should be positively discouraged. That said, as Aurora Plomer has pointed out, it is difficult 'to read Article 18 as indicative of a European consensus that research destructive of human embryos is contrary to human dignity (…).'[26]

Be that as it may, the more important point is that the Strasbourg jurisprudence does no more than deny that human embryos hold rights *directly* under the Convention. This leaves open the possibility that Contracting States may grant *indirect* protection to human embryos, just as in many places protection is afforded to non-human animals. Provided that these indirect protections (motivated by the desire to do the right thing) are not incompatible with the rights directly recognised by the Convention—and, it should be noted, there is no Convention right that explicitly protects the interests of researchers in having access to human embryos for their base materials—then no regulatory incoherence arises.

We can put this point to the test in a straightforward way. Germany, because of its sensibilities about embryo protection, already places very considerable legal restrictions on researchers such as Oliver Brüstle. Notably, in German law, there is a general prohibition on the importation and use of human embryonic stem cells, from which derogation is permitted only where a number of restrictive conditions are met—for example, that the stem cells were sourced from embryos that were created for reproductive purposes but that have now become supernumary. Does anyone think that these laws are incompatible with the European Convention on Human Rights? Suppose, though, that Germany took the restrictions a step further and prohibited the kind of research in which Brüstle is engaged. Would this violate any of Brüstle's rights under the Convention? If, despite heroic attempts to construct a supporting right[27], the answer to this question is that it would not, then there is surely no way that we can accuse the CJEU of violating Brüstle's rights by merely excluding patents on his research. To repeat, the CJEU merely signals that it is contrary to the Directive to encourage this kind of research by use of the patent regime.

The following are the key points in this analysis indicating that the decision in *Brüstle* is not substantively incoherent in the sense that it contradicts the jurisprudence of the European Convention on Human Rights. First, although there is no direct support in European human rights jurisprudence for the legal protection of human embryos, neither is there any direct support in human rights jurisprudence for researchers having a right to use human embryos as research tools or as a source of stem-cell materials. Secondly, laws that prohibit certain kinds of research activities that involve the use of human embryos are not obviously incompatible with the jurisprudence of European human rights. Thirdly, it follows *a fortiori* that a regula-

[26] A Plomer, 'After *Brüstle*: EU Accession to the ECHR and the Future of European Patent Law' (2012) 2 *Queen Mary Journal of Intellectual Property* 110, 132.

[27] For an argument tapping into Art 1 of the 2001 Protocol to the Convention, which concerns the protection of property (and, by implication, intellectual property) rights, see Plomer, 'After *Brüstle*', 130 f.

tory refusal to encourage the use of human embryos for research is not obviously incompatible with the jurisprudence of European human rights.

So, far from being substantively incoherent relative to the jurisprudence of European human rights, it is arguable that the decision in *Brüstle* is very much in line with Strasbourg, neither protecting human embryos against permissive national laws nor encouraging researchers to use human embryos. Moreover, if *Brüstle* violates some right of researchers that we construct out of the Convention, then a broad sweep of restrictive background law is likely to be even more seriously in violation.

This, however, might be thought to let the CJEU off too easily. To be substantively coherent, it might be insisted that the Court's position must not only be human rights compatible but compatible for sound human rights reasons. We can sketch two ways in which such comprehensive coherence might be argued for, one line of argument relying on precautionary reasoning, the other on considerations of comity.

First, human rights considerations might indicate that a precautionary approach should be taken with regard to the treatment of human embryos. This, in turn, might be argued for in two ways. One argument is that we simply cannot be confident about the moral status of the human embryo. We are confident that a human embryo is distinguishable from, say, a table and chairs but how confident can we be that it is distinguishable from born humans? In the human rights jurisprudence a line is drawn between unborn and born humans; but why should we draw the line there? And, whatever characteristics that we think born humans have that are the basis for recognising them as direct holders of rights, can we be sure that unborn humans do not also have these characteristics? If we have got this wrong in relation to human embryos, we do them a terrible wrong when we use them for research purposes.[28]

The other precautionary argument is that instrumentalising human embryos might indirectly corrode respect for the rights of born humans.[29] In the different context of the well-known *Omega Spielhallen* case[30], we find an example of this kind of precautionary reasoning. In paragraph 12 of the Judgment, we read that:

'The referring court states that human dignity is a constitutional principle which may be infringed either by the degrading treatment of an adversary, which is not the case here, or by the awakening or strengthening in the player of an attitude denying the fundamental right of each person to be acknowledged and respected, such as the representation, as in this case, of fictitious acts of violence for the purposes of a game. It states that a cardinal constitutional principle such as human dignity

[28] Compare D Beyleveld and R Brownsword, 'Emerging Technologies, Extreme Uncertainty, and the Principle of Rational Precautionary Reasoning' (2012) 4 *Law Innovation and Technology* 35.

[29] Similar arguments might be offered for the protection of non-human animals: see P Carruthers, *The Animals Issue* (Cambridge, Cambridge University Press, 1992). And, for a succinct expression of the concern, see S Turkle, *Alone Together* (New York, Basic Books, 2011) 47: 'This is, of course, how we now train people for war. First we learn to kill the virtual. Then, desensitized, we are sent to kill the real.'

[30] Case C-36/02 *Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn* [2004] ECR 1-9609.

cannot be waived in the context of an entertainment, and that, in national law, the fundamental rights invoked by Omega cannot alter that assessment.'

No doubt, claims of the kind that 'permitting x causes y', or 'permitting x increases the likelihood of y', or 'permitting x encourages y' are highly contentious. However, where 'y' is of high value in a scheme of human rights thinking, there are precautionary reasons for at least taking a hard look at such claims.

Secondly, there is the idea of comity: where communities are morally divided, there is an argument that respect for different views justifies some finessing of the regulatory position in order to cause members the least moral distress. Arguably, this is a plausible reason for declining to enforce contracts that still deeply offend some moral sensibilities. Similarly, might it be argued that the CJEU in *Brüstle* was declining to encourage human embryonic stem cell research for reasons of comity? The basis of this decision would then be that the CJEU judged that those members of the human rights community who believe that a precautionary approach should be taken would be more offended by the encouragement of patentability than those members who do not take such a (precautionary) view would be offended by the Court's unwillingness to signal such encouragement.

Although such human rights arguments might have guided the thinking in the *Brüstle* case, all the surface indications are that the thinking of the CJEU is much more dogmatically dignitarian. Quite simply, where human embryos are used as research tools, human dignity is compromised and such research activities are not to be encouraged.[31] If the better interpretation of the European jurisprudence is that it is predicated on a liberal articulation of human dignity, then the former (human rights inspired) accounts have the better credentials; for, on this reading, the latter account would involve a deeper kind of regulatory incoherence.[32] It would mean that, although a human rights-compatible defence of the decision in *Brüstle* can be mounted, the CJEU is actually operating with a dignitarian ethic that is antithetical to human rights—and, relative to the more demanding test, it follows that the decision in *Brüstle* lacks comprehensive coherence.

12.5 Three Further Charges of Incoherence

The two charges of incoherence that I have considered do not exhaust the options available to those who question the coherence of the *Brüstle* decision. In this part of the paper, I will sketch three further charges of incoherence. These are as follows: first, that the CJEU violates a Rule of Law standard of impartiality; secondly, that its prescriptive approach fails to cohere with the margin of appreciation typically accorded to Contracting States where moral consensus is lacking; and, thirdly, that

[31] Similarly, two accounts might be given of the decision of the ECJ in *Omega Spielhallen* (n 30).

[32] In support of such a liberal rights-driven interpretation, I would rely on arguments derived from A Gewirth, *Reason and Morality* (Chicago, University of Chicago Press, 1978).

it fails to cohere with a certain vision of a regional association of communities of rights.

12.5.1 The CJEU Violates a Rule of Law Standard of Impartiality

There is no gainsaying that the CJEU should decide in accordance with the values of the Rule of Law. What this requires (and prohibits) in relation to adjudication depends, of course, on how one articulates the Rule of Law. For present purposes, we need not get into contested aspects of the Rule of Law. It suffices to say that, on anyone's view, the Rule of Law demands that judges should stay neutral and impartial, in the sense that they should not side with a particular political view as such. Drawing on this minimal requirement, critics might detect a lack of impartiality—and, hence, incoherence—in the decision in *Brüstle*, because the Court (as the critics would have it) sides with the prohibitionists.

This charge of incoherence strikes me as particularly weak. To be sure, the outcome of the case is that the CJEU upholds the view of those who oppose patentability; and, insofar as the court 'takes sides', it is with those who argue for non-encouragement rather than those who argue for encouragement of this kind of research. Yet, given that a decision has to be made, the CJEU cannot avoid making a choice; if it had ruled *in favour of* patentability, it would have been open to just the same kind of charge (although it would now be the prohibitionists raising the objection). Even if we allow that excluding patents on Brüstle's research is generally in line with the prohibitionist view, the CJEU is not actually prohibiting anything; and, perhaps more importantly, its decision on patentability is not aligned with the views of the prohibitionists for that reason (that is, for the reason that it so aligns). Moreover, there is no suggestion that the CJEU takes into account considerations that are improper, in the sense that they compromise its impartiality and independence; and there is surely no way that such a charge can be substantiated.

We can compare comparable criticisms of the European Patent Office's (EBA's) ruling in the *WARF* case: If we side with the critics, we will say that the EBA should have noted that there is no agreement amongst members as to the morality of using human embryos for research purposes; that to exclude the patent on moral grounds would be to privilege the dignitarian views of those members who already have domestic prohibitions against the destruction of human embryos for research purposes; and that the EBA has no warrant for such partiality. But, of course, we might turn this argument on its head. If, in the absence of a common moral position amongst members, the EBA declines to exclude the patent on moral grounds, then it privileges the liberal view of those members that already have permissive domestic regimes with regard to human embryo research. Whichever way the EBA decides, its ruling will align with one or other of the rival constituencies; there is no third option which will enable it to stay neutral. However, the fact that the outcome is not neutral as between the positions advocated by rival political constituencies is

not the same as saying that the EBA (or the CJEU) defected from the impartiality requirements of the Rule of Law.

Courts, especially appellate courts, make decisions all the time that are welcomed by some political groups and denounced by others. But, so long as the Courts are applying themselves in good faith to the question of what the law means or requires in such cases, so long as the Courts have not been corrupted, captured, or otherwise compromised by the political branch, there is no breach of the Rule of Law.[33]

12.5.2 The CJEU's Approach is Out of Line with the Margin of Appreciation Typically Given to Member States

In the jurisprudence of the ECHR, the doctrine of the margin of appreciation allows some room for Contracting States to interpret and apply the provisions of the Convention in their own way. Where questions, such as the question of the moral status of the human embryo, are deeply contested, where members take many different views on the matter, the Strasbourg jurisprudence treats this pluralism as, so to speak, a sleeping dog that is best left to lie. If a Contracting State appears as a serious outlier, it is likely to be pulled back into the main band of difference[34]; but, in general, Strasbourg does not insist that all members take the same line.

By contrast, so the objection runs, in the *Brüstle* case, the CJEU demands that all members treat Article 6(2)(c) as excluding patentability on research products or processes that involve, or rely on, the proximate or remote destruction of human embryos. Accordingly, there is no room for manoeuvre in Article 6(2)(c) and this, the objectors maintain, fails to cohere with the general approach of giving some margin.

Is this a good objection? As I have said before, *Brüstle* does not in any way impinge on the background regulatory options that are available to member states. Member states may prohibit, permit, or require the use of human embryos for research, indeed even require such use for industrial or commercial purposes. Patent exclusion notwithstanding, member states may also find ways of supporting and encouraging human embryonic stem cell research through, for example, their science funding programmes or tax policies. After *Brüstle*, the impingement is purely and simply on the patentability of this kind of research; but that is the extent of the intervention. In the larger regulatory picture, where the margin of appreciation for member states remains wide and where there are ways of incentivising stem cell research outside the patent regime, the Court's intervention might seem like

[33] Compare the defence of appellate court judges against the accusation that they act inappropriately as 'legislators' in 'hard cases'; seminally, see R Dworkin, *Taking Rights Seriously* (revised ed) (London, Duckworth, 1978).

[34] For a case in point, see *S and Marper v United Kingdom* [2008] ECHR 1581.

something of an empty gesture. Accordingly, with such a minor impingement on the margin, this charge of incoherence does not look like a particularly strong objection.

There is, however, another angle to this objection. The point here is not so much that the CJEU requires all member states to come unequivocally into line with the exclusion in Article 6(2)(c) but that it interprets the concept of a 'human embryo' very broadly. Following the advice of Advocate-General Bot,[35] the CJEU in the *Brüstle* case insists that, for the purposes of the Directive, there must be a common understanding of the term 'human embryo'; and, it will be recalled, (according to the CJEU) that understanding is to be specified broadly as covering 'any human ovum after fertilisation, any non-fertilised human ovum into which the cell nucleus from a mature human cell has been transplanted, and any non-fertilised human ovum whose division and further development have been stimulated by parthenogenesis….' Now, the objection here is that such a broad and inclusive reading, denying to member states any leeway in their interpretation of 'human embryo', lacks coherence alongside the margin of discretion that is often given in Europe.

This objection might resonate with, among others, European consumer lawyers. To make another short detour, since the mid-1980s, the Community's principal strategy for harmonising the law of the consumer marketplace has been to rely on Directives. Until recently, the Directives have been measures of minimum harmonisation—that is, Directives leaving the member states some discretion (or margin) to provide for stronger measures of consumer protection going beyond the minimum.[36] As a result, the landscape of consumer protection law across Europe is still quite variable; the minimum standards apply in all consumer markets but there are different degrees of national 'gold-plating' above the minimum. For suppliers who wish to extend their business across borders, the variation in national laws can operate as some kind of obstacle.[37] The margin of discretion, in other words, damages the unity of the market; instead of a single market, suppliers are faced with, so

[35] Fully aware of the many different views as to both the meaning of a human embryo and the degree to which such embryos should be protected. Advocate General Bot insists that the legal position as settled by the Directive is actually perfectly clear. Within the terms of the Directive, the concept of a human embryo must be taken as applying from 'the fertilisation stage to the initial totipotent cells and to the entire ensuing process of the development and formation of the human body' (para 115). *In themselves*, isolated pluripotent stem cells would not fall within this definition of a human embryo (because they could not go on to form a whole human body). See AG Bot, Case C-34/10, *Oliver Brüstle v Greenpeace e.V*. [2011] ECR I-9821.

[36] Examples include the earlier Directives on doorstep selling (85/577/EEC), consumer credit (87/102/EEC), package holidays (90/314/EEC), unfair terms (93/13/EEC), and distance selling (97/7/EC).

[37] For evidence, see S Vogenauer and S Weatherill, 'The European Community's Competence to Pursue the Harmonisation of Contract Law – An Empirical Contribution to the Debate' in S Vogenauer and S Weatherill (eds), *The Harmonisation of European Contract Law* (Oxford, Hart, 2006) 105; and the supporting case for a proposed Regulation on a Common European Sales Law, COM(2011) 635 final.

to speak, '27 [or more] mini-markets'[38]. In response, the Commission's latest Directives seek to apply maximum harmonisation measures; the minimum standards now become the maximum; and the margin of discretion is eliminated.[39] For many consumer lawyers, this is a step too far, impinging on local control in respect of the fine-tuning of the balance of interests between suppliers and consumers.

In the context of consumer contract law, the question of how far the Commission needs to go in securing the unity of the market hinges on the importance that one attaches to cross-border trading. Generally, consumers prefer to shop close to home (although on-line consumption can change this); and critics of maximum harmonisation will ask whether such deep intervention into local control is proportionate to the regulatory aims. Why not, critics might ask, limit these maximum harmonising measures to cross-border contracts, leaving local consumer law within the discretion of the member states? [40]

To return to patentability and the definition of a 'human embryo', we might ask in a similar fashion whether the view in *Brüstle* is disproportionate relative to the aims of the Directive. According to Recital 5, the raison d'être for Directive 98/44/EC is that differences between the laws and practices of each member state 'could create barriers to trade and hence impede the proper functioning of the internal market'. Again, in *Commission v Italy*, the aim of the Directive is expressed as being 'to prevent damage to the unity of the internal market'.[41] Prima facie, this has some plausibility because venture capitalists will surely prefer to invest in small biotech start-ups where innovative and commercially exploitable processes or products are patentable. If Europe has many different patent regimes, investment (and the companies in which investments are made) will tend to be concentrated in those regulatory areas where patents are available. However, on closer inspection, it is apparent that there are two major flaws in this argument.

First, harmonising patent law falls a long way short of creating a level playing field. To be sure, patentability is one element in the regulatory environment for research and development in biotechnology; but the more fundamental elements are the background prohibitions and permissions. Even if patents are not excluded, investors will prefer to back research and development in those areas where the regulatory environment overall is most congenial. Accordingly, harmonising patent law prevents some damage to the unity of the internal market but does nothing to correct the most important differences between national laws. Within Europe, there will still be room for a significant element of regulatory arbitrage.

[38] Per Commissioner Kuneva, giving a public lecture on 'Transformation of European Consumer Policy' at Humboldt University, Berlin, 28/3/2008.

[39] See R Brownsword, 'Regulating Transactions: Good Faith and Fair Dealing' in G Howells and R Schulze (eds), *Modernising and Harmonising Consumer Contract Law* (Munich, Sellier, 2009) 87.

[40] For one such example, see C Twigg-Flesner, *A Cross-Border-Only Regulation for Consumer Transactions in the EU: A Fresh Approach to EU Consumer Law* (Berlin, Springer, 2011).

[41] *Commission v Italy*, para 58.

Secondly, the idea that investment in biotechnology should not be impeded by regulatory barriers that might vary from one part of the market to another makes good sense where (as was the Commission's overall intention) the policy is to encourage investment in biotechnology. Hence, the harmonising of patent law to improve the chances of investment crossing borders makes some sense where the thrust of the Directive is to affirm the patentability of new biotechnology, as is the case in relation to sequencing work around the human genome. However, it makes no sense at all where the thrust of the Directive is to exclude patentability. Having the same laws excluding patents where human embryos are used by researchers simply means that investment will be inhibited across the region; and, defining human embryos broadly for exclusionary purposes simply extends the scope of the inhibition. The problem with the unity of the market argument (as applied to the exclusions from patentability) is that it simply does not fit with the view that the regulatory tilt of the Directive is to encourage research and development in modern biotechnologies (which surely was the Commission's dominant regulatory purpose).

By a somewhat meandering route, therefore, we arrive at the conclusion that the elimination of the margin of discretion with regard to the definition of 'human embryo' might be out of line with the general strategy of minimum harmonisation; but, more tellingly perhaps, we conclude that broadening the scope of the exclusion, far from securing the unity of the market, fails to cohere with the fundamental purpose of the Directive (namely, enabling investment in modern biotechnology).

12.5.3 The Decision Fails to Cohere with a Certain Vision of a Regional Association of Communities of Rights.

No doubt, there are many visions of communities that take rights seriously. However, there is a rationally defensible view that starts with building and protecting a secure platform for agency (this platform being constituted by the generic conditions that enable agents freely to choose and to pursue their own plans and projects) and then licenses communities to articulate their rights commitments in their own way.[42] This is a vision of each community of rights giving its best interpretation of its rights commitments. Within such communities there are many potential points of disagreement—for example, about the interpretation, scope, and ranking of particular rights, about the priorities where rights conflict, and about the qualifying conditions for membership of the community of rights (and, concomitantly, how marginal or prospective members are to be treated). In all these cases, a moral community needs to have very good reasons to surrender local control over the decisions that need to be made. For good reason, a community of rights will be reluctant to cede control over the best interpretation of its rights commitments; members of such communities need to believe that they are doing the right thing.

[42] See R Brownsword, *Rights, Regulation and the Technological Revolution* (Oxford, Oxford University Press, 2008).

In this context, how strong a reason is given by the need to harmonise trade rules? Without doubt, communities cannot expect to trade in regional or global clubs without some loss of control. As Chief Justice Burger put it in *Bremen v Zapata Off-Shore Co*,[43] the expansion of business and industry is unlikely to be encouraged if nation states 'insist on a parochial concept that all disputes must be resolved under [their local] laws and in [their] courts'; it is simply not possible to 'have trade and commerce in world markets and international waters exclusively on [local] terms (...)'[44] However, it is one thing agreeing to harmonise trade rules that are largely morally neutral, it is quite another to surrender control over important moral decisions. To insist on parochialism in such important matters is entirely appropriate for a community that takes its rights commitments seriously. From this perspective, the (economic) unity of the European market looks like an inadequate reason for a community of rights to hand over the right to decide on such an important matter as the moral status of a human embryo.

Granted, as I have emphasised several times, the *Brüstle* decision only touches and concerns patentability, not the background regulatory prohibitions or permissions. For moral communities to cede decision-making power on patentability is nowhere near as serious as ceding control over the background prohibitions or permissions. The fact remains, though, that there is no good reason for making even such a small concession. Accordingly, if we track back to the seat of the concession, we will say that the Directive should have been drafted in such a way that reserved to each member state the right to apply its best moral judgment in setting its own regulatory environment for the use of human embryos by researchers. And, relative to the aspirations of communities of rights, we will conclude that the incoherence ultimately lies, not so much in the *Brüstle* decision, as in the deal done that underpinned the Directive itself.

12.6 Regulatory Coherence and Legal Coherence

For private lawyers, it goes without saying that the body of doctrine should be coherent. For example, we expect the rules of contract law to form a coherent code. So, for many years, contract lawyers of my generation asked: if 'freedom of contract' is the governing principle, how do we explain the protection of consumer contractors, the hard look at standard forms, and the policing of 'unfair' terms? To satisfy the ideal of coherence, it eventually had to be acknowledged that consumer transactions were now regulated by a separate scheme.[45] In the same way, we might wonder how well the *WARF* case and *Brüstle* cohere with the previous jurisprudence which, for the most part, holds that the moral exclusion is triggered only where it would be

[43] 407 US 1 (1972).

[44] Ibid, 9.

[45] Generally, see R Brownsword, *Contract Law: Themes for the Twenty-First Century* (Oxford, Oxford University Press, 2006).

inconceivable to grant a patent or where there is an overwhelming consensus that it would be immoral to do so.[46] In both *WARF* and *Brüstle* the fabric of patent law seems to be badly torn; and, for the sake of coherence, lawyers need to work hard at stitching the pieces together again.

In relation to both contracts and patents, the premise of doctrinal coherence is severely disrupted once the Commission adopts 'a regulatory mind-set' focused on harmonising the marketplace. From a regulatory perspective, the only idea of coherence is an instrumental one: provided that a regulatory intervention works relative to the regulator's purposes, then coherence is satisfied. Crucially, a regulator need not cross-check that the principle underlying the latest intervention is coherent with the principle underlying some other intervention; regulators are simply directing regulatees.[47] Of course, it is important that regulatory interventions do not interfere with one another's purposes (in the way, for example, that there are concerns about competition law interfering with the incentives for innovation offered by patent law)[48]; but, there is no problem of incoherence if the regulators take a pragmatic approach to the effective pursuit of their policies.

Moreover, even without the Brussels agenda, private lawyers must accept that, as legislation overtakes the case-law, there will be some incoherence. This is politics. Rival political constituencies seek to influence the policy and text of the law. Sometimes, compromises and accommodations indicate a lack of coherent purpose.[49] Directive 98/44/EC is surely a perfect example. On the one hand, the Directive secures the interests of the scientific research community by declaring that innovative work around the human genome (including work that replicates naturally occurring sequences) is in principle patentable.[50] On the other hand, Article 6 of the Directive sets limits on patentability that reflect some of the concerns of those various constituencies that oppose developments in modern biotechnologies (especially the use of human embryos as research tools).[51]

In the light of arguments sketched in the paper, what should we make of the apparent (and possibly inevitable) decline of coherence in regulatory Europe?

First, we should hold onto the vision of a regional association of communities of rights. Perhaps we do not need to cross-check for coherence but we certainly need to check upwards to the fundamental rights commitments of the community. In all its

[46] See, eg, Plant Cells/PLANT GENETIC SYSTEMS Case T 0356/93; and E Armitage and I Davis, *Patents and Morality in Perspective* (London, Common Law Institute of Intellectual Property, 1994).

[47] This is drawn out very clearly in H Collins, *Regulating Contracts* (Oxford, Oxford University Press, 2002) 8: 'The trajectory of legal evolution alters from the private law discourse of seeking the better coherence for its scheme of principles to one of learning about the need for fresh regulation by observations of the consequences of present regulation.'

[48] For an extensive jurisprudence, see R Whish and D Bailey, *Competition Law*, 7th ed (Oxford University Press, 2012) ch 19.

[49] For an excellent case-study, albeit in a very different context, see A Murray, 'The Reclassification of Extreme Pornographic Images' (2009) 72 *MLR* 73.

[50] See, eg, recitals (20) and (21), and Art 5(2).

[51] See, eg, recitals (37), (38) and (42).

phases, even if the legal enterprise becomes a regulatory enterprise, the regulatory environment should be compatible with respect for human rights and underlying human dignity.

Secondly, trade imperatives should not be permitted to 'collateralise' or displace or compromise moral imperatives.[52] Communities of rights, in a regional association of such communities, should value their (relative) moral autonomy. Moral subsidiarity is not simply a recognition that, on some matters, local decision-making is more efficient; the point is that moral communities need to give their commitments their own best interpretation. Any weakening on these ideals is again a worrying case of incoherence.

Thirdly, the values that seem to underpin Recital 38 and Article 6 of the Directive reflect a conservative conception of human dignity. With the development of modern biotechnologies, such dignitarian values have attracted considerable support.[53] However, there is a tension between this conception of human dignity and the autonomy-based conception that underlies the modern articulation of human rights. Elsewhere, I have termed this the tension between 'human dignity as empowerment' (a rights-based conception) and 'human dignity as constraint' (a duty-based conception).[54] For a community of rights to permit the latter conception of human dignity to intrude through moral gateways in the law is clearly incoherent. In this light, the moral exclusions of the Directive and the decision in *Brüstle* seem to be motivated by a value that does not cohere with human rights commitments.[55]

Finally, to underscore the previous point, it should be appreciated that there is an important difference between Europe as a region (and project) of 'closed' pluralism, where human rights (together with 'human dignity as empowerment') represent the fundamental values, and Europe as a region (and project) of 'open' pluralism, where rights-based values are in competition with conservative dignitarianism.[56] In the latter, the moral bonds are relaxed; tolerance implies more than acceptance of margins of difference—there is an acceptable heterogeneity; and the demand for regulatory coherence is correspondingly weaker.

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[52] Compare, S Leader, 'Collateralism' in R Brownsword (ed), *Human Rights* (Oxford, Hart, 2004) 53.

[53] See R Brownsword, 'Human Dignity, Human Rights, and Simply Trying to Do the Right Thing' in C McCrudden (ed), *Understanding Human Dignity* (Oxford, Oxford University Press, 2013) 470.

[54] D Beyleveld and R Brownsword, *Human Dignity in Bioethics and Biolaw* (Oxford, Oxford University Press, 2001).

[55] For an even more worrying example, see the judgment of the Grand Chamber at the European Court of Human Rights in the case of *SH v Austria* (application no 57813/00) 3/11/2011. There, the Court seems to permit Austria to rely on conservative dignitarian values to justify its restrictive IVF laws (prohibiting third-party donation of gametes).

[56] For the implications of the difference between 'open' and 'closed' value pluralism, see R Brownsword, 'Regulating the Life Sciences, Pluralism, and the Limits of Deliberative Democracy' (2010) 22 *Singapore Academy of Law Journal* 80; id, 'Framers and Problematisers: Getting to Grips with Global Governance' (2010) 1 *Transnational Legal Theory* 287.

12.7 Conclusion

The CJEU's decision in the *Brüstle* case finds itself at the centre of a more general debate about the coherence of the European regulatory environment. Although several of the charges of incoherence that have been made in relation to the CJEU's decision do not stick, there might well be others that have better prospects. However, it is tempting to think that the most serious examples of incoherence are to be found in the Directive itself—in the ceding of moral judgment for the sake of regional trade and the opening of the door to a conservative dignitarian ideology. From the perspective of the many communities of rights that have signed to the European Convention on Human Rights and that populate the European Union, these are acts that lack coherence.

We can place these concluding remarks within the context of a more general concern, especially amongst private lawyers, about the prospects for legal and regulatory coherence. Traditionally, private lawyers set the bar for coherence rather high. As transactions become more heavily 'regulated', coherence seems to be less of a desideratum; what matters is that regulatory interventions are effective relative to their purposes. With the development of a multi-level regime of law and regulation in Europe, coherence seems even more elusive. Nevertheless, even though pragmatists might want to immunise legislation and regulation against anything more than charges of instrumental incoherence, that is not rational where there are fundamental governing values—it is simply not coherent to act on the basis that the unity of the market must be achieved at all costs. Europe is committed to overarching values of respect for human rights and human dignity[57]; such fundamental commitments always govern instrumental considerations, both as to the ends pursued and the means employed; and they are the essential tests of the coherence of the regulatory environment whether the spotlight is on contract law or patent law.

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[57] Explicitly so in Art 2 TEU, according to which the Union is founded on 'the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities.' Art 2 continues by emphasising that these 'values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail.'

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Chapter 13
Does Private Regulation Foster European Legal Integration?

Fabrizio Cafaggi

Abstract More recently the role of the European regional regulator in the global regulatory space has attracted more attention, opening up a wider debate on the role of regional regimes in global regulation. In particular the slice of the debate relevant for this essay concerns the extent to which regional regulatory systems are drivers of differentiation and can be seen as obstacles of regulatory globalization or, on the contrary, are the pillars of a global system where multiple actors, organized around territorial or functional metrics, contribute to regulatory design and implementation.

13.1 Introduction

European legal integration can be seen as a form of transnational regional integration driven by several objectives: the creation of an internal market; the implementation of the four freedoms of movements; the protection of fundamental rights. The complementary dimensions of integration emerge clearly while comparing the goal of the internal market creation and that of fundamental rights protection, where the value of universality has to be balanced with differences across countries and communities.

In the past, the process has been primarily conceived as the creation of a common regulatory space, co-existing with national regulatory regimes. The most common term to describe this architecture is that of multilevel governance to capture the interdependence between different institutional layers, reflected in the competence system of the European Union.

The evolution of European integration, however, has not been linear: transfer of powers from Member States (MS) to the European level has not always coincided

I would like to thank Loic Azoulai and Laszlo Bruszt for comments received on earlier drafts. I would like to thank Federica Casarosa for research and editorial assistance. Responsibility for mistakes is mine.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_13,

with legislative harmonization. On the contrary, often the broadening scope of integration has corresponded to the increasing degree of flexibility and differentiation both in institutional and policy terms. Higher vertical integration, e.g. the expansion of competences and the impact of EU policies, have often paralleled with horizontal differentiation and flexibility. But even within vertical integration, the increasing use of enhanced cooperation agreements and the paramount example of monetary policy, divided between the Euro-zone and the remaining EU countries, exemplify the complexity of the path towards economic and political integration. This development has created tension between integration and differentiation calling for new paradigms like that of flexible integration.[1] The policy areas, where forms of flexible integration have occurred, range from pensions to employment policies, from health to culture. The TFEU has adopted this approach by making numerous references to policy coordination via guidelines rather than through legislation.[2] The adoption of a similar methodology has been advocated, so far without great success, in the field of private law.[3]

Integration through law represents one avenue that has to be complemented by other instruments.[4] It is important to underline from the outset that legal integration does not coincide with legislative harmonization, either full or minimum. Nor does it imply harmonization of institutions and practices. Rather, it includes new modes of governance and non-legislative instruments among which private regulation stands out. The weaknesses of legislative integration and the recognition of the limited scope of judicial integration have forced to develop governance patterns operating outside both legislation and adjudication. The process of legal integration concerns the relationship between EU legal order and MS legal orders even beyond those areas falling within EU competences. The scope of European integration should therefore not be constrained within the limits of EU legislative competences. While clearly the birth of European Communities was aimed at promoting a higher degree of legal harmonization, it soon became clear not only that there were several patterns for harmonization—some building on centralized, others on decentralized decision-making—but also that integration requires respect for diversity of legal traditions and local institutions, both public and private.[5] Integration thence encompasses both harmonization and differentiation, making potentially conflicting legal orders compatible. Compatibility rules prevent or mitigate conflicts where separate

[1] See for a first attempt to systematize the development G De Burca and J Scott (eds), *Constitutional change in EU. From uniformity to flexibility* (Oxford, Hart Publishing, 2002). In their joint introduction the Authors state: 'over the past ten years the paradigm (…) of uniformity, homogeneity and one-directional integration is gradually being replaced by one of flexibility, mixity and differentiation', at 2.

[2] See Art 5 TFEU in relation to economic, employment and social policies.

[3] See F Cafaggi (ed), *Quale armonizzazione per il diritto europeo dei contratti?* (Padova, CEDAM, 2003) and, under the label of open method of approximation W van Gerven, 'Bringing (Private) Laws Closer to Each Other at the European Level' in F Cafaggi (ed), *The institutional framework of European private law* (Oxford, Oxford University Publishing, 2006) 39.

[4] See M Cappelletti, M Seccombe and J Weiler (eds), *Integration Through Law: Methods, tools, and institutions* (Berlin, de Gruyter, 1986).

[5] The principle is now clearly stated in Art 4 TEU.

legal orders can clash and a shared system of legal sources is missing. The growing role of compatibility rules, exemplified by mutual recognition and the principle of functional equivalence, is of paramount importance when looking at private law making.

The process of legal integration is not only the result of endogenous factors in particular the development of the so called community method. It responds to exogenous variables as well. The effects of the financial crisis have seriously challenged the strategic choices of the founding fathers. The idea that economic and legal integration could lead to political integration has been undermined by new dynamics, primarily driven by global factors, which require political rather than technical integration.

More recently the role of the European regional regulator in the global regulatory space has attracted more attention, opening up a wider debate on the role of regional regimes in global regulation. In particular the slice of the debate relevant for this essay concerns the extent to which regional regulatory systems are drivers of differentiation and can be seen as obstacles of regulatory globalization or, on the contrary, are the pillars of a global system where multiple actors, organized around territorial or functional metrics, contribute to regulatory design and implementation.

13.2 Different Perspectives on European Legal Integration Within the Private Sphere

By European Private Regulation (EPR) I refer to those regimes created and governed by private actors with the use of private law instruments, primarily contracts, that regulate the economic and social behavior. Not only they refer to 'spontaneous regulatory regimes' but they also include those directly or indirectly promoted or stimulated by EU public institutions.

EPR is part of European private law and represents one of its under-investigated components.[6] Its foundations are contractual since the birth of the private regime is grounded on the principle of collective private autonomy and self-governance. Private standards are the result of private autonomy, but at the same time may constrain freedom of contract. The definition of standards may have implications for outsiders, excluded from the trade requiring compliance with the standard, and for insiders that give up alternative opportunities when joining the regime. If, for instance, producers join a certification regime they undertake the obligation to comply with the requirements defining a market for those certified products that becomes inaccessible for those who are not certified or, absent mutual recognition, for those who have joined a different certification scheme that sufficiently differentiate the two products (e.g. organic and non-organic food).

[6] See F Cafaggi, 'Private Regulation in European Private Law' in A Hartkamp et al (eds), *Towards a European civil code*, 4th ed (Alphen aan den Rijn, Wolters Kluwer, 2011) 91.

What is the scope of EPR? European private rule-making unlike public legislation is not constrained within the system of EU legislative competences.[7] It can and has developed both in the economic and social domains beyond those of the European Union ranging from financial regulation to consumer protection, from forestry to e-commerce, from food safety to data protection, from advertising to the payment system, from private pension to aviation and so on.

What is the degree of variation? EPR constitutes a form of regional legal integration with strong functional components but its scope and instruments vary dramatically across sectors and regimes. The relationship between private regulation and European integration is complex and varies both across sectors, at times, working as an agent of integration and, at times, as a factor of fragmentation.[8]

We are far from a uniform and coherent trend that can be unitarily conceptualized, where general principles and patterns could be distilled. Fragmentation increases when analyzing how EPR works in practice. One of the main weaknesses of private rule making has been enforcement. Both because of lack of independence and too strong decentralization of enforcement by private bodies, private regulation has not operated effectively, except for cases such as advertising, and a few others. Effective enforcement, however, is a key for legal integration. Regional rule-making with local enforcement without any form of coordination and peer monitoring is bound to fail. For this reason, new modes of governance should focus on compliance and enforcement mechanisms in private rule making both within and among connected regimes.

How do conflicts within the private sphere influence the regulatory choices and the effects on integration? The private sphere is highly differentiated both across States and within socio-economic communities. It is composed by industry, NGOs, professional communities whose interests and objectives are often divergent and at times conflicting. Conflicts emerge not only between industry and consumers but also, within industry, among enterprises. They concern regulatory objectives but also preferences over the modes and degrees of European integration. In many instances, conflicts arise about costs allocation of the process of integration[9]. Disagreement about distribution of costs may undermine the process or reduce its speed. Legal integration may take different forms when private regulators include multiple stakeholders with different preferences concerning what and how to harmonize, from contexts where there is only one class of stakeholders whose preferences are homogeneous.

Within the industry, a relative common feature across sectors relates to the different regulatory preferences between large, and small and medium enterprises. The

[7] On the relationship between European private regulatory law and legislative competences see H-W Micklitz, 'The forgotten dimension of private law' in L Azoulai (ed), *The Question of Competence in the European Union* (Oxford, Oxford University Press, 2014) forthcoming.

[8] See F Cafaggi and A Janczuck, 'Private regulation and legal integration: the European case' (2010) 12 (3) *Business and Politics* 1.

[9] See below the illustration of the payment system failure. There the major question was the allocation of the costs of legal integration. Private actors were unable to find a workable solution and the Commission modified its role and the regulatory strategy moving away from private regulation.

former are often the drivers of EPR. They are major players in the EU markets and promote harmonization and standardization of rules and instruments in order to take advantage of economies of scale and scope. The latter are divided. On the one hand, are those ones which want to expand and grow push for higher integration; on the other, those which have significant local influence and tend to oppose stronger integration to preserve their local market power against potential competitors.

These tensions often translate into a delicate balance between national and European trade associations. Beyond the formal structure, which often looks like a federation, divergences between the national and European level arise over the desirable path towards integration.

Private regulatory regimes tend to have always at least two and sometimes three dimensions: a European, a national and an intermediate where supranational, but infra-European, coalitions are created. Within multilevel models the relationships among levels are rather different depending on the distribution of the regulatory power, which is often a variable of market power and geographic location within Europe. But also of the institutional framework. Patterns of legal integration governed by private rule-making may differ when they operate within areas of shared competences from areas where MS States have primary or exclusive competences. Comparison between those fields where legislative integration has occurred and those areas still primarily or exclusively in the domain of MS provides evidence of how complementarity between private and public instruments operates.[10] The various legislative instruments used by EU institutions may combine in different modes with private regulation.[11]

Before examining the specific features of legal integration driven by private actors it is important to analyze the conceptual differences between two forms of integration, territorial and functional, drawing on the debate taking place at transnational level.[12]

13.3 Comparing and Contrasting Territorial and Functional Integration via EPR

Regional integration is based on a metric, which reflects administrative boundaries.[13] Regions generally coincide with supranational entities, federated or associated for single or multiple purposes. Trade has been one of the most powerful drivers

[10] See A Janczuck, *Private regulation and European integration*, Doctoral thesis (Florence, European University Institute, 2011).

[11] See Cafaggi, 'Private regulation in European Private law', 91.

[12] See L Bruszt and R Holzhacker (eds), *The Transnationalization of Economies, States, and Civil Societies* (New York, Springer, 2010); M-L Djelic and K Sahlin-Anderson, *Transnational Governance Institutional Dynamics of Regulation* (Cambridge, Cambridge University Press, 2006); S Sassen, *Territory, Authority, Rights: From Medieval to Global Assemblages* (Princeton, Princeton University Press, 2006).

[13] See L Bruszt and G McDermott, 'Integrating Rule Takers: Transnational integration regimes shaping institutional change in emerging market democracies' (2012) 19 *Review of International Political Economy* 742.

of regional integration and the creation of many supranational organizations like Nafta, Mercosur, Asean. The European Union is different. The creation of internal market has been a major driver of regional integration but never the only one; incrementally other objectives have been to the scope of regional integration added both within the economic domain (monetary and more recently fiscal) and in the social and cultural realm[14]. This multiplicity is well reflected in the Lisbon Treaty on the functioning of European Union and in the jurisprudence of the Court of Justice of EU (CJEU).

Functional integration does not run along administrative boundaries. The reference points are rather communities, which develop across States boundaries, and economic units. Religious communities are perhaps the most illustrative example but more recently, also due to technological innovation, many other forms of functional integration in the social sphere have developed thanks to the Internet giving rise to epistemic communities that self-regulate themselves. These communities share common rules, often privately produced, that foster their integration but also preserve local identities within transnational larger groups.

In the economic domain, forms of functional legal integration occur in single markets or along global supply chains when common rules apply not only to the multinational companies and its subsidiaries but also to the suppliers and the subcontractors.[15] The unit of analysis and the metric of integration are here defined according to the scope of the activity and the effects, rather than to the administrative boundaries like the seat of the chain leader.

Private rule-making operates along territorial and functional boundaries depending on the regime. It would thence be mistaken to identify territorial integration with the public sphere, and functional integration with the private sphere. Private actors operate along both dimensions partly because private communities are often territorial, partly because of the complementarity with the public sphere. Private orders have often a territorial dimension because they have co-evolved with nation-states or with other public entities at the supranational level, like international organizations.

As we shall see, the fact that private actors operate within both dimensions may create conflicts within the private sphere between different regulatory regimes reflecting the two logics.

Legal integration offers a partially distinctive perspective on the relationship between territorial and functional integration. If one starts from the now shared conclusion that States have lost the monopoly of law making power (assuming they ever had it!) and adopts the perspective of legal pluralism, even regional integration, within and between States, results in coordination among a plurality of legal orders. Somewhat paradoxically the assumption of legal pluralism in the field of

[14] See F Snyder, 'EMU— Integration and differentiation: Metaphor for European Union' in P Craig and G de Burca (eds), *The Evolution of EU Law,* 2nd ed (Oxford, Oxford University Press, 2011) 687.

[15] For a broader analysis see F Cafaggi, *New foundations of transnational private regulation* (Malden, Wiley-Blackwell, 2011) 20 ff.

public legislation can lead to revert the conventional view and claim that plurality of legal orders is embedded in territorial integration while functional legal integration tends to define self-sustained legal orders, which are or try being insulated from other legal systems. The reality however is, as usual, more complex; it is hard to find a functional legal regime totally insulated from other regimes whichever territorial metric they select to regulate themselves. Still the peculiarity of the legal dimension in the distinction between territorial and functional integration is worth keeping in mind when shifting from monopoly of rule-making power to plurality of rule-givers within single territories. The insight from the legal perspective can provide some basis for more general conclusions.

Territories and communities co-exist. So do territorial and functional forms of integration, including legal integration. But conflicts might arise between the two metrics of integration leading to different results.

An open question is the extent to which freedoms may protect forms of functional integration to the same extent as those of territorial integration.

The following examples will provide a sample of variety of governance arrangements within private regulation and how this variation may reflect on different integration patterns.

13.4 Some Illustrations

The field of data protection represents one of the most integrated field from the perspective of private regulation. The Directive 1995/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data made explicit references to the use of codes of conduct.[16] MS have made great use of codes and other instruments giving rise to different types of arrangement, from ex post approval, to ex ante delegation, to co-regulatory arrangement. The use of codes, however, has not been accompanied by coordination among the code drafters and those who manage their implementation. Control over practices is highly decentralized and definition of common practices rather hard. The proposed Regulation on general data protection can be seen as a starting point for coordination as it includes a provision whereby bodies and associations enacting codes of conduct can seek an advisory opinion on the compliance of the codes with the regulation.[17] The new provision seeks to harmonize compliance criteria of private regulatory instruments in the field that have been based on rather different approaches at MS level. The new regulation introduces binding corporate rules (BCR); it also imposes the adoption of binding rules by larger corporation under the control of a single Data Protection Agency (DPA).[18]

[16] See Art 27.

[17] See Reg on the protection of individuals with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation), Art 38.

[18] See General Data Protection Regulation, Arts 42 and 43.

Overall the use of private regulatory instruments for the implementation of the directive seems to have enhanced fragmentation. It is too early to see the effects on integration by BCR but it should be expected a higher degree of harmonization if coordination among DPAs works effectively. In the industry, there are different positions concerning the use of data protection policies as a form of self-regulation: large enterprises advocate forms of self-regulation directly agreed upon with DPAs; whereas SMEs do not have resources and capabilities to manage data protection regimes and promote collective rather than individualized regimes.

In the field of advertising, the role of European private regulation started at international level, when in 1937 the International Chamber of Commerce Code on advertising was implemented. Only in 1992, the European Advertising Standards Alliance (EASA) was created, with an initial focus on cross-border complaints. Thus, European legislation and international codes pre-existed the birth of EASA. Here, the function of the European organization has been directed towards coordination rather than rule-making. Only lately and to a very limited extent in the field of digital advertising, EASA has moved more directly into rule-making.

In the field of advertising, local languages, cultures and beliefs strongly matter: integration has to respect cultural diversity. Also harmonization of rules, which in the public domain has led to complete harmonization with directive 2005/29/EC, cannot eliminate differences in the implementation of codes of conduct. On the contrary common rules should preserve local cultures especially in the area of decency and morality where values and beliefs are strongly context-dependent. Regional private integration is here aimed at improving coordination among national private regulators, making access to dispute resolution faster, enhancing ex ante control and promote wider participation of consumer and human rights organizations.[19]

In 2002, EASA and its members—i.e. national self-regulatory bodies (SROs)—started drafting Best practice recommendations precisely with the aim of identifying the practices and foster mutual learning among national SROs. One of the main goals was to ensure that the new Member States, following the enlargement in 2004, could build SROs with the support and technical assistance of EASA. Thus, EASA became an instrument for capacity building and regulatory transplants from one to other national private regulatory regimes.

After enlargement the Round table on Advertising led by Robert Madelin,[20] then director of DG Sanco, expressly required a road map with commitments on the private regulators to be monitored and publicly reported by EASA. Effectiveness of private regulation became the most relevant and challenging objectives for EASA, which at the same time was gaining power and recognition as a global player. In this sector private regulation has operated as a driver of 'flexible harmonization' by using bottom up instruments.

[19] See EASA, Bluebook, 6th ed (2011).

[20] Self-Regulation in the EU Advertising Sector: A report of some discussion among Interested Parties, www.easa-alliance.org/binarydata.aspx?type=doc&sessionId=j1gx2c45y1mw033hcifxnk55/DGSANCO_advertisingRT_report.pdf.

The world of online advertising constitutes a new challenge, introducing new dynamics in regional integration. In this case, the asymmetric power between big non-European Internet service and content providers and EASA might have lowered the influence of European actors in European regulation. The role of the Commission was again that of mediating between global firms and European private regulators to preserve the European bargaining power in the definition of the new rules for online advertising. The online behavioural advertising (OBA) code constitutes a good illustration of how informal complementarity between public and private is leading European regulators towards a global role.[21]

Another interesting case is that of professional European private-regulation. The so called Bolkenstein Directive on Services 2006/123/EC makes references to private regulation. The field is highly differentiated across countries and professions. Local regulations still prevail over European regulation and mutual recognition has been so far the goal. Professions, with great differences among them, depending on the type of services and clients, have resisted a European public regulation and have not generated a common regulatory process to enhance freedom of movement and establishment. The internal market of professions is far from being reality. General rules do not exist even at national level where often each profession designs its own regulatory regime in agreement with public authorities. In some fields, like that of journalism, we range from no or little professional regulation to access and practice, as in the case of the UK, to medium regulation, as in the cases of Italy and Spain where professional bodies exercise strong regulatory power also due to the constitutional principle of freedom of expression.

Legal integration of professions differs depending on the presence of transnational professionals. Where service providers are not integrated—as it is still the case for the majority of legal and medical services—integration is low. In the area of media and journalism, we observe different degrees depending on the medium. Private regulation is almost exclusively State based in relation to press, it is primarily state-based with some European element in broadcast and it tends to be more europeanized in relation to electronic media due also to the influence of global regulators. The increasing presence of new media is radically changing professional self-regulation forcing to adopt global rules, which will affect the European approach. In this framework, it is likely that global content providers, which will push for a higher degree of harmonization, will stimulate regional legal integration. Important changes will occur with liberalization of professional markets to which regional integration may be strongly linked.

The field is highly differentiated across countries and professions. Professions, with great differences among them depending on the type of services and clients, have resisted a European uniform public regulation and have not generated a significant common regulatory process to enhance freedom of movement and establishment. Here, EPR has played a significant role in promoting the definition of common technical rules and cross border professional services.

[21] See EASA, Best Practice Recommendation on Online Behavioural Advertising (2011), available at http://www.easa-alliance.org/page.aspx/386.

A different case is that of Internet service providers (ISP) and the use of private agreements to protect fundamental rights on the internet. Here, the development of private regulation is the result of a liability regime that limits the role of ISP as gatekeepers for violations of copyright, privacy, data protection.[22] In this instance the partial immunity has placed the burden of right holders that are forcing the ISP to negotiate informal agreements imposing non-binding undertakings concerning notice and takedown procedures.[23] Private regulation has been, in this instance, primarily triggered by national courts, which have eroded the ISP immunity and favoured the conclusion of agreements whose effectiveness is yet to be seen.[24]

In the field of EU food safety, private regulation presents two remarkable features which underline institutional complementarity between public and private regulation and its effects on integration: (1) the adoption of the supply chain approach to regulation triggering operators' responsibility and (2) a certain degree of regulatory competition between standard setters and between certifiers. Private regulation, traditionally producers' based, has shifted towards retailers' regulation in the last 20 years. The new regulatory framework designed with Regulation 178/2002/EC has introduced the supply chain approach placing on food operators the task to ensure safety. Responsibility has triggered private regulatory regimes to minimize the hazards and to allocate related responsibilities along the chain. Private regulation is primarily concerned with compliance and certification schemes have been introduced to monitor producers and suppliers conducts, especially in relation to imported food. Certification schemes can operate at B2B level where the retailer wants to control compliance over standards along the chain, or at B2C level when information to consumers needs to be conveyed.

National retailers associations have created competing standards for food safety to be applied by producers and their suppliers—e.g. the British Retail Consortium Standard led by the UK retailers and IFS led by German retailers, and later joined by French and Italian retail associations. These standards often co-exist with individual retailer standards, especially those of the biggest companies, which are aimed at increasing product differentiation and fostering competition. Further proliferation of standards has been somewhat reproduced in certification schemes like EUREGAP subsequently transformed in GLOBALGAP. This excess of private regulatory schemes has increased production costs without creating real benefits for the consumers.[25] The European Commission has repeatedly highlighted risks concerning the creation of barriers to foodstuff trade.[26] Different solutions have

[22] See Dir 2000/31/EC on certain legal aspects of information society services, Arts 12-15 on Internet Service Providers' liability.

[23] See MoU UPDATE.

[24] AG Cruz Villalón, Opinion of 26 November 2013, Case C-314/12 *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH and Wega Filmproduktionsgesellschaft GmbH*, not yet reported.

[25] See SJ Henson and J Humphrey, 'The impacts of private food safety standards on the food chain and on the public standard-setting process', Paper prepared for FAO/WHO, ALINORM 09/32/9D-PArt II, Codex Alimentarius Commission.

[26] See Commission communication, *EU best practice for voluntary certification schemes for agricultural products and foodstuffs*, 201/C 341/04 (hereinafter: *EU Guidelines on voluntary certification*).

been considered: from integration to mutual recognition of standards. The latter seems so far the prevailing view and it has also been promoted by a recommendation of the European commission on certification schemes,[27] with a specific attention to mutual acceptance of audits and inspections.[28] From the industry side, the response to proliferation had been the creation in 2000 of non-profit foundation, namely the Global Food Safety Initiative (GFSI), whose main purpose has been to design a mutual recognition system based on ISO 22000.

More recently in the field of agri-food European initiatives driven by DG Enterprise are trying to define agreements between producers and retailers on commercial practices, concerning price and marketing rather than safety.[29] The Commission has created a consultative body, namely the High level forum for better functioning of food supply chain, which has produced a platform of principles concerning good practices about fairness in B2B vertical relationship.[30] In some member states those principles have been incorporated by reference in legislative acts giving rise to forms of vertical complementarity.[31] Once more, the Commission is acting as a mediator among conflicting private interests that reflect on market structure and supply chains.

The European payment system provides another example of integration via private regulation. In this instance, EU institutions, particularly the Commission and the European Central Bank, promoted private regulation of the payment system in the last part of last century and the beginning of the last decade. Given the difficulties it encountered, it has been replaced by a more formalized co-regulatory regime. Among the major problems was the costs allocation of European legal integration both within the 'banking system' and between the banking system and their customers, industry and consumers. In fact, the European payment system is currently under a radical transformation. For over a decade, there has been an attempt to move from a fragmented to a uniform payment system: the so-called Single Euro Payments Area (SEPA). SEPA aims at "*the creation of an integrated market for electronic payments in euro, with no distinction between national and cross border payments (has been deemed) necessary for the proper functioning of the internal market*".[32] Migration by way of private regulation has been slow and new legislation defines an end date for the migration. A new regulation concerning credit transfer and direct debit is about to be enacted which will regulate instruments and timeline for the consolidation of a fully integrated payment system.[33]

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[27] See *EU Guidelines on voluntary certification*, 7.1.

[28] See *EU Guidelines on voluntary certification*, 7.2.

[29] See at ec.europa.eu/enterprise/sectors/food/competitiveness/forum_food/index_en.htm.

[30] See Decision of 30/7/2010, establishing the High Level Forum for a better functioning supply chain (2010/C 210/03) and vertical relationship in the food supply chain.

[31] See, for example Italy, Art 62.

[32] See Reg 260/2012 establishing technical and business requirements for credit transfers and direct debits in euro, recital 1.

[33] For a detailed analysis see A Janczuk, 'Transnational private regulation and the payment system', HIIL case study, presented in Florence, January 2012.

The new regulation explicitly admits the failure of self-regulation and it identifies governance issues as the major causes of the failure: "self-regulatory efforts of the European banking sector through the SEPA initiative have not proven sufficient to drive forward concerted migration to Union wide schemes for credit transfers and direct debits on both the supply and the demand side. In particular consumer and other user interests have not been taken into account in a sufficient and transparent way".[34] Changes of the SEPA Council have not been considered sufficient; the governance of the SEPA system has been transformed by redefining the governance structure of the European Payments Council. The enactment of the Regulation will then coincide with a radical transformation of the European private regulator, the European Payment Council, changing name and governance to respond to the new needs coming from both its stakeholders and external constituencies which have expressed their voice also through the EC.[35] The changes driven by public, formal and informal, intervention reflects the inability of private regulators to design a regime that provides adequate incentives to voluntary migration to the SEPA.[36]

13.5 The Specificity of Private Regulation in the Process of European Legal Integration

Legal integration is generally examined through the lenses of public institutions. In the debate about European legal integration two main approaches have been discussed: integration through legislation and through adjudication.[37] Clearly the current status is the result of cycles in which one has prevailed over the other.[38] Those who have emphasized the role of Courts, both European and domestic, as drivers of integration have also underlined the dialogue, at times cooperative, at times competitive, between the judiciary and the legislative powers to achieve integration.[39] This implies that the role of national courts as agents of European integration has

[34] Regulation on establishing technical requirements, recital 5.

[35] The new body, which will continue exercising standard setting functions, will present a different balance between European and Member States private bodies both on the banking, customers and the consumer sides. National bodies primarily will play a more relevant role rebalancing the regulatory power within a newly defined regulatory process.

[36] For a detailed analysis see Janczuk, *Private regulation and European legal integration*.

[37] See JHH Weiler, 'The Transformation of Europe' (1991) 100 *The Yale Law Journal* 2403; A Stone Sweet and M Shapiro, 'The New Constitutional Politics of Europe' (1994) 26 *Comparative Political Studies* 397; A Stone Sweet, 'Constitutional Politics: The Reciprocal Impact of Lawmaking and Constitutional Adjudication' in C Harlow and P Craig (eds), *Lawmaking in the European Union* (London, Sweet and Maxwell, 1998); K Alter, *Establishing the Supremacy of European Law: The Making of an International Rule of Law in Europe* (Oxford, Oxford University Press, 2001).

[38] See Weiler, 'The Transformation of Europe'.

[39] See A Stone Sweet, 'The European Court of Justice' in P Craig and G de Burca (eds), *The evolution of EU law*, 2nd ed (Oxford, Oxford University Press, 2011) 122, 131.

often been responsive to the political evolution. Such dialogue has operated between EU institutions, in particular the Commission and the Court, but also between the Court and private regulators especially in the area of fundamental freedoms. More recently the debate on legal integration has shifted from legislative and judicial harmonization to new modes of governance and their effects on integration via experimentation.[40]

Little has been said until recently about the role of private regulation in promoting European integration and in particular legal integration.[41] We refer to the European private regulatory regimes whose primary direct or indirect objective is to contribute to legal integration.[42]

The role of private standard setters in Europe has been considered primarily in relation to competition law and to the (in)applicability of the freedoms to private parties exercising regulatory functions. Specific attention has been devoted to harmonization of technical standards due to the so called 'new approach' and the recognition of the applicability of the fundamental freedoms to these standards.[43] For the purpose of this essay, we look more broadly at private regulation, including not only technical standards but also private regulatory standards that might have technical components as drivers of European legal integration.

Firms, trade associations, NGOs, fundamental rights organizations, experts and their associations, have contributed to legal integration in different ways: by defining common standards, by producing framework rules to be applied by regulated entities, by standardizing contracts at EU level. Unlike integration through legislation and to a significant extent adjudication, which is 'imposed' on private actors, integration via private regulation is based on consent and incentives rather than prescriptions and command. The foundations of private regulation are contractual; the decision to join the regime is voluntary, the governance principle is private collective autonomy and self-governance. At least in theory!

Private regulation is voluntary, except when the rule-making power is exercised on the basis of a formal delegation by public authority.[44] In this case, the adoption

[40] See C Sabel and J Zeitlin, 'Learning from difference: the new architecture of experimentalist governance in the EU' (2008) 14 *European Law Journal* 271; C Sabel and J Zeitlin, *Experimentalist governance in the European Union: towards a new architecture* (Oxford, Oxford University Press, 2010).

[41] See F Cafaggi, 'Private Law-Making and European Integration: Where do they meet? When do they conflict?' in D Oliver, T Prosser and R Rawlings (eds), *The regulatory State* (Oxford, Oxford University Press, 2010); Cafaggi, 'Private regulation and European private law'.

[42] Unlike in the public domain, where the internal market creation is almost always part of the legal basis, in the area of European private regulation integration, let alone harmonization is not necessarily the primary objective.

[43] See the debate generated by ECJ, judgment of 12 July 2012, case C-171/11 *Fra.bo SpA v Deutsche Vereinigung des Gas- und Wasserfaches eV (DVGW) – Technisch-Wissenschaftlicher Verein*, not yet reported. See R van Gestel and H-W Micklitz, 'European Integration through Standardization. How judicial review is breaking down the club house of private standardization bodies' (2013) 50 *Common Market L.aw Review* 145.

[44] Legal voluntariness is often mitigated by socio-economic factors that often make *de facto* binding the subscription to a *de jure* voluntary scheme. The limits of voluntariness and the degree of

of private standards becomes mandatory for the regulated entities.[45] The difference between delegation and other collaborative forms of private regulation is that in the former the public delegating institution has the original rule making power which is then transferred to the private entity, whereas in the latter, private actors exercise rule making power on the basis of private autonomy, e.g. they are the original power holders. The definition of the regulatory power's holder has strategic implications on the description of private regulation alternatively as a form of self-governance or as a form of outsourcing regulatory power from the public to private. Those who believe that regulatory power is intrinsically public describe the rise of private regulation as a form of outsourcing, those who believe that regulatory power may have different sources ground private power into private autonomy, and some link private autonomy to self-governance.

Voluntariness implies that private regulation needs to provide adequate incentives for regulated entities to join regimes and contribute to legal integration. When incentives to subscribe to the regulatory scheme are insufficient or interests of the different private actors are not well-aligned, failure is likely to happen. Failure can occur if entry costs are too high, first mover disadvantages are not considered, externalities on third parties raise 'political' objections. Failure translates into limited subscriptions to the scheme or in lack of compliance by a high number of subscribers. In the perspective of this essay, then failure of private regulation translates into lower or less effective European integration. But the reasons for failure to effectively integrate standards may depend on many factors related not only to the design but also to the implementation as the payment system case demonstrates.

Besides voluntariness, a second important difference with European public legislation as a means of integration is the particular type of multilevel structure. Absent the principle of supremacy of European private regulation over domestic ones, and given that implementation of European private rules is often conferred to domestic private regulators, joint decision-making and vertical cooperation rather than hierarchy is the dominant feature of EPR.[46] In most of the regimes European private regulators cooperate with domestic ones in an integrated regulatory process. In many instances, rulemaking is shared across different layers and the distinction between rule givers and rule-takers blurs. This is not to say that *de facto* rather than

coercion imposed by private power on regulated entities has been addressed by increasing procedural requirement and standard setting procedures.

[45] An exception of the exception is represented by technical standards that, unless otherwise stated in legislation, remain voluntary even in presence of the delegation agreement between the European Commission, Cen and Cenelec (see Art 2 of Reg 1025/2012). Clearly, however, when compliance with technical standards ISO or CEN/CENELEC is required by sector specific legislation its adoption/compliance is mandatory. A question that remains open is the extent to which the general principles set forth therein are applicable to technical standards produced by non-recognized standard setting bodies or to private standards without a technical feature. See F Cafaggi, 'Towards general principles for EU private standards?', on file with the author.

[46] It should be said that the principle of supremacy does not translate into hierarchy even in the public domain as the *Solange* case law and the dialogue between the German Bundesverfassungsgericht and the Court of Justice shows.

de jure asymmetric power between European and domestic private regulators does not exist and that it might translate into stronger influence of one over the others. As a matter of fact, the power often lies with national regulators while European organizations are weaker and relegated to the role of lobbyists. The implementation and the enforcement of private rules are primarily entrusted in the hands of domestic regulators, giving rise to problems concerning divergent compliance and enforcement practices. Divergences are addressed by coordination mechanisms ranging from mutual recognition for domestic disputes to centralization of cross-border complaints.

The multilevel governance structure of many private regimes, with the rule making power allocated at the domestic level defines the nature and the speed of the integration process. However, even within multilevel structures whose dominant feature is the prevalence of the national level we see different emphasis on integration: lower in professional and media regulation, medium in advertising, rather high in food safety and payment just to name some of the sectors illustrated above.

Private regulation can also promote the opposite goal i.e. European legal disintegration when, within a harmonized European legal system, it creates normative communities operating as barriers to free movement and to competition and vehicles of insulation rather than integration.[47] Often private standards are created to exclude competitors from markets or to reduce the power of other communities vis-á-vis the regulating community. In this instance, competition law scrutiny can mitigate fragmentation and increase legal integration when it imposes on the private scheme pro-competitive rules, reducing barriers to entry and switching costs. The applicability of the four freedoms to private regulation introduces important limitations to private autonomy when private actors pursue regulatory objectives whose rationale differs from those imposed by competition law.[48]

13.6 Institutional Complementarities and European Legal Integration. The Different Roles of the European Commission in Orchestrating Private Regimes

Private regulation often operates in the context of complementarity with public action that can deploy formal or, more frequently, informal tools. It is contended that informal collaborations between public and private actors have proved to be very

[47] On the relationship between integration and disintegration see De Burca and Scott, 'Introduction to Constitutional change in the EU'.

[48] On the relationship between free movement and competition law as limits to private autonomy see S Weatherill, 'The elusive character of private autonomy in EU law' in D Leczykiewicz and S Weatherill (eds), *The involvement of EU law in private law relationship* (Oxford, Hart Publishing, 2013) 9, in particular 10-15.

effective to promote legal integration by private regulation. The most relevant feature of collaborative regulation between public and private has been informal institutional complementarity.[49]

European institutions have often informally promoted private regulation in Europe whereas explicit references to co-regulation or other forms of collaborative rule-making are limited in scope. Unlike some MS, like the UK and, to a more limited extent, the Netherlands, where its recognition has taken legislative form, in Europe both *Better*, and more recently, *Smart regulation* have never endorsed a shift to private regulation, let alone its primacy over public legislation. Though, there are clear cases like that of technical standardization where formal delegation to private standard setting bodies has been deployed.[50] But in general, informal complementarity has prevailed over specific forms of co-regulation or delegated self-regulation.

In many areas the European Commission has stimulated the emergence and consolidation of EPR. In some instances EPR has emerged under the threat of public legislation, in other instances as a tool to overcome lack of legislative competence, where clearly no credible threats could operate.[51] A third and growing number of cases fall within areas of legislative competences but are based upon the rationale that private regulators can achieve more effective integration than conventional MSs implementation of EU legislation. Clearly the origins and development of EPR do not fit with only one explanation. The drivers, the degree of heterogeneity of private interests, the distribution of power among the stakeholders are all factors contributing to the definition of the type and speed of legal integration.

The European Commission has promoted the development of private regulation to achieve legal integration in different forms. Not only the Commission has indicated in policy documents where private regulation would be welcome, but it has also played more active functions as steering the process towards forms of governance and regulation aimed at including stakeholders and interests that would have otherwise been left out from the regulatory process, as the cases of internet service providers and advertising show: the European Commission has supported the function of coordination and monitoring of European organizations over national SROs. The informal role of the Commission prevents from qualifying many areas as forms of delegation or co-regulation. In formal terms, these remain purely private regimes even if the influence of public institutions is manifest.

Complementarity has taken different forms evolving over time depending on the dynamics within the private sphere. The different interests between major industry players and national trade associations have driven the path towards different patterns of integration or the failure of the integration process. Often, as in the case of

[49] See HIIL Final report, November 2013, available at www.privateregulation.eu.

[50] W Mattli and T Buthe, 'Setting International Standards: Technological Rationality or Primacy of Power?' (2003) 56 *World Politics* 1; T Buthe and W Mattli, *The New Global Rulers: The Privatization of Regulation in the World Economy* (Princeton, Princeton University Press, 2011).

[51] See A Heritier and S Eckert, 'New Modes of Governance in the Shadow of Hierarchy: Self-regulation by Industry in Europe' (2008) 28 *Journal of Public Policy* 113.

the SEPA the different directorates (DG Competition, DG Market) have mediated among the divergent private interests: banks, customers, consumers.

13.7 Private Regulation, European Negative Integration, and the Courts

A very significant role in defining if and how private regulation can contribute to European legal integration or dis-integration is played by the fundamental freedoms whose applicability to private standard setters has now been fully recognized by CJEU.[52]

In the past one of the problems concerning the relationship between standards and legal integration has been the adoption of a double test depending on whether the standard setting body is a private or a public entity. This is particularly relevant in technical standard setting. Given that in Europe technical standard setters may have different nature, the application of different rules related to freedom of movement to public and private standard setters may undermine the goal of integration.

The move towards horizontal applicability of the four freedoms to private standard setters has reduced the relevance of the public/private distinction and mitigated the risks of regulatory differentiation. The CJEU by recognizing the applicability of the freedoms to private standards has taken a functional approach looking at the function of standards rather than the identity of the standards' producer.[53] A functional approach to standard setting is based on the correlation between process and output. In fact the application of the four freedoms concerns both the effects of private standards and increasingly their modes of production. So far the CJEU has not yet developed sophisticated tests to establish whether national or even transnational private regimes may violate the four freedoms; it is desirable that the development of these tests will look at both procedural and substantive features of the regimes. The judicial scrutiny related to the freedoms should therefore combine both procedural requirements and substantive effects of EPR.[54] Hence, the analysis of violation of freedoms and of proportionality should not only concern the standard's content and its effects but also the procedure for its approval and governance.[55] For example, access of regulated entities to the standard setting procedure and to the standard, once

[52] See case C-171/11, *Fra.bo v DVGW*.

[53] This approach has long standing roots. See case C-415/93 *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman* [1995] ECR I-4921, para 86.

[54] See van Gestel and Micklitz, 'European Integration through Standardization', 175 where the authors claim that *Fra.bo* requires private bodies issuing technical standards to comply with constitutional law making standards.

[55] The general principles set forth in the EU Reg 1025/2012 concerning technical standardization should apply beyond technical standards and become the criteria against which compatibility with free movement is tested. Among the principles drawn from the code of practice drafted by WTO transparency, openness, consensus, independence and efficiency should inform procedural requirements and considered to have general applications.

approved, should not be discriminatory.[56] The definition of entry rules that *de jure* or *de facto* discriminate on the basis of nationality of regulated entities would violate the freedoms and should therefore be subject to scrutiny by national courts in relation to the compatibility with Treaty provisions. The distinction between territorial and functional integration suggests that there are other forms of discrimination not based on nationality that might be considered within the scope of the freedoms when the standard does not have a specific territorial scope as when it is applied to regulated entities that operate within and outside EU.

The functional approach implies that when standards are not harmonized at European level national legislation or private rules by standard setting bodies cannot impose unjustified burdens on regulated entities (standards' users) and should in principle allow mutual recognition of regimes.[57] Thus, the principle of proportionality should apply and the related test indicate the least burdensome regulatory alternative compatible with the objectives of the regime. Professional regulation and food safety represent good illustrations of how the principle of proportionality may determine or at least influence the choice of regulatory instruments by private standard setters compatible with free movement rules and the goal of legal integration. Professions can continue to regulate access at national level, but they have to comply with the principle of non-discrimination and design a mutual recognition regime that permits free movement of professionals among Member States. Similarly certification schemes about food safety can have limited geographical and territorial scope but since they regulate market access they have to operate within a general scheme of mutual recognition that enables free movement of foodstuff across states.

The impact of adjudication and in particular of the case law decided by CJEU on the alternative between integration and disintegration has been comparatively much stronger than that of legislation. After *Fra.bo*, decided in 2012 by CJEU, art. 34 TFEU applies to private standard setting bodies.[58] Hence, the divergences between applicability of free movement of goods to private parties and the other free movement principles (art. 45, 49, 56) have been significantly reduced. This is not to say that a common core of consistent principles applicable to private standard setting have emerged. Among the obligations stemming from applicability of art. 34 stands the duty of private regimes to harness mutual recognition devices that prevent fragmentation and promote free movement of establishments. These obligations arise when (1) the certification activity triggers the presumption that the certified is law compliant and (2) when the certifier acts as a *de facto* monopolist. Control of the power to regulate market entry, regardless of whether it is exercised

[56] On the application of the principle of non discrimination to private parties see N Reich, 'The impact of non discrimination principle in private autonomy' in Leczykiewicz and Weatherill (eds), *The involvement of EU law in private law relationship*, 253 ff., emphasizing the necessity to include the collective dimension of discrimination that is the dominant feature in private regulation.

[57] When the standard setting body in practice regulates entry to a domestic market, Art 28 TFEU applies. See case C-171/11 *Fra.bo v DVGW*, paras 31 f.

[58] The Court, unlike the AG, avoids speaking of direct or indirect horizontal effects but clearly admits the applicability of freedom of movement principles subject to two conditions. See case C-171/11 *Fra.bo v DVGW*, para 32.

by a public or a private entity, falls within the scope of art. 34 according to the Court. If standard setting results in market entry regulation there is scope for judicial scrutiny.

The AG in Fra.bo has further recognized the horizontal applicability of the principle of proportionality both to public and private technical regulation and underlined that in the latter case different conclusions may be reached from the case where regulation by a public body is at stake.[59] Thus, when designing and implementing private regimes, both territorial and functional, private actors are bound by the obligations stemming from the freedoms in relation to the principle of proportionality. For example, in the environmental field agreements can protect the environment and limit movement of goods producing CO_2 emissions without disproportionately limiting freedom of movements of goods and establishments. Similarly, in the field of data protection private agreements can protect privacy and limit cross-boundary data transfers without constraining freedom of movement of goods and services. Restrictions to freedoms can be justified only if private regimes pursue some public interests, e.g. protection of fundamental rights, as in the case of data protection, or consumer protection, as in the case of advertising or food safety.

The changes introduced by the *Fra.bo* judgment will permit scrutinizing local private regimes whose direct or indirect effect is to prevent the creation of a common market by regulating access to the market via regulating access to the standard. As a consequence, the application of free movements' principles to private standard setting permits addressing the effects of regulatory fragmentation and even more importantly (non-)discrimination of regulated entities by the private regulator. At the same time, it may provide incentives to promote positive integration through private regulation by using negative integration instruments (e.g. judicial control).

The Court has not addressed the issue of remedies in case of violation of freedoms by private standard setters. It would be important to provide national courts with guidance on the available remedies against private standards violating the freedoms and the negative effects on legal integration. In particular, CJEU should clarify how far could national courts go when examining how private standards ought to be redrafted in order to be 'compatible' with the freedoms. In other words if and how can national courts use affirmative and not only prohibitory injunctions. Further, it is relevant to evaluate the potential role of damages and compensatory remedies in general and the differences with the policies behind the Courage v Crehan decision in case of violation of competition rules by private actors.[60]

[59] See AG Trstenjak, Opinion of 28 March 2012, Case C-171/11, *Fra.bo v DVGW*, paras 39 and 56. It becomes clear in the words of the AG that the private nature of the rule making body may justify restrictions of free movement when there is a conflict with fundamental rights like freedom of conduct a business and, I would add, freedom of association. The application of the principle of proportionality to private regulation would hence lead to a different balance from that which would be reached had the state been the regulator. See for a broader analysis concerning the application of the principle of proportionality to private regulation F Cafaggi, *Rethinking private regulation in the European regulatory space* (Aalphen an den Rijn, Kluwer, 2006) 3 ff.

[60] Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* [2001] ECR I-6297.

Potentially, the scope for private regimes that protect local values at the expenses of freedom of movement is warranted within the boundaries of the exceptions granted by TFEU provisions in relation to the freedoms. The judicial principles concerning the four freedoms can provide guidance to define personal and material scope of private regimes in the light of the European integration project. So far the case law has expanded the scope to private actors and their regulatory instruments. However, expanding the scope does not necessarily imply homogeneity of limitations for private regulators. It is likely that at a deeper level different principles and constraints on private standards might emerge in relation to each freedom. The next step by the Court should be refining the scope of application by identifying the specific features of free movements that should characterize public interest analysis when private regulation is in place. Both the contractual foundations of private regulation and its public interest objectives are not without consequences in the balancing analysis between free movements and its limitations. There are limits to reducing private autonomy even when it is related to the exercise of regulatory function. It would seem that no predetermined hierarchy should exist between the freedoms and the fundamental rights upon which the rule making power of private organizations is grounded. An important role in defining the balance between freedoms and rights can be found in the principle of proportionality and more specifically the criteria of appropriateness, necessity and reasonableness as defined by the AG in *Fra.bo*.[61]

13.8 Open Questions and Implications for European Integration via Multilevel Private Regulation: Uniformity or Sector Specificity?

The illustrations have provided anecdotal evidence of the relevance of private regulation in European legal integration. Different models of multilevel private regulation have emerged with a significant impact on the patterns of European legal integration: in the payment and advertising fields, there is one strong European player, which has interacted with national banking associations or domestic SROs with opposite results (failure in payment, success in advertising). In food safety, there are competing European private regulators, which have partitioned the regulatory space according to their market incentives but have then to devise forms of coordination in terms of mutual recognition at the global level. The evolution of Eurep.gap is an example on point. In the data protection, national private regulators compete with multinational firms rather than with a European private regulator. There, uniformity is ensured by the public framework. In professional regulation traditional systems present strong domestic regulators and rather weak European associations, primarily engaged in lobbying. Here, the level of legal and institutional integration is still low. In the field of media and journalism regulation is still local;

[61] See V Trstenjak and E Beysen, 'The growing overlap of fundamental freedoms and fundamental rights in the case-law of the CJEU' (2013) 38 *European Law Review* 293.

however private national regulators are challenged by new global regulators, primarily multinational corporations like the content and service providers, changing the scope and instruments of European private regulation.

Legal integration fostered by private regulation proceeds at different speeds depending on the width of the regulated markets, the degree of liberalization, the incentives of different actors to expand or preserve their market shares, and the distributional impact that integration can bring about. Changes of market are driven by changes of players' and/or their market penetration strategies. The relevant private rule makers have changed over time and ever more global players influence if and how European legal integration should occur due to the increase of goods and services imported in or exported from the European Union. Internet, data protection, derivatives, and food safety all provide illustrations of the changes in European private regulation brought about by the expansion of the regulated market and the appearance of new market players.

But European legal integration does not depend only on the features of private standard setting. A preeminent role is that of practices in monitoring compliance and enforcement. Private regulators, certification and auditing schemes have been allocated monitoring tasks concerning both private and public standards. When compliance assessment methods and practices diverge, legal integration objectives may be undermined even if standards are common. The emergence of meta-private regulators in the field of certification and the multiplication of mutual recognition schemes may have a positive effect on the degree of legal integration by designing common rules that third party verifiers have to comply with.

To some extent, the different models of integration through private regulation also depend on plurality or monopoly in the world of public regulators. The payment sector suggests, for example, that different views on internal market and the function of EPR exist both among institutions and even within the same institution, the European Commission, depending on the regulatory objectives e.g. competition and free movement. Incorporating private regulation into the analysis of legal integration shows that within the private sphere incentives of private actors may differ and their alignment around a single strategy is difficult, at times impossible, via pure bargaining among themselves. Often the intervention of the European Commission is crucial to design governance models able to align conflicting interests related to the regulatory objectives reflected into the pathways of legal integration.

It is necessary to disentangle sector specificities and look at them comparatively.

Sectoral differences suggest that modes of legal integration promoted by private regulation vary depending on the level of market integration, the presence of transnational economic players and the structure of the supply chain. As a result the regulatory chain can change with different power allocation across layers. But perhaps the most influential factor is the allocation of regulatory power; in particular whether it is concentrated or dispersed and how it is distributed across the various layers. A relevant exogenous factor can be the legislative competence system: when there are exclusive or shared competences of EU it is more likely that European private regulators are given higher share of power.

Sector specificity justifies the use of different tools and modes of complementarity between public and private regulation as vehicles of legal integration. Integration among different private rule makers can mimic what has happened in the field of public integration or follow new patterns. Different forms of regulatory coordination have been experimented in rule making, monitoring and enforcement: from mutual recognition, to network coordination. Coordination among national or functional rule-makers emerges in those private regimes that pursue the objectives of higher integration, whereas lacks or it is even contrasted where the underlying objective is that of fragmentation and insulation.

Even within a framework characterized by sector specificity are general principles needed to ensure both that private regulation truly promotes integration and does it according to the European Union objectives. A distinction related to the principles should be made between voluntary and mandatory standards.

On the one hand, by definition the objectives of private regulation should be defined by the relevant stakeholders and not by the public institutions. On the other hand, the complementarity, that has almost always characterized the emergence and consolidation of EPR, suggests that at least a voluntary set of common principles should be designed to ensure the pursuit of the objectives of integration consistently with both procedural and substantive values of the European social and economic communities.

Common principles should include procedural requirements related to entry, participation and exit from the private regime. They should also refer to choice among alternative strategies and accountability mechanisms related to regulatory performances. Particularly relevant for the purpose of this analysis are the cases where integration via harmonization is one the explicit regimes' objectives.

When standards are voluntary, private regulators who do not want to subject themselves to these principles should be left with freedom of choice within the limits of competition law, the four freedoms and criminal laws.

Clearly a different set of principles should characterize mandatory private regulation where the legislator, the agency and, to some extent the judiciary, make the private standard mandatory for a class of regulated entities. In this case the European Commission should define common principles that ought to characterize both the governance of the private regulator and the structure of the regulatory process. In relation to the former, the governance should preferably be based on non profit organizations, on functional separation between standard setting, monitoring and enforcement, and it should include accountability systems towards members and external stakeholders affected by the regulatory activity. As to the process, whose regulation should be related to the governance model, it should feature the following: transparency, inclusiveness, participation, proportionality, cost-effectiveness, evaluation of distributional impact both related to the regulated entities and to third parties, mandatory ex ante impact assessment and mandatory ex post reporting.

These features should be present in all private regimes that are subject to delegation or incorporated by reference into the European legal order or approved ex post. It is strongly recommended that EU institutions engage into this examination when

in their directives or regulations decide to incorporate a private standard.[62] In addition mandatory ex ante impact assessment and ex post auditing should be imposed on private regimes whose standards have become mandatory by way of legislation, decisions by administrative agencies and, to a more limited extent, judicial decisions. The assessment should always include the effects on legal integration. Both in the ex ante assessment and in the ex post verification a deep and specific analysis of the effects of the regime on European legal integration should be carried out.

13.9 An Agenda for Future Research

The analysis has showed that European legal integration is the product of both public and private rule-making often coordinated via collaborative ventures mainly of informal nature. The result is the emergence of many forms of institutional complementarity that vary sector by sector, depending on (1) the market structures, (2) the regulatory objectives, (3) the incentives of various actors to integrate territorially and/or functionally, (4) the ex ante allocation of powers among the players which concur in the regime, and (5) the ex post distribution resulting from the implementation of the standard.

Unlike other regional regimes, primarily trade driven, the EU is characterized by a complex set of objectives including internal market and fundamental rights which may result or translate into conflicting views of regional integration.

We have identified different forms of integration dependent on the driving institution: legislation, adjudication, governance. Depending on the relative weight of each one in the regime's design the relationship with private rule making will result in different forms of complementarity. Private rule making can be triggered and influenced not only by legislation but also, and at times even more strongly, by the courts or by network forms of governance. Clearly a judicial framework for private regulation as the case of Internet access and service providers generate different results from a formal legislative framework or an informal interaction with the European Commission.

While clear distinctions exist between the modes of integration via public or private, it is clear that both show high degree of flexibility casting doubts on the conventional view that private regulation is preferable because it can provide higher flexibility. The distinction is on the quality and the effects of flexible integration rather than between rigid/public and flexible/private systems.

The specificity of the European system implies that many different patterns to integration are in place at the same time broadening the scope of the meaning of

[62] Incorporation by reference into European legislation takes place without a test or the request of specific requirements concerning both the governance and the structure of the regulatory process that has produced the incorporated standards. A different approach has been taken in the US. See Recommendation 5/2011 Incorporation by reference adopted by the Administrative Conference of the United States.

European legal integration. Integration does not coincide with harmonization but it is compatible with different forms of regulatory differentiation that result in compatibility rules among communities which may or may not coincide with MS. Thus, legal regional integration displays a wide range of possibility from full harmonization, to flexible coordination, mutual recognition, and compatibility rules.

The foregoing examples show that both the emergence and the success of private regulatory regimes and their effects on integration depend on the ability to find balanced compromises among conflicting interests related to various preferences about modes and objectives of integration within the private sphere. Such conflicts may occur within the same regimes or between functionally equivalent regimes. The role of the European Commission, often informal or based on soft instruments, may contribute finding the right governance devices that combine adequate interest representation and effectiveness as the advertising, the food safety and even the payment system, with some caveats, confirm. The European Commission should become a more active player in fostering coordination among compliance programs and assessment instruments across Europe and between Europe and other continents. This result can be achieved through cooperation with private meta-regulators.

Future research will shed light on how effectively private rule making can contribute to legal integration, how differences with public institutions have played out and to what extent the paradigm of flexible integration reflects a common perspective between private and public regulation.

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Chapter 14
European Unity in Diversity?! A Conflicts-Law Re-construction of Controversial Current Developments

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Abstract The EU has come a long way since its foundation as the European Economic Community in 1957. Starting out as a purely economic union, the integration process has progressively entered into areas of political, social and cultural concern for the Member States. Meanwhile, the institutionalised 'logic of the market' and related harmonisation increasingly lead to tensions not only with varying socio-economic and legal systems, but also with different politicaland cultural perceptions.

'Conflicts-law constitutionalism' aims at developing new awareness for Europe's conflict constellations and their (re-)interpretation with respect to socio-economic diversity, the social embeddedness of markets and the different regulatory cultures in the Member States.Therefore, it does not only serve for critical re-construction of the integration process but also aims at a 'third way' between the defence of the nation state and a quasi-federalist streamlining of Europe`s diversity. This is illustrated with five prominent and topical conflicts where market interests interfere with political, social and cultural preferences: the legendary *Cassis de Dijon* case, the labour law cases of *Viking* and *Laval,* the fully harmonised unfair commercial practices law, the promotion of renewable energies and the regulation of genetically-modified organisms.

This essay was produced in the context of the Bremen Cooperative Research Centre on 'Transformations of the State' where Christian Joerges directs (with Josef Falke) the sub-project 'Trade, Liberalisation and Social Regulation'. Carola Glinski has elaborated the present text on the basis of Christian Joerges' previous work, in particular on C Joerges, 'Unity in Diversity as Europe's Vocation and Conflicts Law as Europe's Constitutional Form' (2011) *TransState Working Paper* No 148, and has applied the theory of conflicts-law to topical political, social and cultural controversies.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_14,

14.1 Introduction

'Unity in Diversity' was the fortunate motto of the ill-fated Draft Constitutional Treaty.[1] This motto deserves to be kept alive, despite its failure, and even more so under the impression of the present all too rash claims for centralising moves outside cumbersome treaty amendment procedures. It seems even safe to say that the challenges that it articulates have become even more obvious: the Member States of the European Union are no longer autonomous but, in ever increasing ways, inter-dependent due to economic and monetary integration and hence depend upon co-operation. And yet, this inter-dependence contrasts strikingly with an ever-greater socio-economic diversity, new schisms between Eurozone countries and other members of the Union, conflicts between north and south, between creditors and debtors. In view of the diversity in the histories of European democracies, their varieties of capitalism, uneven potential and/or willingness to pursue the objectives of distributional justice or protective aims, differentiating answers suggest themselves. The sustainability of the whole European project seems to depend upon the construction and institutionalisation of a 'third way' between or beyond the defence of the nation state, on the one hand, and federalist or quasi-federalist ambitions, on the other.

The reality of the integration process with its institutionalised 'logic of the market' is quite different, and increasingly leads to tensions not only with national economic and legal systems, with varying welfare systems, but also with different political, social and cultural perceptions.

Conflicts-law constitutionalism can not only serve for the critical re-construction of the integration process but also as the 'third way' which this contribution will explore and defend. This, however, must not be misunderstood as a sceptic retreat from Europe's common project with its commitments to democracy and the rule of law. To the contrary, its aim is to develop a new awareness for Europe's conflict constellations and their (re-) interpretation with respect to socio-economic diversity, the social embeddedness of markets and the different regulatory, social and economic cultures in the Member States.

Part 2 of this essay recalls the founding legal integration theories and their exhaustion. In Part 3, the conflicts-law approach is presented as an alternative to Europe's legitimacy *problématique*. Part 4 provides for a re-construction of high-profile and contested conflict constellations, and analyses the inherent legal dynamics towards liberalisation and harmonisation. Part 5 summarises the identified problems and opens up some modest perspectives.

[1] Article I-8 Draft European Constitutional Treaty, [2004] OJ C 310/1.

14.2 The Original Conception of Europe as a 'dual polity' and its Subsequent Development

The project of European integration was a response to Nazi Germany and the Second World War. It was conceptualised and launched as an economic project that aimed at taming economic nationalism (in the Weberian sense). The other aspiration was that a legal condition (a *Rechtszustand* in the Kantian sense) would replace the state of nature among Europe's nation states. European law has transformed the *comitas* among Member States into binding legal commitments. Peace and economic integration were associated with the prospects for societal progress and economic wealth.[2]

The cautious step-by-step integration based upon unanimous political unification processes in the beginning[3] gained new momentum as 'integration through law' driven by economic integration. The cornerstones were the famous judgments of *Van Gend and Loos* (1963)[4] and *Costa* v *Enel* (1964)[5] as well as *Dassonville* (1974)[6] and *Cassis de Dijon* (1979)[7] as well as the introduction of the Single European Act. This development was accompanied by the prevailing assumption (not only) in legal scholarship that integration is a good in itself. Its promotion 'through law' and legal institutions, in particular by a supranational court, was regarded as a reliable assurance of its founding premises.[8]

14.2.1 Founding Legal Integration Theories

The founding integration theories all conceptualised Europe as a 'dual polity' based upon the separation of Europe's economic constitution from 'the political' and 'the social' which would rest with the Member States.

The ordo-liberal school perceived Europe as an ordo-liberal project which relied on economic freedoms and a system of undistorted competition as Europe's (purely) economic constitution, which was not in need of democratic legitimacy. Economic integration was regarded as a sort of autopoietic machinery which, the

[2] C Joerges and M Weimer, 'A crisis of executive managerialism in the EU: no alternative?' (2012) *Maastricht Faculty of Law Working Paper* 2012/7, 2.

[3] The EEC was designed as 'a regime in which markets would be allowed to expand within politically defined limits that would not undermine the preconditions of social cohesion and stability at the national level', see FW Scharpf, 'The asymmetry of European Integration, or why the EU cannot be a social market economy' (2010) 8 *Socio-Economic Review* 211, 215.

[4] Case 26/62 *Van Gend en Loos v Administratie der Belastingen* [1963] ECR 1.

[5] Case 6/64 *Flaminio Costa* v *Enel* [1964] ECR 585.

[6] Case 8/74 *Procureur du Roi v Benoît and Gustave Dassonville* [1974] ECR 837.

[7] Case 120/78 *Rewe-Central AG* v *Bundesmonopolverwaltung für Branntwein* [1979] ECR 649; on which see K Purnhagen, 'The Virtue of Cassis de Dijon 25 years later—It is Not Dead, it Just Smells Funny', in this volume.

[8] Joerges and Weimer, 'A crisis of executive managerialism in the EU', 2 ff.

more it operates in line with the fundamental demands of the market societies, the better it delivers its benefits. The social embeddedness of the economy and the varying welfare-state policies in the form of legally-structured industrial relations and of social security were left to the Member States.[9] In line with this perception, the Treaty of Rome can be read as a constitutional compromise agreed upon by actors whose attitudes, hopes and aspirations differed considerably, but who believed in the positive effects of an opening of national economies while retaining the pluralism in national welfare-state policies.

In line with this perceived division of tasks between Europe and its Member States, (early) European law and its harmonising efforts have been regarded as a purely technocratic regime, administering questions of 'knowledge' and 'objective tasks', legitimised by their solution, but leaving truly 'political' questions to democratic and legitimated bodies.[10] As a result, Giandomenico Majone has conceptualised Europe as a 'regulatory state' which operates essentially through non-majoritarian institutions and which ensures the credibility of commitments to, in principle, uncontested policy goals but leaves truly political decisions, in particular those including (re-) distributional effects to democratically-legitimised national institutions.[11]

Joseph Weiler's path-breaking and later refined vision of Europe and its 'integration through law' conceptualised Europe as an equilibrium between market-building legal supra-nationalism and political inter-governmentalism.[12]

[9] With the main proponents Walter Eucken and Franz Böhm. A Müller-Armack is also significant here, 'Die Wirtschaftsordnung des gemeinsamen Marktes' in A Müller-Armack (ed), *Wirtschaftsordnung und Wirtschaftspolitik* (Freiburg, Rombach, 1966) 40; for further references see C Joerges, 'Unity in Diversity as Europe`s Vocation and Conflicts Law as Europe's Constitutional Form' (2011) *TransState Working Paper* No 148; see also C Joerges and F Rödl, 'On the "Social Deficit" of the European Integration Project and its Perpetuation through the ECJ Judgements in *Viking* and *Laval*' (2008) *RECON Working Paper* 2008/06.

[10] See in particular HP Ipsen, *Europäisches Gemeinschaftsrecht* (Tübingen, Mohr Siebeck, 1972) 176 ff, 1045; *id*., *Verfassungsperspektiven der Europäischen Gemeinschaften* (Berlin, Walter de Gruyter, 1970) 8, and the interpretation by M Kaufmann, *Europäische Integration und Demokratieprinzip* (Baden-Baden, Nomos, 1997) 300, 312 ff; and E Forsthoff, 'Begriff und Wesen des sozialen Rechtsstaats' (1954) 12 *Veröffentlichungen der Vereinigung deutscher Staatsrechtslehrer* 8. The so-called *Sozialstaats*-debate is an evergreen in German constitutionalism; for recent contributions, see F Rödl, 'Die Idee demokratischer und sozialer Union im Verfassungsrecht der EU' (2013) Suppl 1 *Europarecht*; C Joerges, '*Rechtsstaat* and Social Europe: How a Classical Tension Resurfaces in the European Integration Process' (2010) 9 *Comparative Sociology* 65.

[11] See, in particular, G Majone, 'The European Community as a Regulatory State' (1994) *Collected Courses of the Academy of European Law V/1* (Leiden, Martinus Nijhoff, 1996) 321; id, *Regulating Europe* (London, Routledge, 1996). See, also, G Majone, 'Regulating Europe: Problems and Prospects' (1989) 3 *Jahrbuch zur Staats- und Verwaltungswissenschaft* 159; id, 'Cross-national resources of regulatory policymaking in Europe and the United States' (1991) 11 *Journal of Public Policy* 79 and, recently, id, *Europe as the Would-be World Power: The EU at Fifty* (Cambridge, Cambridge University Press, 2010).

[12] See, path breaking, JHH Weiler, 'The Community System: the dual character of supranationalism' (1981) 1 *Yearbook of European Law* 257; id, 'Transformation of Europe' (1990–91) 100 *Yale Law Journal* 2403.

14.2.2 The Completion of the Internal Market and the Exhaustion of Legal Integration Theory

As we all know, this (theoretical) 'dual polity' equilibrium did not remain stable for long.

Clearly, technocracy has never been neutral, and harmonisation and regulation have never been apolitical. Since the late 1960s, and increasingly since the mid-1970s, there has been regulation with implications for health and safety, as well as consumer and environmental protection.[13] The dispute amongst lawyers as to whether, and, if so, to what extent, consumer protection should be categorised as market regulation or rather as social protection ranges back over 30 years.[14]

The introduction of the 1986 Single European Act with the aim of the 'Completion of the Internal Market'[15] through the elimination of all conceivable barriers to trade accompanied by the introduction of majority-voting and the conferral of new competences, however, was widely perceived as the important cornerstone for accelerated harmonisation activities with increasing impact also on non-market policy fields, which put the original equilibrium under ever greater pressure.

The then initiated (de-) regulatory strategies are generally seen today, either affirmatively or critically, as an institutionalisation of economic efficiency and rationality as Europe's core agenda.[16] The subsequent establishment of the European Monetary Union with the Treaty of Maastricht and the Stability Pact completed this type of Europe's economic constitution.[17]

At the same time, however, the entanglement of the internal market with ever more policy fields has also led to substantial 'social regulation' activities in areas such as health and safety, and consumer and environmental protection; a devel-

[13] See only the Chemicals Dir 67/548/EEC, [1967] OJ 1967 L 186/1; the Cosmetics Dir 76/768/EEC, [1976] OJ L 262/169; the Birds Habitat Dir 79/409/EEC, [1979] OJ L 103/1. See, also, the Resolution on a preliminary programme of the European Economic Community for a consumer protection and information policy of 1975, [1975] OJ C 92/1.

[14] Also, the conceptual separation between risk assessment and risk management is a consequence of the awareness of the political aspects of allocation of risks; see, only, U Beck, *Risikogesellschaft* (Frankfurt, Suhrkamp, 1986). See also G Winter, *Risikoanalyse and Risikoabwehr im Chemikalienrecht* (Dusseldorf, Werner, 1995).

[15] See the legendary European Commission's 'White Paper to the European Council on Completion of the Internal Market', COM(85) 310 final.

[16] See, on the one hand, A Hatje, 'The Economic Constitution within the Internal Market' in A von Bogdandy and J Bast, *Principles of European Constitutional Law*, 2nd ed (Oxford, Hart, 2011) 589, and J Drexl, 'Competition Law as Part of the European Constitution', ibid, 659, which are strongly indebted to the ordoliberal tradition, and on the other hand M Höpner and A Schäfer, 'A New Phase of European Integration: Organized Capitalisms in Post-Ricardian Europe' (2010) 33 *West European Politics* 344. Such theoretical controversies vary of course as strongly as Europe's varieties of capitalism. Scharpf, however, regards the introduction of the SEA the logical consequence of the 'highly asymmetric institutional configuration' by the end of the 1970s due to the judicial deregulation by the ECJ`s '*Dassonville-Cassis* line' of decisions, see Scharpf, 'The asymmetry of European Integration', 220, 223.

[17] See also Joerges and Rödl, 'On the "Social Deficit" of the European Integration Project', 4.

opment that was clearly under-estimated by legal integration theory. As a result, the explicit recognition and strengthening of new policy competences in the 1992 Treaty of Maastricht was criticised most distinctively by German ordo-liberals as a break with the ordo-liberal economic constitution.[18] With the codification of values and aims in Articles 2 and 3 TEU and general applicable principles in Articles 7 to 17 TFEU, the Treaty of Lisbon has now constitutionalised the idea of a community of non-market values.[19]

With this development, the EU has also departed considerably from the other two founding theories of Majone and Weiler. The importance of the technocratic tradition in the *praxis* of the integration project can hardly be over-estimated. Its increased weight and the intrusiveness of Europe's regulatory policies were to be organised at supra-national levels without the backing of a consolidated democratic order. Thus, Majone—who respects the primacy of constitutional democracies—stresses with increasing urgency the fallacy of an ever more perfect and comprehensive subjection of the integration project to its 'operational code', the principle 'that integration has priority over all conceivable values including democracy',[20] as well as the camouflage strategies which he calls 'integration by stealth'.[21] Majone continues to underline that Europe is not legitimated to pursue the type of distributional politics which welfare states have institutionalised.[22] His quest for more modesty in Europe's ambitions[23] summarises these observations.

Already in his seminal article on the 'Transformation of Europe', Weiler had delivered an insightful diagnosis of the problematical implications of majority-voting in terms of Europe's legitimacy.[24] He was among the first to realise the normative and political ambivalences of the completion of the Internal Market by the Delors Commission:

[18] See M Streit and W Mussler, 'The economic constitution of the European Community. From "Rome to Maastricht"' (1995) 1 *European Law Journal* 5.

[19] Indeed, the statement from the 1972 European Council Summit already reads like an early attempt to create an embedded liberalism at European level: 'Economic expansion, which is not an end in itself, must as a priority help to attenuate the disparities in living conditions. (…) It must emerge in an improved quality as well as in an improved standard of life. In the European spirit special attention will be paid to non-material values and wealth and to protection of the environment so that progress shall serve mankind'.

[20] Majone, *Europe as the Would-be World Power,* 1.

[21] See G Majone, *Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth* (Oxford, Oxford University Press, 2005).

[22] Majone, *Europe as the Would-be World Power*, 128 ff.—And it is for this reason erroneous to classify Majone as a 'technocrat'. His reserves against a comprehensive European social model rested, from early on, upon the democratic concern for a proper legitimation of distributional politics; see C Joerges, '*Der Philosoph als wahrer Rechtslehrer*. Review Essay on Giandomenico Majone, *Regulating Europe*' (1999) 5 *European Law Journal* 147.

[23] Majone, *Dilemmas of European Integration,* 170 ff.

[24] Weiler, 'The Transformation of Europe', 2461 ff.

'[T]o regard the Community as a technological instrument is, in the first place, to under-estimate the profound political choice and cultural impact which the single market involves—a politics of efficiency, a culture of market.'[25]

Weiler has also never subscribed to the far-reaching ambitions of the convention process,[26] and he is among the most prominent warners against the quest for 'ever more Europe' with comprehensive economic governance.[27]

Until today, a consensus on the interpretation of this new constellation has not emerged. In fact, despite its increasing political implications, European law has been legitimised with various approaches which could be categorised as a mixture between input and output legitimacy. The concept of deliberative supra-nationalism has been based upon the assumption that increasing inter-dependency requires political and legal co-ordination in order to include all those affected in decision-making, which, if it was organised in a deliberative way, could be regarded as legitimate.[28] Others focussed more on the output side regarding the dedication to what are in principle the uncontested policy aims of common European welfare in which all, or at least some, are better off, but nobody is worse off, or in which a raise of the overall European standard requires only minor cutbacks by some high standard countries.[29] Or, as Fritz Scharpf has put it, legitimacy considerations are not required to shoulder more than is necessary. As long as no major legitimacy concerns are raised, European law could be regarded as being sufficiently legitimate.[30]

This, however, has changed. Even before the financial crisis, there had been (smaller or bigger) turning-points in various policy fields, of which *Viking* and *Laval* may be the most (in-) famous examples. Meanwhile, the social, political and democratic 'deficit' of the European Union is on everyone's lips.

In particular, Scharpf has most sophisticatedly analysed the asymmetry of European integration 'through law' towards liberalisation and towards the disintegration of social market economies with a view to the ECJ's broad interpretation of economic freedoms and its impact on the further development of European law.[31]

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[25] JHH Weiler, 'Fin-de-Siècle Europe' in R Dehousse (ed), *Europe After Maastricht: An Ever Closer Union?* (Munich, CH Beck, 1994) 203, 215.

[26] See JHH Weiler, 'On the Power of the Word: Europe's Constitutional Iconography' (2005) 3 *ICON* 173.

[27] See JHH Weiler, 'The Political and Legal Culture of European Integration: An Exploratory Essay' (2011) 9 *ICON* 678.

[28] See, in particular C Joerges and J Neyer, 'From Intergovernmental Bargaining to Deliberative Political Processes: The Constitutionalisation of Comitology' (1997) 3 *European Law Journal* 273.

[29] This focus on a European common good also found its expression in the case law of the ECJ. When interpreting the requirement of a 'high level of consumer protection', the ECJ concluded that this did not need to represent the highest attainable level but that a cutback in individual Member States was justified by the general increase of protection in the EU; see Case C-233/94 *Germany* v *Parliament and Council* [1997] I-4205 on deposit guarantee schemes.

[30] FW Scharpf, 'Legitimacy Intermediation in the Multilevel European Polity and Its Collapse in the Euro Crisis' (2012) *MPIfG Discussion Paper* 12/6, 15 ff, http://www.mpifg.de/pu/mpifg_dp/dp12-6.pdf.

[31] See Scharpf, 'The asymmetry of European integration'.

We can summarise the forgoing observations in an interim conclusion: the *impasses* of the integration *praxis* are mirrored and foreshadowed by the exhaustion of the main theoretical perspectives which have accompanied and oriented legal reflections and theoretical conceptualisations. In particular, these reconstructions have turned a blind eye on the strong liberalising and disembedding dynamics of economic integration and the respective harmonisation needs or ambitions. Where practice and theory differ so significantly, the search for an alternative paradigm seems overdue.

14.3 Conflicts-Law Constitutionalism

The Draft-Treaty's motto, 'Unity in diversity', requires the re-conceptualisation of European law as a new type of supranational conflicts law. This follows from the sociological observation of Europe's complex conflict constellations with the normative implications for European law to cope with them in a way which is reconcilable with democratic requirements. Since the approach has been presented elsewhere often enough,[32] commentary is here restricted to a depiction of its five core messages.[33]

14.3.1 Conflicts Law as Democratic Commandment

Under the impact of Europeanisation and globalisation, contemporary societies experience an ever stronger schism between the decision-makers and those who are impacted upon by the decision-making. This schism poses a democracy problem for anybody defending the idea that the citizens of democratic polities should be able to interpret them, as, in the last instance, the authors of the law with which they are

[32] For an earlier version, see C Joerges, 'Rethinking European Law's Supremacy: A Plea for a Supranational Conflict of Laws' (with comments by D Chalmers, R Nickel, F Rödl and R Wai) (2005) *EUI Working Paper Law* 12/2005; for affirmative and critical comments see C Joerges, P Kjaer and T Ralli (eds), 'Conflicts Law as Constitutional Form in the Postnational Constellation' (2011) 2 *Transnational Legal Theory*; for a particularly sensitive recent discussion cf. G Teubner, *Constitutional Fragments: Societal Constitutionalism in Globalization* (Oxford, OUP, 2012) 150.

[33] In the following, we draw on C Joerges, 'Integration through Conflicts Law: On the Defence of the European Project by means of Alternative Conceptualisation of Legal Constitutionalisation' in R Nickel (ed), *Conflict of Laws and Laws of Conflict in Europe and Beyond—Patterns of Supranational and Transnational Juridification* (Antwerp, Intersentia, 2010) 377 and 'The Idea of a Three-dimensional Conflicts Law as Constitutional Form' in C Joerges and E-U Petersmann (eds), *Constitutionalism, Multilevel Trade Governance and International Economic Law*, 2nd ed (Oxford, Hart, 2011) 413.

supposed to comply.[34] Jürgen Habermas' most recent formula is almost identical to our basic assumption:

'Nation-states (…) encumber each other with the external effects of decisions that impinge on third parties who had no say in the decision-making process. Hence, states cannot escape the need for regulation and coordination in the expanding horizon of a world society that is increasingly self-programming, even at the cultural level (…).'[35]

However, this must not be understood as a kind of *passé-partout* which would justify all kinds of interventions into the political autonomy of constitutional states and their decision-making procedures. Any correction of undemocratic external effects must, in itself, be justified.[36]

14.3.2 The Supranationality of European Conflicts Law

Notwithstanding the connotations of its terminological origin, a conflicts law understanding of EU law must not serve as a retraction from supranationalism as such. Quite to the contrary, it furnishes a justification for the validity of the supranational jurisdiction—albeit one which, at the same time, depicts the limits of supranational rule. As a consequence of their manifold degree of inter-dependence, the Member States are no longer in a position to guarantee the democratic legitimacy of their policies. A European law that concerns itself with the amelioration of such external effects, that is, which seeks to compensate for the failings of the national democracies, may induce its legitimacy from this compensatory function. It can thus operate to strengthen democracy without needing to establish itself as a democratic state.

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[34] This is the observation on which Jürgen Neyer and the present author based their quest for a legitimation of European law by its potential to compensate the structural democracy failures of nation states back in 1997. See C Joerges and J Neyer, 'From Intergovernmental Bargaining to Deliberative Political Processes: The Constitutionalisation of Comitology' (1997) 3 *European Law Journal* 273, 293. Jürgen Neyer has elaborated and refined the argument systematically in his recent monograph entitled *The Justification of Europe. A Political Theory of Supranational Integration* (Oxford, Oxford University Press, 2012). Jürgen Habermas had submitted a very similar idea in his very first essay on European integration. See J Habermas, *Staatsbürgerschaft und nationale Identität* (St. Gallen, Erker, 1991), reprinted in id, *Between Facts and Norms. Contributions to a Discourse Theory of Law and Democracy* (Cambridge MA, The MIT Press, 1998) 491, 503: The citizens today experience 'an ever greater gap being passively affected and actively participating'.

[35] J Habermas, 'Does the Constitutionalization of International Law Still Have a Chance?' in id, *The Divided West* (Cambridge, Polity Press, 2007) 113, 176.

[36] Suffice it here to point to the control and correction of budgetary policies and all sectors of national polities by the regulatory machinery which the Six Pack and the Fiscal Compact have by now established. See, in detail, C Joerges, 'The European Economic Constitution and its Transformation through the Financial Crisis' in DM Patterson and A Södersten (eds), *A Companion to European Union Law and International Law* (Chichester, Wiley-Blackwell, 2013, forthcoming), text accompanying note 53 ff; Joerges and Weimer, 'A crisis of executive managerialism in the EU', 28 ff.

14.3.3 Convergence, Re-construction, Critique

Clearly, such a democratic exoneration of European law is only plausible to the exact degree that it may be re-constructed within this perspective, or that it may be furnished with a conflicts-law orientation. This, however, is already, often enough, the case: European law has given legal force to principles and rules which serve the purpose of supranational 'recognition'—the non-discrimination principle, the supranational definition and the demarcation of legitimate regulatory concerns, the demands for justification for actions that are imposed upon national legal systems, and the proportionality principle—which supplies a legal yardstick against which respect for supranationally-guaranteed freedoms may be measured—and the demand that all public exercise of power pays due regard to fundamental rights. All these principles and rules may be understood as a concretisation of a supranational conflicts law, which guarantees that the actions of the Member States are reconcilable with their position within the Community. This is not to say, however, that the solutions to the conflicts at which European law has actually arrived, are always convincing. Our re-construction of European law in the normative perspectives just outlined will reveal tensions between 'facticity' and 'validity', as well as failures and missed opportunities—and the conflicts approach shares this type of experience with the three approaches which it seeks to replace.

14.3.4 Vertical, Horizontal and Diagonal Conflicts

Europe's multi-level system cannot be organised and administered hierarchically. The legal validity of this insight stems from the apportionment of competences, the limited operational resources available at EU level, and the political inability or 'deficit' for governing certain policy fields, in particular welfare-state policies, which needs to resort to the complementary competences of the Member States. The conflicts-law approach distinguishes accordingly between vertical (between supranational and national law or politics), horizontal (between the Member States or between different policy fields) and 'diagonal' collisions. Diagonal collisions are an important and unique feature of multi-level systems and a constant feature of the Union's *praxis*. This constellation gives rise to two forms of potential conflict—on the one hand, between divergent EU and national policy-fields or orientations, and, on the other, between divergent interest constellations in the Member States—so that very particular mediation arrangements must be identified. This need for mediation is particularly pressing in the case of the EU, where the existence of diagonal conflicts has led, as its corollary, not only to an enormous production of secondary law, but also to the evolution of a particularly intense degree of administrative co-operation, the institutionalisation of advice-giving instances, and the systematic construction of non-governmental co-operative relationships. It could thus be understood as furnishing the integral components of a conflicts-law in which regulation aims could no longer be realised at national level. Accordingly, we distinguish between three layers of conflicts-law ordering or 'three dimensions' of conflicts

law: conflicts law of the 'first order' is flanked, on the one hand, by a conflicts law, which, most specifically in the realm of European comitology, has concerned itself with the elaboration of material (substantive) regulatory options, and, on the other, by a conflicts law, which governs the supervision of para-legal law and self-regulatory organisation.[37]

14.3.5 Conflicts Law as Proceduralising Constitutionalism

It follows from the preceding sections that it would be factually and normatively mistaken to regard EU law as a system of law dedicated to the incremental construction of a comprehensive legal edifice. Europe must learn to accept the fact that its diversity will accompany it far into the future, so that conflicts born out of diversity will continue to characterise the process of European integration. It should, therefore, further concede that this process should be overseen by a type of law which, by virtue of its identification of the principles and rules that govern conflict, will generate the law of the European multi-level system. Europeanisation, then, is not simply a process of change, it is also a learning process. Law cannot pre-determine the substance of such processes, but may yet secure its own normative character, by virtue of its self-dedication to the processes of law-making and its justification ('*Recht-Fertigung*'), which mirror and defend justice and fairness within law.[38] This understanding is by no means simply a Germanic idiosyncrasy.[39] It is akin to, for example, Antje Wiener's notion of the 'invisible constitution'[40] or Deirdre Curtin's concept of the 'living constitution'.[41]

14.4 The Re-Construction of Conflicts, and the Identification of Conflict Norms

As follows from the preceding section, the history of European integration can be re-read as a history of the design of collision norms and procedures, and their interpretation and application by the European institutions. For a re-construction of

[37] On which, see C Joerges and F Rödl, 'Reconceptualising the Constitution of Europe's Post-national Constellation—by dint of Conflict of Laws' in I Lianos and O Odudu (eds), *Regulating Trade in Services in the EU and the WTO. Trust, Distrust and Economic Integration* (Cambridge, Cambridge University Press, 2012) 762.

[38] See R Wiethölter, 'Just-ifications of a Law of Society' in O Perez and G Teubner (eds), *Paradoxes and Inconsistencies in the Law* (Oxford, Hart, 2005) 65.

[39] See M Everson and J Eisner, *The Making of the EU Constitution: Judges and Lawyers beyond Constitutive Power* (Milton Park, Routledge, 2007) in particular 41 ff.

[40] A Wiener, *The Invisible Constitution of Politics: Contested Norms and International Encounters* (Cambridge, Cambridge University Press, 2008).

[41] D Curtin, *Executive Power of the European Union. Law, Practices and the Living Constitution* (Oxford, Oxford University Press, 2009).

the democratic condition of Europe, it is thus not enough to look at the European institutional framework (such as decision modes of the Council and the Parliament) or constitutional rights, but at the structural relationship *between* law and politics. The way in which European law structures the complex conflicts between different legal orders, between the supranational and the national, between harmonisation and diversity, and between market and non-market policy goals has always been of major importance for the reach and direction of the further integration process.

Clearly, the EU is based upon the principles of delegated powers and subsidiarity.[42] The emphasis on the free market over national policies, however, can be traced in primary law to the extensive use of competences, in particular the internal market competence (now Article 114 TFEU),[43] in order to regulate in areas where the EU did not appear to have the competence to regulate, and surely beyond the original expectations of Member States.[44] Safeguards for national protection aims, such as Article 114(4) TFEU, have been applied restrictively by the Commission and the European Court of Justice/Court of Justice of the European Union.[45] The outreach of the fundamental freedoms has been drastically extended by the ECJ/CJEU to areas that are not predominantly trade-related, whilst, at the same time, the justification of limitations to the free movement of goods and services, in particular, has been made ever more difficult. In secondary law, the favouring of the internal market over diverging national policies finds its main expression in the shift from minimum harmonisation to total harmonisation, and in the introduction of the principle of origin, which legally or factually narrowed down national regulatory leeway. Even further, where secondary law expressly leaves discretion to the Member States, this discretion has sometimes been limited again by the Court via the application of the fundamental freedoms.[46]

Procedurally, competences have been transferred from the Member States to EU level, in particular through the introduction of majority-voting with the Single European Act and its continuous extension, although there are still exceptions for sensitive policy-fields.[47] Centralised approval procedures in areas such as pharmaceutical law, chemical law or genetically-modified organisms (GMOs) have been

[42] Now Art 5(1) TEU.

[43] Often based upon dubious impact assessment exercises, see H-W Micklitz, 'The Relationship between National and European Consumer Law—Challenges and Perspectives' (2008) *Yearbook of Consumer Law* 35.

[44] See, eg, Dir 2011/24/EU on the application of patients' rights in cross-border healthcare, [2011] OJ L 88/45.

[45] See, eg, Case C-512/99 *Germany v Commission* [2003] ECR I-845, on rock wool; Commission decisions 2000/509/EC, [2000] OJ L 205/7; 2001/570/EC, [2001] OJ L 202/37 on organostannic compounds.

[46] See Section 4.2 below.

[47] Such as taxes, see Arts 113, 192, 194(3) TFEU; social security, see Arts 21(3), 151(1)(c) with 152; languages, see Art 118(2) TFEU on language issues in patent law.

introduced. The use of comitology procedures has been extended even to areas where not only technical, but also political, decisions are at stake.[48]

In the following, we will re-construct some of the conflicts that have arisen in the past decades. As a starting-point, we use the legendary case of *Cassis de Dijon*. We then depict the evolution of EU unfair commercial practices law in order to illustrate far-reaching liberalisation and harmonisation dynamics in the law and politics relationship. Next, we recall the (in-) famous labour law cases of *Laval*[49] and *Viking*.[50] Finally, we turn to recent conflicts around the promotion of renewable energies and the regulation of genetically-modified organisms. These examples represent the areas of cultural, social and political diversity.

14.4.1 Cassis de Dijon

The judgment of *Cassis de Dijon* is a classic example of different perceptions of a decision in academic writing. It can be regarded as not only a conflict between different legal orders, but also as a conflict between liberalisation and protective aims.

The Court's response to the controversy between Germany and France over Germany's prescriptions on a minimum percentage of alcohol in liquor could be reconstructed as a solution of a conflict between different national (legal) perceptions on 'liquor'. In this respect, it was as plausible as it was trifling: the confusion of German consumers could be avoided, and a reasonable degree of protection against erroneous decisions by German consumers could be achieved by simply disclosing the lower alcohol content of the competing French liquor. In this respect, the application of the principle of proportionality to the German provisions appears to represent a well-balanced approach to the conflicting interests.

On closer inspection, the Court's answer to the conflict in *Cassis* is not as plausible as it appears at first sight, since it has—as has been pointed out—at the same time resolved a conflict between market freedoms and protection aims in an asymmetric manner. The issue, then, is whether the Court has gone a step too far when complementing the recognition of the constitutional status of economic freedoms by its authoritative definition of the kind of concerns which are deemed compatible with the establishment of a common European market, at the same time reducing

[48] For an attempt to introduce a comitology procedure in the area of unfair contract terms law, see the proposal for a Directive on consumer rights, COM(2008) 614 final. Critique by H-W Micklitz, 'Review of Academic Approaches to the European Contract Law Codification Project' in M Andenas et al (eds), *Liber Amicorum Guido Alpa* (London, BIICL, 2007) 710.

[49] Case C-341/05 *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundetet al* [2007] ECR I-11767.

[50] Case C-438/05 *International Transport Workers' Federation, Finnish Seamen's Union v Viking Line ABP, OÜ Viking Line Eesti* [2007] ECR I-10779.

these concerns to justifications, to exceptions from the rule, that are to be interpreted narrowly and are subject to the principle of proportionality.[51]

This leads to another aspect of this judgment. As Damian Chalmers[52] has emphasised, what was at stake in this constellation, which did not only affect the two parties directly-involved, was the marketing strategies of powerful distribution chains such as REWE which posed a threat to the survival of small shops which were not in a position to provide consumers with such a broad variety of products. Through the upgrading of economic freedoms to constitutional rights, the CJEU has indeed assumed *en passant* constitutional functions which (powerful) economic players could draw on in order to change their own internal national economic relations.[53]

Furthermore, the judgment was a cornerstone for subsequent harmonisation ambitions in the area of consumer law, in particular in the area of unfair commercial practices, as will be shown below. In particular, the principle of mutual recognition, which the ECJ had *en passant* introduced for non-justified regulatory concerns, poses a strong 'incentive' for at least minimum harmonisation.[54]

All this emphasises the reading of *Cassis* as a conflicts-law case. The ECJ handed down a ruling on a complex conflict constellation. This ruling does provide a legal framework for this conflict. The Court, however, failed to evaluate all the dimensions of this conflict when pursuing its market-building agenda. This judgment '*is*' nonetheless conflicts law, albeit not necessarily good law.

14.4.2 Unfair Commercial Practices Law

For the sake of illustration of conflict resolutions which lead to ever-increasing harmonisation and liberalisation, we use the area of unfair commercial practices law, with comparing remarks on consumer contract law. The legal development in this policy area aptly exemplifies the inter-relation between the interpretation of fundamental freedoms, private international law rules and the development of secondary law—and therefore highlights the dependence of the political process on the legal (pre-) structuring of conflict constellations.[55]

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[51] See, in particular Scharpf, 'The asymmetry of European integration', 219 ff. See, in a similar vein, AJ Menéndez, 'United they diverge? From conflicts to constitutional theory? Critical remarks on Joerges' theory of conflicts of law' (2011) *RECON Working Paper* 2011/6.

[52] D Chalmers, 'Deliberative Supranationalism and the Reterritorialization of Authority' in B Kohler-Koch and B Rittberger (eds), *Debating the Democratic Legitimacy* (Lanham, Rowman & Littlefield, 2007) 329, 334.

[53] See E Steindorff, 'Probleme des Art. 30 EWG' (1984) 148 *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* 338. See also Scharpf, 'The asymmetry of European integration', 221 ff with further references: Private 'enforcers' of fundamental freedoms and their 'persistent (…) search (…) for new obstacles to remove' could be regarded as a major driving force for liberalisation.

[54] See, also, comprehensively Scharpf, ibid, 224 ff.

[55] See, generally, Scharpf, ibid, 223 ff.

Although consumer law might neither be as much at the heart of social protection as minimum wages, nor as highly politicised as renewable energies or GMOs, it provides us further with a good example of the legal development in a policy area with a dual character between market regulation and social protection. One can trace the step-by-step shift of competences towards the European level as well as the shift of the substance of European legislation in the direction of (a liberalised) market. What is at stake here is not just the level of consumer protection, but also the attitudes or habits of different national cultures regarding fair or unfair market behaviour.[56]

At the outset, the regulation of unfair commercial practices was entirely in the competence of the Member States. They were free to regulate the level of protection as they deemed appropriate, and the (then non-harmonised) rules of private international law ensured that foreign traders had to comply with the domestic regime if they wanted to enter the domestic market. The applicable collision norms, if any, were the competence system of the EEC Treaty, which made the harmonisation of laws (under then Article 100 EEC) dependent on unanimity and did not cater for the harmonisation of private international law at all. The provisions on the free movement of goods and the free movement of services did not seem to apply, as unfair commercial practices law was not related to the crossing of borders.

This changed, of course, with *Cassis de Dijon*; with the implication that national measures that were meant to protect consumers from unfair commercial practices were tested for their 'necessity'. As we all know, the German prohibition on the low-alcohol liqueur Cassis failed that test.

The balance was further shifted by the consumer image that the ECJ adopted in the following. In *Mars*,[57] the ECJ developed the concept of the 'reasonably circumspect consumer' as the benchmark for the necessity test under Article 36 EEC. Thus, under the then new interpretation of the collision norm of Article 36 EEC, Member States only remained in the position to protect 'reasonably circumspect consumers'.

The Misleading Advertising Directive 84/450/EEC[58] could be interpreted to have re-opened national leeway in the particular area of misleading advertising and recognised national varieties by explicitly adopting the concept of minimum harmonisation.[59] Again, however, the ECJ stepped in and 'clarified' that going beyond the minimum standard of the Directive was only allowed within the limits defined by primary EU law. In essence, this interpretation did not allow much regulatory

[56] On cultural diversity in advertising see T Wilhelmsson, 'Harmonizing Unfair Commercial Practices Law: The Cultural and Social Dimensions' (2006) *Osgoode Hall Law Journal* 461

[57] Case C-470/93 *Verein gegen Unwesen in Handel und Gewerbe Köln e.V. v Mars GmbH* [1995] ECR I-1923, para 24.

[58] [1984] OJ L 250/17.

[59] According to Article 7, '(t)his Directive shall not preclude Member States from retaining or adopting provisions with a view to ensuring more extensive protection for consumers, persons carrying on a trade, business, craft or profession, and the general public'. On minimum harmonisation as recognition of plurality see T Wilhelmsson, 'Private Law in the EU: Harmonised or Fragmented Europeanisation?' (2002) 10 *European Review of Private Law* 77.

freedom to the Member States, due to the consumer image that was underlying the ECJ's interpretation of the fundamental freedoms.[60]

An interesting retreat of the ECJ occurred in the case of *Keck and Miouthard*[61] when the ECJ excluded 'national provisions restricting or prohibiting certain selling arrangements' from the scope of application of Article 30 EC. Thus, whereas product-related measures remained under the strict justification regime of Article 36 EEC and the ECJ's idea of an 'average consumer', other measures fell back to the regulatory discretion of the Member States.

It was in the context of fostering the internal market through on-line trade that this new balance between EU law and national laws was tipped again towards Europe. With the Electronic Commerce Directive 2000/31/EC,[62] the 'collision norm', according to which Member States could, through private international law, ensure that all traders had to comply with the national regime of unfair commercial practices law, was defeated by the principle of origin. The consequence of the principle of origin was that foreign traders only had to comply with the law of the Member State in which they were domiciled, rather than with the stricter regime of the law of the marketplace. Thus, Member States lost control over the behaviour of those foreign traders, which, at the same time, put pressure on the domestic traders, and, through them, on the national legislators to relax the national regime of unfair commercial practices law.

This development certainly paved the way for a new collision regime at the level of secondary EU law: the Unfair Commercial Practices Directive 2005/29/EC,[63] which, by and large, totally harmonised this area of law, thereby also codifying, in its Article 5, the concept of the 'average consumer' as developed by the ECJ. Importantly, the fully-harmonised regime not only covers product-related commercial practices, but also those that had been spared by the ECJ in *Keck and Miouthard*. The scope of the application of the Directive is now determined by the notion of 'business-to-consumer commercial practices'.[64]

And this was still not the end of the matter. Not only did the ECJ interpret the Directive strictly by confirming its total harmonisation character that disallows Member States to maintain their prohibitions of certain practices beyond the blacklist of Annex A of Directive 2005/29/EC,[65] but it went even further by applying the Directive rigorously to the so-called 'dual-purpose measures'. These are measures which are partly meant to protect consumers but which pursue other regulatory

[60] For a summary, see AG Jacobs, Case C-312/98 *Schutzverband gegen Unwesen in der Wirtschaft e.V. v Warsteiner Brauerei Haus Cramer GmbH & Co. KG* [2000] ECR I-9187, paras 59 ff.

[61] Joined Cases C-267/91 and C-268/91 *Criminal proceedings against Bernard Keck and Daniel Mithouard* [1993] ECR I-6097.

[62] [2000] OJ L 178/1.

[63] [2005] OJ L 149/22.

[64] Defined as any act, omission, course of conduct or representation, commercial communication including advertising and marketing, by a trader, directly connected with the promotion, sale or supply of a product to consumers.

[65] Joined Cases C-261/07 and C-299/07 *VTB-VAB NV v Total Belgium NV and Galatea BVBA v Sanoma Magazines Belgium NV* [2009] ECR I-2949.

goals as well, for example, the protection of the environment. The leading case here is *Mediaprint*.[66] In essence, the new collision norm—full harmonisation of the protection of the economic interests of consumers through unfair commercial practices law—has thus been extended to the protection of other interests through unfair commercial practices law.

The relevance of the principle of origin for this development can be illustrated by comparing unfair commercial practices law with consumer contract law. In the latter area of consumer contract law, the balance of interest was also safeguarded through the principle of minimum harmonisation. The EU legislator was able to adopt certain standards that were meant, at least from the 1990s onwards, to empower the consumer as a market actor, while the Member States were free to maintain or to introduce higher standards to afford greater social protection to consumers.[67] Private international law supported this balance in cross-border situations, as the mandatory rules of the Member State consumer laws prevailed over lower standards of other laws that the parties (or, rather, the traders) would chose if the consumer was approached by the trader in his or her own Member State.[68]

This balance came under pressure with the EU Commission's turn towards total harmonisation of consumer contract law from the year 2000 onward, with Directive 2002/65/EC on the direct marketing of financial services, the Consumer Credit Directive 2008/48/EC, the Timeshare Directive 2008/122/EC and the Consumer Rights Directive 2011/83/EU. With these directives, Member State regulatory power was reduced to certain regulatory choices that EU law explicitly allowed.

However, despite this increased pressure towards maximum harmonisation, the Member States were still able to maintain certain national standards in the form of regulatory choices, in order to block attempts by the Commission to cancel national rules through harmonisation—the most telling examples being the failed total harmonisation of unfair contract terms law and consumer sales law—, to prevent the use of comitology procedures for the further development of the law (which the Commission attempted in the case of the unfair contract terms law)[69] and also to force the EU legislator to regulate consumer contract law at a truly high level of protection in order to attain the necessary majority of votes from the Member States. Finally, in the most sensitive area of services of general interest, such as energy and telecommunications, the principle of minimum harmonisation is still used.

Thus, what is striking here is the pre-structuring of the legal development at two major crossroads: the concept of the 'average consumer' within the interpretation of what is now Article 36 TFEU, and the introduction of the country of origin principle with the E-Commerce Directive 2000/31/EC.

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[66] Case C-540/08 *Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG v "Österreich"-Zeitungsverlag GmbH* [2010] ECR I-10909.

[67] For the relevance of the principle of minimum harmonisation for this development, see H-W Micklitz, 'Zur Notwendigkeit eines neuen Konzepts für die Fortentwicklung des Verbraucherrechts in der EU' (2003) *Verbraucher und Recht* 2, 7.

[68] See now Art 6 of the Rome I Regulation (EC) No 593/2008, [2008] OJ L 177/6.

[69] See the proposal for a Directive on consumer rights, COM(2008) 614 final.

14.4.3 Viking and Laval

Viking and *Laval* have by now been presumably the most discussed cases with regard to the 'neoliberal tilt' of the Court, or, in our terminology, for diagonal conflicts.

The ECJ had to decide upon the reach of the right of establishment (*Viking*: the flagging a Finnish ferry out to Estonia) and upon the freedom to provide services (*Laval*: the Latvian subsidiary of a Swedish parent company). The conflicting interests in these two cases were those of Finnish seamen and Swedish construction workers who wanted to defend their jobs and wages through collective action and faced the danger of being replaced by cheaper Estonian seamen or Latvian construction workers. What deserves closer scrutiny is a critical re-construction of the principles and rules which the ECJ invoked and developed. The *Laval* case is also of particular importance for the interplay between ECJ jurisprudence and secondary law.

In *Viking*, the ECJ started out by emphasising that the 'right to take collective action, including the right to strike (…) [is] a fundamental right which forms an integral part of the general principles of Community law'.[70] Then, however, the Court rigidly re-configured the traditional balance between economic freedoms at EU level and social rights at national level, explaining that the Member States, although 'still free, in principle, to lay down the conditions governing the existence and exercise of the rights in question (…) must nevertheless comply with Community law (…). Consequently, the fact that Article 137 EC does not apply to the right to strike or to the right to impose lock-outs is not such as to exclude collective action such as that at issue in the main proceedings from the application of Article 43 EC'.

In *Laval*, the ECJ followed its judgment in *Viking* with a view to the applicability of the freedom to provide services to collective actions, but the decision is of particular importance for the interpretation and impact upon secondary law, namely, Directive 96/71/EC concerning the posting of workers.[71] In principle, the freedom to provide services implies the right to bring along one's own workers and employ them according to home country conditions. In order to mitigate the related possibility of the dumping of wages and other working conditions, the Directive provides in Article 3, amongst others, that Member States can ensure that workers posted to their territory enjoy a number of the host country's minimum working conditions, including minimum wages. According to Swedish law, the fixing of (minimum) wages is left to collective agreements between employees and employers to be enforced through strikes and collective action, which also applies to foreign employers. The ECJ, however, declared the strikes and collective action of the Swedish labour unions against Laval to be an infringement of the freedom to provide services. It thereby interpreted the Posted Workers Directive, the function of which has been regarded throughout Europe as a limitation of mere wage competition, in

[70] Case C-438/05 *Viking*, para 44.

[71] Dir 96/71/EC concerning the posting of workers in the framework of the provision of services, [1996] OJ L 18/1.

a way so as to declare disproportionate all (union) activities whose aims go beyond the minimum working conditions enumerated in Article 3(1) of the Directive and provided for by legal statute or collective-bargaining agreements declared universally applicable.

Thus, although Article 153(5) TFEU (ex-Article 137(5) EC) explicitly negates any EU competence regarding wages, collective action and the right to strike, the ECJ puts them under the scrutiny of the fundamental freedoms and thereby impacts upon the national balance of employers' and employees' rights. Unions' rights are seen as interference with the fundamental freedoms, have to be 'necessary' and are interpreted in a restrictive way.

What is regarded 'necessary' is then derived from a restrictive interpretation of the minimum requirements of the Posted Workers Directive, even though recital (22) of the Directive states that it does not interfere with 'the law of the Member States concerning collective action to defend the interests of trades and professions' and although the perceived intention of the Directive was to provide for safe and fixed minimum standards, instead of banning all collective action with further aims. As a consequence, unions' rights, which are already weakened due to international allocation competition and the free movement of workers, are further weakened.

Another potential consequence is that of a re-configuration and harmonisation of—varying and constitutionally fixed—national social models since welfare systems that are, like the Swedish one, based upon strong unions' rights seem to be well advised to change to a system of statutorily-fixed minimum requirements and therefore increased regulatory powers of the state.[72]

14.4.4 Promotion of Renewable Energies

The promotion of renewable energies is to serve to illustrate how political projects (increasingly) collide with the European institutionalised logic of the market.

Energy policy is and has always been at the centre of national economics and politics, and socio-economic conditions are as divergent between the EU Member States as political attitudes are, the most fundamental one relating to the use of nuclear power, for which the respective Member State competence is laid down in Article 194(2) 2 TFEU. In addition, the promotion of energies from renewable sources is an undisputed part of the European climate and energy policy framework as laid down in Article 194(1) TFEU and concretised in Directive 2009/28/EC on the promotion of the use of energy from renewable sources.[73] At the same time,

[72] For a comprehensive analysis, see C Joerges and F Rödl, 'On the 'Social Deficit' of the European Integration Project and its Perpetuation through the ECJ Judgements in *Viking* and *Laval*', RECON Working Paper 2008/06. See also N Reich, 'Free Movement v. Social Rights in an Enlarged Union—the *Viking* and *Laval* Cases before the ECJ' (2009) 10 *German Law Journal* 125 for a differing analysis of the *Laval* Case.

[73] [2009] OJ L 140/16.

however, a competitive integrated European electricity market is being developed, based upon subsidies law[74] and the free movement of goods.

In the absence of a (coherent) EU-wide promotion scheme, the promotion of renewable energies is carried out mainly at national level, which basically leads to the (financial) support—either per feed-in-tariffs or per quotas—of the respective national producers. Feed-in-tariffs, in particular, enable the Member States to adjust their promotion schemes to further political aims such as structural development or a diverse and de-centralised energy supply. The German feed-in-tariffs, for example, differ considerably for different sources of renewable energy, and are higher for small-scale than for large-scale producers.[75]

Initially, in its famous *PreussenElektra* judgment,[76] the ECJ justified the purely national scope of support schemes for environmental reasons, and thus left the Member States with wide discretion in the design of their promotion schemes. This approach is also reflected in Directive 2009/28/EC which provides, amongst others,[77] for the acceptance of different national promotion approaches (mainly per feed-in-tariffs or quotas),[78] the freedom of Member States to decide upon the inclusion of foreign renewable energies into their national promotion schemes,[79] and respective voluntary co-operative instruments,[80] as well as for considerations concerning national preferences for structural development or de-centralized energy supply. The Directive could, therefore, be regarded as a political consent not to agree upon harmonisation but to respect variety. Meanwhile, the support schemes have operated very well and the production of renewable energy has increased considerably, not insignificantly based upon small- and medium-scale producers. Thus, the increasing competitive impact of renewable energies and the inhibiting effects of (different) national promotion schemes on the development of an integrated energy market have become a major concern both for the Commission and in ECJ/CJEU proceedings.

[74] Subsidies law is not discussed here. See J Lutz, M Schütt and V Behlau, 'Klimaschutz durch nationale Energiebeihilfen, Möglichkeiten und Grenzen nationaler Maßnahmen zur Förderung Erneuerbarer Energien und Energieeffizienz unter dem europäischen Beihilferegime' (2011) *Zeitschrift für Umweltrecht* 178; C Glinski, 'Legal Constraints and External Effects of the German „Energiewende": A search for Adequate Collision Approaches' in C Joerges and C Glinski (eds), *Authoritarian Managerialism versus Democratic Governance* (Oxford, Hart, 2014 forthcoming).

[75] See §§ 23 ff EEG.

[76] Case C-379/98 *PreussenElektra AG* v *Schleswag AG* [2001] ECR I-2099.

[77] Central is of course the determination of binding national minimum quotas of renewable energies in the energy mix, see Art 3 with Annex I A.

[78] Art 2 lit. k).

[79] Art 3(3)2; see, also, very clearly recital (25). Even stronger Art 15 (2) sub-para 4: foreign certificates cannot be included into the (mandatory) national quota.

[80] Arts 6 to 11.

In the currently pending case of *Essent Belgium*,[81] the Flemish promotion scheme is under scrutiny.[82] In his opinion of 8 May 2013, AG Bot considered the fact that the Directive did *not* harmonise promotion systems, but left the respective design and opening to foreign producers explicitly at the discretion of the Member States, to be non-harmonisation which would trigger the (full) applicability of the fundamental freedoms.[83] Then, he proceeded to reject all the reasons why a preference of national renewable energy producers over their foreign competitors could be justified for environmental reasons. To the contrary, such a preference would hinder an environmentally-reasonable allocation of resources.[84] He argued that the combat against climate change was not of national but of common European concern. What is particularly problematical in this regard is that AG Bots turned a blind eye to the distribution of the financial burdens in an open system. He challenged the argument that the opening of the market may well have negative economic effects which could lead to a breakdown or to a minimalised performance of the national promotion schemes as being not proven, and ignored the problem it might put the political acceptance of the promotion of green energy at risk if consumers have to finance foreign renewable-energy producers.

Furthermore, AG Bot rejected all other political aims beyond an EU-wide optimised allocation of resources to be valid concerns in energy law, for example: a balanced distribution of installations between nations, a close-by electricity supply or structural development to the advantage of local or regional small- and medium-sized producers which clearly benefit from a reliable national market.[85]

Such an interpretation would, in effect, reduce national political leeway, for example, with a view to the German '*Energiewende*', to the promotion of economic efficiency *qua* EU-wide tendering of national quotas.[86] Thus, in essence, the conflict constellation is similar to that of *Laval*, as the justification of an obstacle to the fundamental freedoms is at stake, but the liberalisation thrust goes even further as secondary law—Directive 2009/28/EC here—does not even contain a (potentially enumerative) positive list of acceptable national measures, but points, instead, towards the political discretion of the Member States.

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[81] AG Bot, Opinion of 8/5/2013, joined Cases C-204/12 to 208/12 *Essent Belgium NV* v *Vlaamse Reguleringsinstantie voor de Elektriciteits- en Gasmarkt*, not yet reported.

[82] In essence, under that scheme energy suppliers have to buy a certain number of green energy, documented with green certificates. This quota can only be fulfilled with green certificates from Flemish renewable-energy producers, whilst electricity from foreign energy-producers, even if certified, does not count.

[83] Ibid, para 70: 'First of all I want to point out that due to the lack of a harmonised support regime for renewable energies by Directive 2001/77/EC, the Member States are obliged to respect the fundamental freedoms of the Treaty, which includes the free movement of goods' (translation by the authors).

[84] Ibid, paras 102 ff.

[85] Ibid, para 105 f.

[86] For comprehensive analysis, see Glinski, 'Legal Constraints and External Effects'.

14.4.5 Genetically-Modified Organisms

The authorisation scheme for genetically-modified organisms (GMOs) provides for Europeanised procedures of administrative co-operation and decision-making which are meant to mediate between an integrated market and nationally-differing perceptions of the protection of health, safety, the environment and other values, in our terminology, the second dimension of conflicts-law. It provides for a telling exemplification of the ever-increasing centralisation of competences to the disadvantage of national-decision margins accompanied by privatisation and the scientification of the centralised procedure to the disadvantage of political processes. In a policy area that is as political and as controversial as that of GMOs for the Member States, it simultaneously highlights the inadequacy and the political rejection of this centralisation.

The harmonisation of product standards has always been at the centre of classical EU 'regulation' as a means of ensuring the functioning of the integrated market. Although the determination of food-safety standards or the (risk) management of dangerous substances has clearly never been purely apolitical harmonisation, recent developments have posed new problems with regard to their ever-increasing centralisation[87] and their politicisation.

Comparable to the chemicals regime, Regulation (EC) No 1829/2003[88] has introduced a centralised authorisation scheme for genetically-modified food and feed, with the European Food Safety Authority (EFSA) being responsible for risk assessment and authorisation decisions to be taken by the Commission based upon comitology procedures according to Article 291 TFEU. Directive 2001/18/EC on the deliberate release into the environment of GMOs,[89] in contrast, had left the decision on the release of GMOs into the environment—in a co-ordinated European procedure—to the Member States. Correspondingly, the Regulation primarily authorises the Commission to decide upon (provisional) safeguard measures, whereas, according to the Directive, this responsibility remains with the Member States.

The introduction of the so-called 'one door, one key' principle, which aims at facilitating the application procedure and enables the applicant to obtain the authorisation for all the (intended) uses of a GMO with one single application, has led to the inclusion of the release decision (originally left to the Member States) into the EFSA/Commission authorisation procedure on the use as food or feed. In

[87] The REACH system, Reg (EC) No 1907/2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) [2006] OJ L 396/1, that has introduced a centralised European system of risk management for chemicals and replaced the former national procedures, is regarded to be the most elaborated system of EU administration and an important cornerstone in this development. Although criticised for the privatisation of risk assessment, it seems to 'operate' without major political conflicts.

[88] Reg (EC) No 1829/2003 concerning the traceability and labelling of genetically modified organisms and the traceability of food and feed products produced from genetically-modified organisms [2003] OJ L 268/24.

[89] [2001] OJ L 106/1.

Monsanto, the ECJ also applied this principle and the related centralisation of competences to safeguard measures due to new information.[90]

Thus, the centralisation of product authorisation has been expanded to the centralisation of cultivation permissions as well as to the respective safeguard measures—without a comparably direct relationship to the tradability of GMO products in the internal market, which alone might justify this strong centralisation, albeit with serious impact upon both agriculture and the environment in the different Member States. The main argument is the facilitation of procedures in favour of the applicants.[91]

This has also led to the extension of some problematical aspects of the EFSA risk assessment, such as privatisation and (monopolised) scientification to the disadvantage of dissenting opinions,[92] to the cultivation decision. Furthermore, the EFSA is an agency which specialises in food safety and is, therefore, far less equipped than Member State institutions to assess the varying ecological and agrarian risks of GMO cultivation.[93] Together with the decision modes in the comitology procedure—where a majority against authorisation is necessary,[94] and where, even in the case of such a majority against the proposal, the Commission has the possibility to appeal and to take a decision by default in the event that the Appeals Committee fails to give an opinion[95]—approval decisions are *de facto* taken hierarchically by the Commission, based upon the EFSA risk assessment, instead of (deliberative) political processes and even against the majority of Member States.[96] It goes without saying that the centralised procedure therefore does not provide for the inclusion of

[90] And even to GMOs (maize MON 810) authorised under the previous scheme, see Joined Cases C-58/10 to C-68/10 *Monsanto SAS et al* v *Ministre de l'Agriculture et de la Pêche* [2011] ECR I-7763; on which, see C Glinski, 'Sieg und Niederlage für die grüne Gentechnik' (2011) *Zeitschrift für Umweltrecht* 526.

[91] See Glinski, 'Sieg und Niederlage für die grüne Gentechnik'.

[92] The revised burden of proof—in theory based upon the precautionary principle—leads to the major influence of the private risk assessment by the applicant, which is regularly not questioned by the EFSA, and thus Member State concerns are not taken seriously.

[93] See e.g. G Winter, 'Das Inverkehrbringen von unerkannten gentechnisch veränderten Organismen—Ein Problem? Ein gelöstes Problem?' (2005) *Neue Zeitschrift für Verwaltungsrecht* 1133, 1136.

[94] See Art 5 of Reg (EU) No 182/2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, [2011] OJ 55/13. Under the previous regime of Decision 1999/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission, [1999] OJ L 184/23, even a qualified majority was necessary to oppose the Commission's proposal for a decision.

[95] See Art 6(2) of Reg (EU) No 182/2011.

[96] For a comprehensive analysis see, in particular, M Weimer, *Democratic Legitimacy through European Conflicts Law? The case of EU administrative Governance of GMOs* (Florence, EUI PhD Thesis, 2012). See also id, 'Between scientification and politicization—the failure of risk governance in EU regulation of GMOs, and its implications for Conflicts-Law-Constitutionalism' in Joerges and Glinski (eds), *Authoritarian Managerialism versus Democratic Governance*, with further references.

(non-scientific) *political* considerations, such as the protection of small-scale agrarian structures, consumer preferences, or moral or religious views.

As the authorisation of GMOs—and, in particular, their cultivation—is a highly contested and politicised question throughout Europe, with some Member States being totally opposed, this centralised approval scheme does not work in practice, and has always led to deadlocks, national bans and European *moratoria*—again, declared as infringements of European law by the ECJ/CJEU.[97]

Thus, the Commission has suggested the re-decentralisation of competences concerning cultivation decisions in order to ease the deadlock: a Member State may limit or prohibit the cultivation of EU-wide authorised GMOs for other reasons than adverse effects on health and the environment, which are regarded as having already been assessed by the EFSA, for example, in order to protect small-scale agricultural structures. A respective 'opt-out' clause is to be included into Directive 2001/18/EC.[98]

However, the proposal has not yet been adopted. One concern raised is that the possibility for national opt-outs, which, however, could not be based upon environmental concerns, would reduce the pressure and critical attention on the EFSA risk assessment and ease the European approval of GMOs, which would thus be tradeable throughout Europe and—despite national cultivation opt-outs—still expand creepily.[99]

14.5 Conclusion

'Unity in diversity' instead of 'integration over all conceivable values including democracy', the starting-point of our reflections, transposes the ambitions and perspectives of the conflicts-law approach. It is based upon the assumption that conflicts due to cultural, political and socio-economic diversity will remain a prominent feature of the European project, and that European law derives its legitimacy from structuring a civilised and thoughtful conflict resolution or mediation which is based upon the rule of law and in line with democratic commandments—but without assuming the mandate to streamline Europe's diversity. This holds true for

[97] See the already mentioned ECJ, Joined Cases C-58/10 to C-68/10 *Monsanto SAS et al v Ministre de l'Agriculture et de la Pêche* [2011] ECR I-7763, where the ECJ denied the Member State competence for safeguard measures. See, also, ECJ judgment of 26 September 2013, Case T-164/10 *Pioneer Hi-Bred International, Inc. v Commission*, not yet reported, where the ECJ has interpreted this political deadlock as a failure of the Commission to act.

[98] See proposal for a Regulation amending Directive 2001/18/EC as regards to the possibility of the Member States to restrict or prohibit the cultivation of GMOs in their territory, COM(2012) 375 final. The proposed inclusion of a new Art 26b into the Directive is to contain the 'opt-out' clause.

[99] See Glinski, 'Sieg und Niederlage für die grüne Gentechnik': For a detailed analysis of the to date failure of the adoption process, see Weimer, 'Between scientification and politicization', each with further references.

the classical (diagonal) conflicts of the first dimension as well as for the structuring of co-operative decision-making procedures in Europe's 'regulatory politics', our second dimension, where our hopes focus on the quality of deliberation.

At the same time, the above constitutes the framework for a critical re-construction of European law which it deems legitimate only to the degree that it may be re-constructed in line with these perceptions.

In particular, the conflicts-law approach does not back a shift in the relation between law and politics, which either pre-determines the direction of the political process, or renders the politically-driven governance of a certain policy area impossible. What it suggests, is that European law should *not* be used as a substitute and compensation of Europe's political deficit.[100] The same applies with a view to Europe's 'social deficit'.

Two elements of the conflicts-law approach should be stressed again: to wit, 'characterisation' and the particularities of 'diagonal conflicts'. 'Characterisation' is precisely the message of private international law, the disciplinary tradition which the conflicts-law approach seeks to recall, and which Ernst Rabel explained in his seminal essay on this very topic.[101] And it was he who added that the operation called 'characterisation' has to take the views of the forum and the concerned jurisdictions seriously.

The European law parallel is the principle of enumerated competences. 'Diagonal conflicts' describe conflicts between the supranational and the national level, in which different fields of law at either level are affected. This conflict constellation is of particular concern where the supranational level—regularly a fundamental freedom—interferes with the protection or pursuit of non-market policy goals in a field of law at national level, for the (re-) regulation of which the EU has no competence, is not equipped, or where no consent can be reached.

The examples described above confirm the assertion that European law 'is' conflicts law. But is it 'good conflicts law'? The analysis has illustrated a range of mechanisms which lead to an increasing shift in the law-politics-relation towards the legal (pre-) determination of the political process which favours the interests of the market over (national) social, political or cultural concerns.

The development of consumer law has highlighted two particular aspects of this shift: Firstly, the ECJ's comprehensive interpretation of the proportionality principle—which was not limited to the necessity of national regulation but entrenched in an examination of the adequacy of protection aims against the benchmark of the newly-developed concept of the 'reasonably circumspect consumer'—and the introduction of the principle of origin which limited and undermined further protection goals not only in national frameworks but also in the subsequent European political process. Secondly, the ECJ further re-defined the national decision-margins

[100] See, for a systematic elaboration, M Everson and C Joerges, 'Reconfiguring the Politics–Law Relationship in the Integration Project through Conflicts–Law Constitutionalism' (2012) 18 *European Law Journal* 644.

[101] E Rabel, 'Das Problem der Qualifikation' (1931) 5 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 241.

which secondary law had left open or had re-opened. This has resulted not only in the pre-determination of liberalising politics, but also in an increased pressure towards maximum harmonisation.

A comparable shift in the law-politics-relation is looming in the areas of labour law and energy law. The *Laval* and *Viking* judgments also mirror these features of ECJ case law: Again, the ECJ has entrenched its examination to the adequacy of a national measure, in both, *Laval* and *Viking*, of collective action—against a newly-introduced benchmark; in *Laval*, it has turned secondary law provisions enabling national minimum standards into the maximum attainable.

In this context, 'characterisation' and 'diagonal conflicts' gain particular weight. In both cases, the discrepancy between economic freedoms and collective labour law is at stake. Antoine Lyon-Caen argues that there is a categorical difference between economic law and labour law as the latter has been constituted as an alternative to the law of the market.[102] This categorical difference is not written in stone, but is deeply rooted, albeit in a variety of forms, in the history of industrial and democratised societies.[103]

The EU cannot, however, provide for a substitute for the distributional and balancing achievements of the national welfare state. If EU law 'trumps' national labour constitutions, this not only has an impact upon national constitutions but also leads to the respective 'vacuum' or 'social deficit' at EU level, and shifts the balance between employers' and employees' rights. Although it seems perfectly justified to further the efforts of the new Member States to use their competitive advantages, it seems by no means plausible that a shift in the balance of power between employers and employees strengthens their chances of economic development and of building up own social models. This is even less plausible when one considers that the *Viking* judgment has undermined the policies of the International Transport Workers' Federation, which were supported by both the Finnish and the Estonian seamen's unions, and that the *Laval* case was initiated and financed in Sweden.

The CJEU proceedings in the pending energy law case of *Essent Belgium* are striking in that they can be regarded an example of a judicial challenge of an explicit political consent by the Member States not to agree upon harmonisation but to respect varieties of national (promotion) systems for renewable energy, and therefore to respect the pursuit of varying additional policy goals. If this attack were successful, the national political leeway (with regard to the promotion of renewable energies) will be considerably reduced in the direction of promoting economic efficiency—although energy policy is at the heart of national politics and reveals fundamentally differing attitudes among the EU Member States.

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[102] See A Lyon-Caen, 'Droit communautaire du marché vs. Europe sociale', contribution to the symposium *The Impact of the Case Law of the ECJ upon the Labour Law of the Member States*, Berlin, 26/6/2008, organised by the Federal Ministry of Labour and Social Affairs, www.bmas.de/portal/27028/2008__07__16__symposium__eugh__lyon-caen.html.

[103] R Dukes, 'Hugo Sinzheimer and the Constitutional Function of Labour Law' in G Davidov and B Langilde (eds), *The Idea of Labour Law* (Oxford, Oxford University Press, 2011) 57.

Last, but not least, the GMO example highlights in an impressive manner the limits of harmonisation and centralisation in order to ease the functioning of the integrated market. At first sight, the European framework for the approval of GMOs comes close to a codification of our deliberative 'ideals' as it provides for a separation between risk assessment and risk management, the former based upon the principle of precaution, the latter upon the inclusion of different policy goals, while both procedures institutionalise horizontal co-operation. The failure of the approval scheme in practice, however, strongly indicates that it has not succeeded in generating legitimacy.[104] This can only partly be explained by the remaining institutional design defects such as the reversed-majority requirement. It is far more convincing to conclude that (an ever increasing) harmonisation in highly controversial and/or sensitive policy fields which fails to take account of deeply-rooted political, cultural or socio-economic preferences is simply not able to create legitimacy. In such cases, conflicts-law would suggest that the legislator abstain from harmonisation (at all costs). This is even more the case where the only benefit of harmonised regulation would be the facilitation of trade and approval procedures in favour of the applicants. The suggested re-decentralisation of competences with a view to the political aspects of cultivation decisions provides a first step forward.

These examples in no way undermine the basic assumptions of our approach, but, to the contrary, demonstrate that conflict constellations where the delineated political and social limits to integration and harmonisation are ignored raise legitimacy concerns. Thus, the conflicts approach proposes to develop new sensitivity for Europe's complex conflict constellations and for the value of the concerns involved. 'Judicial restraint' versus 'judicial activism' does not exhaust the potential of the traditions on which the conflicts-law approach builds, but serves to constitute another important cornerstone.

The Treaty of Lisbon can be read to have strengthened the constitutional balance between centralisation and diversity, and between market integration and social protection. It has established a framework and principles, which may also serve the purpose of supranational 'recognition' in line with a conflicts-law reading. In particular, the principle of enumerated competences, the subsidiary principle and the specific competence norms such as Articles 153(5) and 194(2) 2 TFEU all call for respect for national preferences. With the codification of values and aims in Articles 2 and 3 TEU and principles in Articles 7 to 17 TFEU, the Treaty of Lisbon has also constitutionalised the balance between market and non-market aims. Together with the non-discrimination principle, the proportionality principle and the respect for fundamental rights, these rules can be understood as a concretisation of a supranational conflicts law.

[104] See, again, Weimer, 'Between scientification and politicization'.

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Chapter 15
The Virtue of Cassis de Dijon 25 Years Later—It Is Not Dead, It Just Smells Funny

Kai Purnhagen

Abstract This piece specifies how and where the Cassis de Dijon case influenced EU internal market regulation. For a start, I will place the case into the more general context of internal market integration. I will then highlight the different concepts that have been developed from the Cassis de Dijon case such as e.g. the theory of the information paradigm, the confident consumer, the principle of mutual recognition, and the "new approach". I will show how each of these concepts has developed in the course of internal market law. Finally, I will conclude that albeit that these principles have come under attack from various sources, the lessons drawn from Cassis de Dijon still remain the yardstick for the evaluation of internal market law today. I have to apologize for the lack of modesty by relying occasionally on works that I have published earlier. I take this contribution also as an opportunity to react to criticism on previous publications of mine by putting them into the more general context of internal market regulation.

Most people know Hans Micklitz nowadays as a well-established, concentrated, eager scholar, carefully balancing pros and cons before formulating a strong argument. Sometimes, when he feels relaxed and is not distressed from his numerous duties he is involved with as Head of the Department of Law at the European University Institute, one may observe the rare opportunity to hear some story from an earlier time when he was struggling as a youngster in academia, a peculiar thing especially

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Assistant Professor in Law and Governance at Wageningen University and Distinguished International Visitor at Erasmus University of Rotterdam Law School. I am indebted to Susanna Vince for proof reading. Small parts of this piece have been published earlier in J-U Franck and K Purnhagen, 'Homo Economics, Behavioural Sciences and Economic Law: On the Concept of Man in Internal Market Regulation and its Normative Basis' in K Mathis (ed), *Law and Economics in Europe: Foundations and Applications* (Dordrecht, Springer, 2014) 329 and A Afilalo, D Patterson and K Purnhagen, 'Statecraft, the Market State and the Development of European Legal Culture' in G Helleringer and K Purnhagen (eds), *Towards a European Legal Culture* (Munich/Oxford/Baden, Baden, CH, Beck/Hart/Nomos, 2014) 227.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_15,

in the "empire of light"[1] of the for good reasons proud German *Rechtswissenschaft*: in one of these stories, Hans Micklitz had to present in front of the faculty a then newly published ECJ[2] case concerning a German prohibition of the distribution of a French brand of liquor 'Cassis de Dijon' since the marketing of fruit liqueurs was subject to the condition of a minimum alcohol content of 25 %.[3] After a careful analysis of the case and upon presentation, he did something that can be murderous for a youngster in most cultures of European academia: in a straightforward fashion, he told the faculty that this judgment had the potential to change the whole EU internal market law system. The reactions received are predictable to those who have some insights into German academia: He met utmost resistance. Obviously, it was not for a youngster to make such a claim. Such a statement, no matter whether right or wrong, is reserved for more senior staff. But also on the substance: how could an innocent case from the area of food law concerning a ban of liquor affect the EU legal system to such an extent?

Looking back 25 years later, this story seems a farce. The Cassis de Dijon case and its subsequent (political) interpretation by the European Commission[4] have indeed triggered a whole new understanding of internal market harmonization way beyond foods. For the first time it allowed to develop autonomous concepts of EU law such as the principle of (conditional[5]) mutual recognition, which has since materialized into an independent "market access" criterion, the concept of the confident consumer, or the information paradigm,[6] which influenced a large bunch of primary and secondary law, way beyond the area of food law and even law outside of the EU. This piece hence aims at emphasizing that Hans Micklitz was right to specify how and where the Cassis de Dijon case influenced EU internal market regulation. For a start, I will place the case into the more general context of internal market integration (15.1). I will afterwards highlight the different concepts that have been developed from the Cassis de Dijon case such as e.g. the theory of the information paradigm, the confident consumer, the principle of mutual recognition, and the "new approach". I will show how each of these concepts has developed in the course of internal market law (15.2). Finally, I will conclude that albeit that these principles have come under attack from various sources, the lessons drawn

[1] See S Vogenauer, 'An Empire of Light? II: Learning and Lawmaking in Germany Today' (2006) 26 *Oxford Journal of Legal Studies* 627.

[2] Now officially named 'Court of Justice of the European Union', see Arts 251 ff TFEU. Hereinafter I will refer to it as 'the Court' or the 'ECJ'.

[3] Case 120/78 *REWE v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

[4] K Alter and S Meunier-Aitsahalia, 'Judicial Politics in the European Community: European Integration and the pathbreaking Cassis de Dijon decision' (1994) 26 *Comparative Political Studies* 535.

[5] S Weatherill, 'Why there is no 'principle of mutual recognition' in EU law (and why that matters to consumer lawyers)', in this volume, emphasises the risks that may follow if one does not emphasize the conditionality of the principle of mutual recognition.

[6] See K Purnhagen, *The Politics of Systematization in EU Product Safety Regulation* (Dordrecht, Springer, 2013) 10.

from Cassis de Dijon still remain the yardstick for the evaluation of internal market law today (15.3). I have to apologize for the lack of modesty by relying occasionally on works that I have published earlier.

15.1 The Cassis de Dijon Case and its Impact on the Internal Market Concept

The establishment of an internal market is traditionally based on the concept of classical free trade theory.[7] First formulated by Adam Smith as a theory of absolute advantage, it was David Ricardo who subsequently advanced the idea to a theory of comparative advantage[8]: even if one assumes that a country was more efficient in the production of all goods than another country, both countries would gain by trading with each other, as long as they were characterized by different relative efficiencies. That is because the former country may gain when it specializes in the production of the good where it has a comparative advantage, supposing it may trade that good for other goods whose production it gives up. By removing obstacles for cross-border trade a greater number of transactions will be possible, cooperation and specialization based on a division of labour will be facilitated, and competitive pressure will increase. Ideally, this will result in an efficient allocation of production, labour and capital, cheaper and better products for all market players in the internal market, and ultimately in an enhancement of social welfare.[9] Consequently, the European legislature is called on to ensure that regulatory initiatives that are based on the competence of the Union to establish an internal market, and particularly on its competence pursuant to Article 114 TFEU, are ultimately apt to indeed reach the efficiency gains that are promised by the project of establishing an internal market.[10]

In light of this neo-classical concept, the harmonizing measures before *Cassis de Dijon* were mainly concerned with erasing market barriers along the lines of national frontiers. In primary law, the *Dassonville* judgment made certain that, wherever common rules imposed by secondary law have not yet levelled Member State laws according to a European standard, any measure that actually or potentially, directly

[7] See on the historical roots of classical free trade theory DA Irwin, *Against the Tide: An Intellectual History of Free Trade* (Princeton, Princeton University Press, 1996).

[8] D Ricardo, *On the Principles of Political Economy and Taxation* (London, John Murray, 1817) Chapter 7.

[9] See W Molle, *The Economics of European Integration*, 5th ed (Columbus, McGraw-Hill, 2006) 35 f and 67.

[10] This is reflected, eg, in recital (4) Dir 2007/64/EC on payment services in the internal market, [2007] OJ L319/1: 'It is vital, therefore, to establish at Community level a modern and coherent legal framework for payment services […] which is neutral so as to ensure a level playing field for all payment systems, in order to maintain consumer choice, which should mean a considerable step forward in terms of consumer cost, safety and efficiency, as compared with the present national systems.'

or indirectly hindered trade would be subject to judicial scrutiny.[11] This brought to the Court a wide array of domestic laws, ranging from health measures to pornography, store closing laws, worker safety, consumer protection, product safety, and virtually every regulation of the marketplace with the potential to slow trade. If France did not permit the marketing of apples exceeding its allowed pesticide level, any apple coming from a European Member State adhering to a laxer regulatory standard would be excluded from the French market. If Britain followed stringent obscenity rules, materials produced under more permissive Danish standards would not be allowed access to the British market. If Germany relied on worker training to ensure operator safety with respect to particular machinery, and France chose an automation philosophy, then German machines would not satisfy standards necessary to be operated in France.

Secondary law made clear that this rationale was enforced. It erased market barriers by levelling the disparate laws in the Member States through the prescription of common European standards. Measures based on Art. 100 TEEC (now Art. 114 TFEU) made certain that Member State's barriers to trade were erased up to a point where the legal objectives enumerated in Art. 36 TEEC required individual protection (re-regulation). In those days, it was without question that this required first re-regulation at a Union level (and not Member State level) and second classical top-down regulation (and not innovative regulation, which also takes account of insights from e.g. private law). In product safety law, the first acts and their successors hence stipulated classical command-and-control mechanisms, which regulated the product's lifecycle to different extents.[12] The removal of trade barriers was intended to be achieved by the setting of detailed, obligatory substantial and procedural standards, which prescribe actions required from special target groups instead of setting performance standards, which had been the dominant governance mode in the EU for almost 30 years.[13] We still see the heritage of this classical integration method today when we look into the wording of Art. 114 (1) TFEU, which only allows "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States", albeit that phrase is nowadays used way beyond this wording to solve "specific problems of cross-border transactions."[14]

This classical model soon came under attack. The *Dassonville*-formula brought in front of the Court a wide array of measures, too many for such a small Court to handle.

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[11] Case 8/74 *Procureur du Roi v Dassonville* [1974] ECR 837.

[12] See for a comprehensive study on the the regulative practice at that time C Joerges, J Falke, H-W Micklitz and G Brüggemeier, *Die Sicherheit von Konsumgütern und die Entwicklung der Europäischen Gemeinschaft* (Baden-Baden, Nomos, 1988) 252 ff.

[13] See R Tricker, *CE Conformity Marking and New Approach Directives* (Oxford MA, Butterworth-Heinemann, 2000); C Hey, K Jacob and A Volkery, 'Better regulation by new governance hybrids? Governance models and the reform of European chemicals policy' (2007) 15 *Journal of Cleaner Production* 1861.

[14] T Ackermann, 'Buying Legitimacy? The Commission's Proposal on Consumer Rights' (2010) 21 *European Business Law Review* 589.

> "(T)aken to extremes, a broad reasoning of Dassonville might mean that Article 34 could be used to challenge rules limiting Sunday trading or development in the green belt or age restrictions on who can buy alcohol."[15]

As nearly any national measure which qualifies as a "trading rule"[16] could be scrutinized by the ECJ, this legislation maximizes "the right for individuals to participate on the market on whatever terms they choose,"[17] and enforces an understanding of the EU legal order as an economic constitution. On the one hand, such a wide interpretation of "measures having an equivalent effect" in *Dassonville* was needed at a time where the internal market project "was in its infancy and national protectionist traditions were well-entrenched, while national judges were still often unfamiliar with EU law."[18] It hence formed an "effective tool to cull the dead wood of centuries of accumulated legislation."[19] On the other hand, these rules under scrutiny of the Dassonville formula often served a social purpose[20] and, upon closer inspection, while they might meet the "trading rule"-test their effect on trade was only little and quite remote.[21] With this interpretation, the Court had hence interfered deeply into the sovereignty of Member States, maybe a little too much for what the Member States could handle. If the Court would have continued with only the *Dassonville*-approach, the Member States' support for the European integration project and therefore its legitimacy would have been seriously at risk.

The classical harmonization method via standard-setting in secondary law came likewise under attack. Although in line with the classical European command-and-control method that was originally envisaged by Art. 100 TEEC (now Art. 114 TFEU), this purely centralized regulator model was subject to heavy criticism on several accounts. For some, this traditional harmonization approach was ill-suited to achieving the objective of market integration, as these Directives regularly covered only one of a wide range of aspects in the respective product sectors.[22] For others, the "Europeanisation"-approach resulted in the use of this command-and-control-regulation to an extent which had never been exercised before even in national law.[23] In their view, "it produced 'Europroducts', which alienated the consumer."[24]

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[15] C Barnard, *The Substantive Law of the EU*, 4th ed (Oxford, Oxford University Press, 2013) 75.

[16] See Case 3/76 *Kramer* [1976] ECR 1279. The second qualification that the rule had to be 'enacted by the Member States' did not have much disclosure power in practice, see Barnard, *The Substantive Law of the EU*, 76 f.

[17] Barnard, *The Substantive Law of the EU*, 74.

[18] D Chalmers, G Davis and G Monti, *European Union Law*, 2nd ed (Cambride, CUP, 2010) 748 f.

[19] Barnard, *The Substantive Law of the EU*, 75.

[20] See more elaborately K Tuori, 'European social constitution: between solidarity and access justice', in this volume.

[21] Barnard, *The Substantive Law of the EU*, 75.

[22] For a comprehensive overview to this criticism see Joerges et al. *Die Sicherheit von Konsumgütern*, 273 ff., who also provide a massive account of data in order to substantiate the criticism.

[23] Lord Cockfield hit the nail on the head at a speech delivered in London on 22 February 1988 to the Federation of British Electrotechnical and Allied Manufacturers, where he described the concept of this European command-and-control regulation as 'If it moves, harmonise it!', cited after A McGee and S Weatherill, 'The Evolution of the Single Market: Harmonisation or Liberalisation' (1990) 53 *The Modern Law Review* 583.

[24] McGee and Weatherill, 'The Evolution of the Single Market', 582.

Either way, there was widespread agreement that the classical standard setting approach envisaged by Art. 100 EEC (now Art. 114 FEU) was not suitable for the achievement of the goals set by the respective Directives.[25]

It is against these perils of the understanding of internal market harmonization at that time that one has to evaluate the *Cassis de Dijon* case. Under unspoken but quite obvious recourse to the Dormant Commerce Clause from US law,[26] the ECJ developed in *Cassis de Dijon* a solution for the perils from Dassonville. The facts of the *Cassis de Dijon* case are well known, such is the judgment of the ECJ. It shall hence suffice to highlight the main facts and reasoning of the case:

Germany had prohibited the distribution of a French brand of liquor since the marketing of fruit liqueurs was subject to the condition of a minimum alcohol content of 25 %. The ECJ, interpreting the notion of measures having equivalent effect to quantitative import restrictions as it is now laid down in Article 34 TFEU, deviated from the classical harmonization model with several arguments.

It first determined that, if they are "necessary in order to satisfy mandatory requirements"[27], "obstacles to the movement within the community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted."[28] The Court then enlisted some of these "mandatory requirements": "the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer."[29] This finding of the Court was in direct confrontation with the classical idea of the realization of comparative advantages. By accepting especially the "defense of the consumer" and the "protection of public health" as a restriction to trade, the Court acknowledged that the idea of an internal market cannot convincingly put forward vis-à-vis its addressees if the free movement of goods results in an inefficiently high level of both, physical and monetary damage. In other words, if the wealth maximizing virtues of internal market integration are accompanied by negative external effects which may harm third parties, we may seriously put the whole concept of internal market integration at risk. Since *Cassis de Dijon*, classical free trade theory is hence accompanied by the need to counterbalance commercial freedom with its negative externalities even beyond those which are dealt with in antitrust law. This statement in isolation would have had the potential to revolutionize internal market

[25] Commission White Paper 'Completing the Internal Market', COM(85) 310 final; Commission Communication on the Development of European Standardization ("Green Paper") of 16 October 1990, [1991] OJ C20/1 and Commission Communication on Standardization in the European Economy, [1992] OJ C96/2. In a larger context from today's view: D Trubek and L Trubek, 'New Governance & Legal Regulation: Complementarity, Rivalry, and Transformation' (2007) 13 *Columbia Journal of European Law* 539; D Hanson, *CE Marking, Product Standards and World Trade* (Cheltenham, Edward Elgar, 2005) 37.

[26] See eg the Opinion of Justice Cardozo, Supreme Court of the USA, *Baldwin, Commissioner of Agriculture and Markets, et al v. G.A.F. SEELIG, Inc*., March 4, 1935.

[27] Case 120/78 *Cassis de Dijon*, para 8.

[28] ibid.

[29] ibid.

law, as it allowed re-regulation at Member State and also Union level to a great extent.

If the ECJ had remained silent after this passage, the possibilities to justify national restrictions to trade would have been endless. It would have turned around the whole concept of classical free trade theory by allowing Member States to implement legislative measures that were formally turned down as obstacles to trade under the *Dassonville* formula. Furthermore, this passage has the potential to be interpreted as requiring the European standardization of products in order to meet the requirements of primary law for the sake of consumer and health care protection.[30] It thereby expanded the standardization-approach from secondary law to primary law, albeit that it had already proven to be ill-suited for the establishment of the internal market in secondary law. In short: such a reading of *Cassis de Dijon* would have rendered the whole concept of internal market integration meaningless. In *Cassis de Dijon*, the ECJ hence had convincingly brought to light the two conflicting goals of internal market regulation: on the one hand, classical free trade theory required removing obstacles to trade in Member State law in order to ensure the benefits gained from comparative cost advantage (de-regulation). On the other hand, the project of the internal market could not be convincingly put forward towards its addressees and the people affected by it if it did not recognize and counterbalance negative externalities resulting from de-regulation (re-regulation). Action was hence required in order to make these two conflicting goals work for the sake of the successful establishment of the internal market.

In *Cassis de Dijon*, the ECJ proposed a solution, which embraced two elements: a concept that has later been labelled as "information paradigm" and a concept that has later been labelled as "principle of mutual recognition" or "principle of equivalence", which has nowadays matured into the notion of "market access":

Regarding the first one, the Court explicitly clarified that the protection of the consumer and public health does NOT require mandatory standardization of products: the line of argument that such

> standardization of products placed on the market and of their designations (…is) in the interests of a greater transparency of commercial transactions and offers for sale to the public (…) cannot be taken so far as to regard the mandatory fixing of minimum alcohol contents as being an essential guarantee of the fairness of commercial transactions, since it is a simple matter to ensure that suitable information is conveyed to the purchaser by requiring the display of an indication of origin and of the alcohol content on the packaging of products.[31]

This passage stipulates one solution which sought to solve the arising problems of the conceptual debate on the regulatory framework for the internal market: it identifies a dichotomy of "information-related" vs. "content-related" rules in conjunction with the statement that when a problem has been identified as requiring a regulat-

[30] ibid, para 13: '(T)he fixing of limits in relation to the alcohol content of beverages may lead to the standardization of products placed on the market and of their designations, in the interests of a greater transparency of commercial transactions and offers for sale to the public.'

[31] ibid, para 13.

ing measure (i.e., it is assumed that market mechanisms alone are insufficient to ensure the necessary degree of consumer protection, fairness of competition etc.), preference should be given to an information-related rule wherever that seems sufficient to cure the problem.[32]

The Court then moved on to develop whether in this light the protection of the consumer required a content-related measure: it clearly answered this in the negative:

> There is (…) no valid reason why, provided that they have been lawfully produced and marketed in one of the Member States, alcoholic beverages should not be introduced into any other Member State; the sale of such products may not be subject to a legal prohibition on the marketing of beverages with an alcohol content lower than the limit set by the national rules.[33]

This passage reiterated the ethos of the *Dassonville*-formula, which had already put a significant amount of de-regulatory pressure on Member States.[34] If Member States needed to accept products lawfully marketed in other Member States, consumers could realise a comparative advantage from products that could be produced cheaper in other Member States. This passage hence fostered competition of domestic products with other European products and put serious pressure on Member States with inefficient regulation to deregulate in order to stay competitive.[35] While this passage hence ensured that internal market law will still be primarily occupied with erasing national obstacles to trade by putting serious pressure on the Member States with regards to the de-regulating function, consumers may still opt-out of the benefits of comparative advantage if they value the external effects as so negative that they do not outbalance the benefits from comparative advantage. If a beer producer from one country seeks market access for its products in another Member State, this Member State must "not prevent the importation of products which have been lawfully manufactured and marketed in other Member States"[36]. However, if consumers

> attribute specific qualities to a product manufactured from particular raw materials, it is legitimate for the member state in question to seek to give consumers the information which will enable them to make their choice in the light of that consideration.[37]

This acknowledges that domestic laws have a social function, which reacts to the different learning curves of consumers that are to be expected in the different Member States, which result from the previous disparate regulations across the EU.[38] In

[32] See JA Usher, 'Disclosure Rules (Information) as a Primary Tool in the Doctrine on Measures Having an Equivalent Effect' in S Grundmann, W Kerber and S Weatherill (eds), *Party Autonomy and the Role of Information in the Internal Market* (Berlin, de Gruyter, 2001) 151, 152 f.

[33] Case 120/78 *Cassis de Dijon*, para 14.

[34] H Schepel, *The Constitution of Private Governance* (Oxford, Hart, 2007) 27.

[35] Barnard, *The Substantive Law of the EU*, 20, 94.

[36] Case 178/*84 Commission v Germany (Reinheitsgebot)* [1987] ECR 1227, para 35.

[37] ibid, Summary, para 3.

[38] See in this respect on the example of health claims H Bremmers, B van der Meulen and K Purnhagen, 'Multi-Stakeholder Responses to the European Union health claims Commission' (2013)

exceptional circumstances only, when the negative externalities are so severe that if a materialization of the risk would put the whole concept of the internal market at risk, Member States may prevent access of products to their domestic market via content-related measures.

Cassis de Dijon hence indeed introduced a new, fundamental concept of internal market harmonization: the fundamental freedoms grant any producer the right to circulate a product, once lawfully marketed in one Member State, freely in any Member State of the EU, in principle regardless of the respective Member State regulations. Disparate regulations may hence generally not hinder the free circulation of such a good, even if they have not yet been harmonized by secondary legislation. Secondary law is hence not needed, as in these areas, the competition of legal orders[39] and the deregulatory pressure on non-efficient legal regimes of Member States will over time lead to the harmonization of legal rules at the most efficient level. Such a harmonization by competition of legal orders is, however, not envisaged for regulatory measures that fall within the scope of "mandatory requirements". Producers have to accept such disparate regulation in Member States. If the EU legal order demands harmonization in these areas, it has to do so proactively via secondary law and within the competence regime of the Treaty. However, the limit to which producers have to accept disparate law in Member States' legal systems is not endless. Regulatory measures of Member States within the "mandatory requirements" still need to be proportionate.[40] This means, as the Court cleared, that whenever an information-related rule is sufficient to cure the problem, it shall be given preference over a content-related rule. In these cases it is hence for the consumer and not for the Member State to choose whether the risk of externalities is greater than the benefits from comparative advantage.

15.2 From Decision to Doctrine—How the Legal Concepts developed From *Cassis de Dijon* Have Created the Heart and Soul of Internal Market Law

The findings in *Cassis de Dijon* inspired scholars and the legislature alike. In this respect, several concepts have been developed from the *Cassis de Dijon* case, which I will lay out in detail in this chapter. Maybe the most influential one has been the principle of "mutual recognition", which later matured into the notion of "market access" (15.2.1). But *Cassis de Dijon* inspired developing quite a number of other approaches such as the theory of the information paradigm (15.2.2), the confident consumer (15.2.3), and the "new approach" (15.2.4).

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13 *Journal on Chain and Network Science* 161, 163.

39 See Barnard, *The Substantive Law of the EU*, 20, 94.

40 Very clearly in this respect Case 261/81 *Rau* [1982] ECR 3961, para 12.

15.2.1 The Principle of (Conditional) "Mutual Recognition"

The Court's reasoning in paragraph 14 of *Cassis de Dijon* was later elevated to a general principle dubbed "principle of equivalence" or "principle of mutual recognition." This principle

> means that products/services lawfully put on the market in one Member State can and should be allowed access to the markets in other Member States because they have already satisfied home-state controls.[41]

It was, however, not without politics that a simple paragraph evolved from a judgment on food law to a principle of EU law.[42] While some already see an approval of the principle of equivalence by the Court in *Dundalk*[43] 1 year later,[44] the "Communication from the Commission regarding the Cassis de Dijon judgment"[45] in the same year interpreted paragraph 14 of the judgment in such a way that all national standards were presumed to be equivalent and hence any product produced in accordance with such a national standard would have to have access to the market in all Member States. This communication raised criticism, as many accused the Commission of going much further in its policy statement than the court had ruled.[46] Another attack came from people with concern in the deregulatory aspect enshrined in *Cassis de Dijon*. These critiques deserve special mention here, as the jubilee Hans Micklitz was, among others, one of the main proponents of such a critique[47]: It starts from the premise that the national competition of standards as fostered by the *Cassis de Dijon* principle may result in a race to the bottom. This creates a "regulatory gap" at national level, which – in their view – then needs to be filled by Union law.[48] The proponents had a point, since we know from Akerlof's lemon's market[49] that such a competition might indeed result in a decrease of quality standards. Whether this

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[41] Barnard, *The Substantive Law of the EU*, 656.

[42] K Alter and S Meunier-Aitsahalia, 'Judicial Politics in the European Community: European integration and the pathbreaking Cassis de Dijon decision' (1994) 26 *Comparative Political Studies* 535.

[43] Case 45/87 *Commission v Ireland* (Dundalk) [1988] ECR 4929.

[44] M Dauses and A Brigola, 'Grundregeln' in M Dauses (ed), *Handbuch des Europäischen Wirtschaftsrechts*, 31st del (Munich, CH Beck, 2012) para 120. In fact, the judgment still followed the old method of non-discrimination.

[45] [1980] OJ C 256/2, see for an evaluation L Gormley, 'Cassis de Dijon and the Communication from the Commission' (1981) 6 *European Law Review* 454.

[46] See M Egan, *Constructing a European Market* (Oxford, Oxford University Press, 2001) 109; R Barents, 'New developments in measures having equivalent effects' (1981) 18 *Common Market Law Review* 271. Criticism about the political dimension of the interpretation of the judgments *Cassis de Dijon* and *Dassonville* continues until to date, see eg N Bernard, 'On the Art of Not Mixing One's Drinks: Dassonville and Cassis de Dijon Revisited' in M Maduro and L Azoulai (eds), *The past and future of EU law* (Oxford, Hart, 2010) 457.

[47] Joerges et al., *Die Sicherheit von Konsumgütern*, 294 with further reference

[48] Ibid, 294 with further reference

[49] G Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488.

also leads to a decrease of product quality is subject to debate. While Akerlof's lemon example would also support such a view, case-law practice in the Court points in the opposite direction: in *Drei Glocken*[50] the Court acknowledged evidence that in spite of an increasing liberalization of the pasta market the market shares of pasta made from wheat of higher quality increased.[51] A recent study conducted by Anu Bradford goes one step further: Regulatory competition of standards in nation-states may even result in a race to the top: if smaller markets liberalize but bigger markets do not, this may even lead to a "Brussels effect", where dense regulation of larger markets increasingly dominates more liberalized regulation.[52] However, even if a "race to the bottom" is at risk, by introducing the provision of "mandatory requirements", the Court paid witness to the fact that in some cases the deregulatory aspect needs to be counterbalanced by re-regulation, either at the national or at the Union level. This is why it is important to emphasize that there is no unconditional principle of mutual recognition in EU internal market law.[53] For every measure that falls outside of the "mandatory requirements" it is hence comprehensible to make them subject to competition as they may not only be used to (I am here paraphrasing Weatherill's words) chop down the dead woods of centuries of regulatory traditions in all Member States,[54] but also to ensure that European consumers get what they need at the lowest reasonable prize available in the European market. Only in this area, they are able to harvest the benefits from comparative costs' advantage to the full extent without having to pay for the costs of coping with the negative effects of externalities.

15.2.1.1 The Principle of Mutual Recognition and Internal Market Law of Product Safety Regulation

The ECJ hence wisely furthered and deepened the principle of mutual recognition in its case law. If a beer producer from one country seeks market access for its products in another Member State, this Member State must "not prevent the importation of products which have been lawfully manufactured and marketed in other Member States"[55]. Hence, it also constitutes a measure of equivalent effect if margarine lawfully produced and packed in an EU Member State needs to be repacked in order to be sold on the Belgian market.[56] And if a Mars bar, which

[50] Case 407/85 *Drei Glocken GmbH v USL Centro-Sud* [1988] ECR 4233.

[51] ibid, para 27.

[52] A Bradford, 'The Brussels Effect' (2012) 107 *Northwestern University Law Review* 1.

[53] S Weatherill, 'Why there is no 'principle of mutual recognition', in this contribution, emphasises the risks that may follow if one does not emphasize the conditionality of the principle of mutual recognition.

[54] S Weatherill, 'Pre-emption, harmonisation and the distribution of competence' in C Barnard and J Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford, Hart Publishing, 2002) 49.

[55] Case 178/84 *Reinheitsgebot*, para 35.

[56] Case 261/81 *Rau*.

complies with rules on fair trade needs to be repacked, because it does not comply with German rules on fair competition, it needs to be qualified as a measure having equivalent effect.[57] The Court did not only deepen the principle of mutual recognition. By putting more flesh on its bones, it also widened its application by introducing an "other-reading"[58] duty of Member States. It required from Member States not only to recognize products lawfully marketed under other national law. It moreover supported the Commission's political agenda to make the principle of mutual recognition a corner stone of harmonization as it required from Member States to implement clauses of equivalency in their national laws.[59]

In the wake of the BSE crisis, however, the principle of mutual recognition in the core of internal market law, which has always been food law,[60] was seriously threatened. The BSE—crisis forced EU institutions and Member States to admit that under certain circumstances, such as those where new scientific evidence is available in a crisis, the minimum harmonization approach of the principle of mutual recognition creates negative externalities that are detrimental to the establishment of the internal market. The initial reactions of the EU, which issued draconian measures against the UK, were followed by a chaotic dispute between European institutions, Member States, and country representatives. A back-and-forth process, imposing then loosening regulatory measures at several levels, accompanied this struggle.[61] This even convinced the most resistant Member States such as the UK to transfer more power to European institutions in order to provide for common legislation at European level.[62] As a result of this experience, the EU issued as a horizontal (!) Regulation (!) the General Food Law and set up the EFSA in Parma in 2002. This approach to govern the whole food law market with a single, directly applicable Regulation was a far cry from the initial idea of governing the food market with the principle of mutual recognition. In recent cases, the ECJ seems to have given up the approach of minimum harmonization completely. Even when interpreting provisions in the General Food Law, it does so with a maximum harmonization approach in terms of uniform consumer protection. In *Berger v Bayern*, it

[57] Case C-470/93 *Verein gegen Unwesen in Handel und Gewerbe Köln v Mars* [1995] ECR I-1936, para 13.

[58] K Armstrong, 'Mutual Recognition' in Barnard and Scott (eds), *The Law of the Single European Market,* 231.

[59] See eg § 54 of the German Food Code.

[60] Since the foundation of the European Communities, 'the harmonisation of the European food market ranked high on the agenda' of the respective European organisations as a means of coping with diverging safety standards throughout Europe, see S Krapohl, 'Thalidomide, BSE, and the single market: An historical-institutionalist approach to regulatory regimes in the European Union' (2007) 46 *European Journal of Political Research* 38.

[61] C Joerges, 'Law, Science and the Management of Risks to Health at the National, European and International Level—Stories on Baby Dummies, Mad Cows and Hormones in Beef' (2001) 7 *Columbia Journal of European Law* 6 ff. with further reference.

[62] See for an in-depth analysis Krapohl, 'Thalidomide, BSE, and the single market', 39, P Shears, F Zollers and S Hurd, 'Food for Thought: What Mad Cows Have Wrought With Respect to Food Safety Regulation in The EU And UK' (2001) 103 *British Food Journal* 63, each with further reference.

favoured an interpretation of the information regulation in the General Food Law in the light of consumer protection without even mentioning the fact that consumers' interest needs to be balanced with the producer's fundamental right to free movement of foodstuffs.[63] However, The ECJ acknowledged that EU authorities may only interfere if the Member States authorities have "ascertained" a threat to the health of consumers.[64] By doing this, it somehow counterbalances the cutting back of the principle of mutual recognition by increasingly acknowledging that Member States can voice their concerns by exercising their margin of discretion as to when to interfere. In this sense, the decrease of the principle of mutual recognition results in an increase in the principle of home-country control.

After these developments, some already foresaw the end of the principle of mutual recognition. Indeed, if we look into the area of new governance products such as food and feed, pharmaceuticals and chemicals,[65] there is not much left of this principle. Just when most people thought that the principle was dead, the Commission launched the 'Package on the internal market for goods' in February 2007,[66] which brought the principle of mutual recognition back on the table in internal market law. However, this time, the Union institutions targeted the different harmonization area of 'new approach'-products, which have formerly developed independently from 'new governance' products. Regulation 764/2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State[67] (mutual recognition Regulation) as well as its accompanying pieces Regulation 765/2008[68] and Decision 768/2008/EC[69] provide concise directions as to how the mutual recognition of the marketing of 'new approach'-products shall be organized at both, institutional and substantial level.

In secondary law, the principle of mutual recognition is nowadays applied in its pure sense mainly in the area of 'new approach'-products. In the area of 'new governance'-products, and in certain 'new approach'-products as well, it lives on as a principle of leaving the margin of discretion when to interfere in terms of product safety largely to Member States. While the principle of mutual recognition in its pure sense is hence on the one hand on the decline at least in the area of 'new governance'-products, it seems to enjoy a renaissance as a principle of "market access" in the interpretation of the "measures having an equivalent effect" of Art.

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[63] See judgment of 11 April 2013, Case C-636/11 *Karl Berger v Freistaat Bayern*, not yet reported. See in this respect also K Purnhagen, 'Beyond Threats to Health: May Consumers' Interest in Safety Trump Fundamental Freedoms in Information on Foodstuffs?' (2013) 38 *European Law Review* 711.

[64] See Case C-636/11 *Karl Berger v Freistaat Bayern*; Case C-470/03 *AGM-COS.MET* [2007] ECR I-2749; see also Purnhagen, 'Beyond Threats to Health', 717.

[65] For the terminology of 'new governance' and 'new approach' products see Purnhagen, *The Politics of* Systematization, 3-6.

[66] COM(2007)35.

[67] OJ 2008 L 218/21.

[68] OJ 2008 L 218/30.

[69] OJ 2008 L 218/82.

34 TFEU.[70] It refers to the idea that, taken down to its basic rationale, the principle of mutual recognition indeed shall contribute to opening up Member State's market for products of other Member States, thereby primarily granting them access. In this respect, the Court has correctly targeted the *Keck*-formula as an arbitrary criterion, which hinders the enforcement of market access. In its constant struggle between the correct application of the *Keck*-criteria with the *Cassis-de-Dijon* principle[71], in *ANETT*[72] the Court seems to have finally given emphasis on the market access criterion derived from *Cassis de Dijon* to the detriment of *Keck*.[73] It seems, after a long struggle, that *Cassis de Dijon* has finally won.[74]

15.2.1.2 The Principle of Mutual Recognition and External Relations: The Case of Switzerland

The principle of mutual recognition did not stay within the borders of the EU but went on to other jurisdictions such as Switzerland. In 2010, Switzerland implemented the *Cassis-de-Dijon* principle by autonomous adaptation. Art 16a to 16e of the Technical Barriers to Trade and the Marketing of Products on the basis of international regulations incorporated the principle of mutual recognition into Swiss federal law. The officially communicated reason was an expected decrease of prices for consumer products, especially for foods, in Switzerland.[75] The Swiss authorities hence planned to benefit from the comparative advantages promised by the introduction of the *Cassis-de-Dijon* principle. However, the Swiss did not adopt the principle pars pro toto. Some products such as foodstuffs are subject to mandatory authorization and the reasons for justification of non-marketing have to comply with a black list.

15.2.1.3 The Principle of Mutual Recognition and The Area of Freedom, Security and Justice

The principle of mutual recognition did not only travel beyond the borders of the EU, it also travelled from internal market law to the area of Freedom, Security and

[70] See in this respect J Snell, 'The notion of market access: a concept or a slogan?' (2010) 47 *Common Market Law Review* 437; M Jesse, 'What about Sunday Trading…? The Rise of Market Access as an Independent Criterion under Article 34 TFEU' (2012) 3 *European Journal of Risk Regulation* 437.

[71] See for an overview on how this struggle translated into the notion of 'market access' Barnard, *The Substantive Law of the EU*, 18-25, 102–108.

[72] Judgment of 26 April 2012, Case C-456/10 *ANETT*, not yet reported.

[73] See Jesse, 'What about Sunday Trading…?', 437; K Purnhagen, 'Anmerkung' (2012) *Juristenzeitung* 742.

[74] See for a more elaborate analysis Weatherill, 'Why there is no 'principle of mutual recognition' in EU law'; also Jesse, 'What about Sunday Trading…?', 437; Purnhagen, 'Anmerkung', 742.

[75] See *Botschaft zur Teilrevision des Bundesgesetzes über die technischen Handelshemmnisse vom 25. Juni 2008*, 7275, www.admin.ch/opc/de/federal-gazette/2008/7275.pdf.

Justice. The European Arrest Warrant brought to light the need to balance between mutual recognition of national warrants on the one hand and individual fundamental rights in the EU on the other; an issue that internal market lawyers have been dealing with since the 1970s.[76] Shortly after, the European Council endorsed in its Tampere Programme in 1999 the principle of mutual cooperation as the future "cornerstone of judicial co-operation in both civil and criminal matters within the Union"[77]. The Hague Programme in 2004 went even further by asking for a comprehensive approach to implement the principle of mutual recognition in all phases of criminal proceedings to be developed.[78] In the area of freedom, security and justice, however, the principle of mutual recognition only gained treaty recognition after the Lisbon Treaty entered into force on December 1st 2009. To this end, Art. 82 TFEU now explicitly recognizes the principle of mutual recognition as a cornerstone of the judicial cooperation in criminal law.

15.2.2 The Information Paradigm

While it is common knowledge that the *Cassis de Dijon* case triggered the principle of mutual recognition, significantly lower attention was attributed to the idea that it also triggered a concept that was later called the "information paradigm".[79] According to this notion, as the internal market is characterized by differentiated and fragmented conditions, it might only operate effectively to the benefit of all market players and to the society as a whole if the consumers who were on the one hand enriched with a wider choice of products had on the other hand to bear the burden of perceiving and processing information which were relevant to decide which product actually could meet their preferences.[80] By and large it shall be considered sufficient to ensure, for reasons of consumer protection, free access to information which might be relevant for a rational transaction decision. [81]

One of the reasons why the "information paradigm" was not taken up to the same extent as the principle of mutual recognition might be that the connection between preference of information regulation over content-related regulation might not be evident at first sight. Indeed, the ECJ originally developed this concept as an ex-

[76] From this perspective, it hence makes sense that the area of freedom, security and justice and internal market law were lumped together in the Lisbon Treaty.

[77] European Council, 15 and 16/10/1999, Tampere, Presidency Conclusions.

[78] Commission Communication The Hague Programme: ten priorities for the next five years. The Partnership for European renewal in the field of Freedom, Security and Justice, COM(2005) 184 final, [2005] OJ C 236.

[79] E Steindorff, *EG-Vertrag und Privatrecht* (Baden-Baden, Nomos, 1996) 195 f. The notion of an 'information model' in the internal market context has subsequently been taken up by several authors, see *inter alia* the articles in S Grundmann, W Kerber, and S Weatherill (eds), *Party Autonomy and the Role of Information in the Internal Market* (Berlin, de Gruyter, 2001).

[80] See also Franck and Purnhagen, 'Homo Economics', 336 f.

[81] ibid.

pression of the principle of proportionality with regard to the interpretation of the free movement of goods (Article 34 TFEU) and therefore as a standard of Union law confining domestic law that establishes obstacles to free trade. However, subsequently the Court also applied the same yardstick to construe which practices may be considered "deceptive" under secondary law that aimed at harmonizing domestic protective standards in order to ensure free trade in the internal market.[82] This spillover of the consumer concept from the interpretation of a fundamental freedom to legislative internal market activities of the Union, that is, from the de-regulatory to the re-regulatory aspect of internal market law, is consequent. As most of this legislation is based on Art. 114 TFEU, secondary internal market legislation in principle follows the same rationale. Furthermore, it has to be regarded as settled law that not just the national legislatures but also the institutions of the Union are bound by the fundamental freedoms.[83]

The "information paradigm" reflected insights from economic regulation at this time. Several reasons were brought forward in economics that established a general preference of information-related over content-related regulation: in microeconomic price theory it had already been knowledge for a long time that for markets to function, market players must obtain adequate information on prices and quality of marketed products. In the 1970s economists started to focus on information deficits as a potential reason for market failure, and on possible remedies to counter such risks. Akerlof famously described in his seminal paper on "lemon markets" the mechanism whereby informational deficits on the part of consumers due to prohibitively high search costs generate a risk of adverse selection among available products, resulting in a failure of the market to provide high quality goods.[84] It is basically this theory that provides the economic justification to regulate markets if market mechanisms such as signalling through advertisement, labelling and other instruments, reputational mechanisms or information intermediation,[85] do not suffice to provide for an adequate level of product-related information, or where market players are rationally ignorant of available information due to prohibitively high costs or cognitively inapt to perceive and process available information.

Though the early protagonists of an information paradigm for internal market regulation could not yet appreciate the insights of cognitive psychology, behavioural economics or other disciplines on characteristics of human behaviour, as they were taken up only during the last decade or so by legal writers, they were certainly not naïve as to the realities of consumers', investors' or other market players' individual capacity to process information and to reach rational decisions on that basis.

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[82] Case C-315/92 *Verband Sozialer Wettbewerb v Clinique Laboratories and Estée Lauder* [1994] ECR I-317, para 16; Case C-77/97 *Österreichische Unilever v Smithkline Beecham Markenartikel* [1999] ECR I-431, para 27; Case C-99/01 *Linhart and Biffl* [2002] ECR I-9375, para 26.

[83] Case C-51/93 *Meyhui v Schott Zwiesel Glaswerke* [1994] ECR I-3879, para 11.

[84] Akerlof, 'The Market for "Lemons"'; previously, EH Chamberlin, 'The Product as an Economic Variable' (1953) 68 *Quarterly Journal of Economics* 1, 24–27, had already described the risk of adverse selection due to consumers' ignorance of product quality.

[85] See for an overview on market mechanisms that may counter informational deficits J-U Franck, *Europäisches Absatzrecht* (Berlin, de Gruyter, 2006) 190–203.

Steindorff, for instance, made it clear that his concept had to be understood as a normative one when he wrote that the internal market "demanded" a circumspect consumer. It is for the sake of internal market integration that market players should bear the burden of perceiving and processing information, and also the drawbacks that may follow should they carry out a market transaction suffering a cognitive deficit.[86]

As this "information paradigm" followed from *Cassis de Dijon*, it was first taken up in the area of food law. In *Rau*[87], the ECJ made explicit that, in order to enable consumers to distinguish between margarine and butter, it shall suffice to ask for information legislation instead of repackaging. Consumers are protected "just as effectively by other measures, for example by rules on labelling, which hinder the free movement of goods less."[88] It continued to emphasize this priority of information regulation in the beer purity case. [89] Consumers would be protected sufficiently from misleading practices "by the compulsory affixing of suitable labels giving the nature of the product sold."[90] When EU law moved from case to codex in food law in 2002, the information paradigm was recognized as one of the cornerstones of EU food legislation: Art. 8 of the General Food Law explicitly stipulates that consumer protection in food law is primarily geared towards "providing a basis for consumers to make informed choices". This is also the reason why the major bunch of regulatory measures available in food law are information-related. The General Food Law grants to EU institutions, as well as executing Member State administration, mainly information rights and duties. Despite the fact that Art. 14 General Food Law requires all foods that are marketed on the EU market not to be unsafe; the main tool available for regulators in order to ensure the safeness of foods is information regulation. The chamber of horrors with product bans etc. is only available in special circumstances, such as those of genetically modified foods or in the wake of a crisis. EU Regulation 1169/2011 confirms the fact that the "permit but inform" logic still forms the major regulatory method on the provision of food information to consumers, which will apply starting from December 13th 2014.[91]

The information paradigm did not stay in food law, but travelled on to other market areas. While it is plausible to extend this approach to other search and experience goods such as chemicals or pharmaceuticals, the information paradigm has also formed a cornerstone in the area of credence goods on the financial market. While information regulation at EU level is conventionally justified by consideration of economic theory[92], it is often overlooked that legislation in financial market regulation in the EU does not refer to the general economic rationale of intervention

[86] Steindorff, *EG-Vertrag und Privatrecht*, 195 f.

[87] Case 261/81 *Rau*.

[88] ibid, para 12.

[89] Case 178/84 *Reinheitsgebot*.

[90] ibid, para. 32.

[91] Reg (EU) No 1169/2011 on the provision of food information to consumers, [2011] OJ L 304/18.

[92] See eg G Spindler, 'Behavioural Finance and Investor Protection Regulations' (2011) 34 *Journal of Consumer Policy* 315.

into financial markets that are also used at the nation-state level. While some statements read in isolation might lead to such a conclusion, a look into the large bunch of financial market regulations brings to light that it is actually the "information paradigm" created in *Cassis de Dijon* which forms the basis for regulatory intervention. To this end, for example recital (21) of Directive 2003/71/EC (Prospectus Directive)[93] stipulates that "[i]nformation is a key factor in investor protection." Recital (18) of the Prospectus Directive becomes even more concrete:

> The provision of full information concerning securities and issuers of those securities promotes, together with rules on the conduct of business, the protection of investors.

While these provisions could still be justified by free-standing regulatory theory, recital (52) Life Insurance Directive[94] makes unambiguously clear that the *Cassis-de-Dijon*-like information paradigm forms the basis for information regulation in financial market law. It stipulates that

> [i]n an internal market for assurance the consumer will have a wider and more varied choice of contracts. If he/she is to profit fully from this diversity and from increased competition, he/she must be provided with whatever information is necessary to enable him/her to choose the contract best suited to his/her needs.

15.2.3 The Confident Consumer

Closely related to the "information paradigm" is the concept of the "confident consumer". It draws on the normative basis that by and large it shall be considered sufficient to ensure for reasons of consumer protection free access to information, which might be relevant for a rational transaction decision. Based on these insights gained from the *Cassis de Dijon* case, authors such as Steindorff,[95] Weatherill,[96] and Wilhelmsson[97] developed at a more abstract level which normative "internal market player" is assumed in EU law. In this sense, in the internal market context, consumer protection and unfair competition law had to be interpreted instrumentally and hence, reconciled with the normative objectives to foster free trade and the integration of the national markets. Especially Steindorff made it clear that, according to this notion, the internal market "demanded" such a circumspect consumer.[98] They hence proposed in the context of the internal market the concept of a confi-

[93] Dir 2003/71/EC on the prospectus to be published when securities are offered to the public and admitted to trading, [2003] OJ L 345/64.

[94] Dir 2002/83/EC concerning life assurance, [2002] OJ L 345/1.

[95] Steindorff, *EG-Vertrag und Privatrecht*, 195.

[96] See S Weatherill, 'The evolution of European consumer law: from well informed consumer to confident consumer' in H-W Micklitz (ed), *Rechtseinheit oder Rechtsvielfalt in Europa?* (Baden-Baden, Nomos, 1996) 423.

[97] T Wilhelmsson, *Social Contract Law and European Integration* (Aldershot, Dartmouth Publishing, 1995) 145 f.

[98] Steindorff, *EG-Vertrag und Privatrecht*, 195 f.

dent consumer as an antithesis to the concept of a weak and vulnerable consumer.[99] Thus, protection against deceptive practices, for instance, must not take the ignorant consumer as a yardstick since such an approach would ultimately require the prescription of uniform products.[100]

The concept was not developed out of the blue, but relied on and was reflected by the ECJ's case law on a "reasonably well-informed and reasonably observant and circumspect" consumer.[101] To be sure, also this ECJ's concept has to be regarded as a normative one. This insight is supported by the fact that the ECJ on various occasions denied the deceptive potential of a commercial communication without considering its actual perception by the addressees in question.[102] It is against the background of these cases that the jubilee Hans Micklitz has widened the concept of the confident consumer to also cover the protection of legitimate expectations.[103] The normative concept of the "confident consumer"[104] was of relevance as long as internal market regulation was mainly concerned only with the realization of the fundamental freedoms. Hans Micklitz has pointed to the fact that internal market law has meanwhile adopted other, more social values, which need to be taken into account as legitimate expectations of the consumer in the concept of the "confident consumer".[105] Indeed, internal market law has matured to also encompass principles, basic rights and citizenship rights,[106] which have to be reflected also in the normative concept of EU consumer law.[107] It becomes evidently clear that consumers can only fulfil their duties as a functional player on the internal market if EU law equips them also with the means consumers need in order to fulfil this function.

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[99] See *inter alia* the articles in Grundmann, Kerber and Weatherill (eds), *Party Autonomy*.

[100] AG Capotorti, opinion of 16 January 1979, Case 120/78 *Cassis de Dijon*: 'But the idea of this widespread, if not general, incapacity on the part of the consumer seems to me to doom to failure any effort to protect him, unless it be to impose upon him a single national product the composition of which is constant and is rigorously controlled.'

[101] The ECJ has consistently used this wording since its judgment in Case C-210/96 *Gut Springenheide and Tusky v Oberkreisdirektion Steinfurt* [1998] ECR I-4657, para 37. Prior to this decision the Court had already referred to the '[r]easonably circumspect consumer' as yardstick, Case C-470/93 *Mars*, para. 13: 'Reasonably circumspect consumers may be deemed to know that there is not necessarily a link between the size of publicity markings relating to an increase in a product's quantity and the size of that increase.'

[102] Case C-238/89 *Pall* [1990] ECR I-4827, paras 18–21; Case C-315/92 *Estée Lauder*, paras 19–23; Case C-465/98 *Darbo* [2000] ECR I-3397, paras 21–34; Case C-99/01 *Linhart and Biffl* [2002] ECR I-9375, paras 31–35.

[103] H-W Micklitz, 'Legitime Erwartungen als Gerechtigkeitsprinzip des europäischen Privatrechts' in L Krämer, H-W Micklitz and K Tonner (eds), *Recht und diffuse Interessen in der Europäischen Rechtsordnung: Liber amicorum Norbert Reich* (Baden-Baden, Nomos, 1997) 245.

[104] See on the normativity and its reasons also Franck and Purnhagen, 'Homo Economics', 337 f.

[105] Micklitz, 'Legitime Erwartungen als Gerechtigkeitsprinzip des europäischen Privatrechts', 245.

[106] M Hesselink, 'Are we Human Beings or Mere Consumers?' (2006) 12 *European Voice* 38.

[107] Franck and Purnhagen, 'Homo Economics', 337 f; M Hesselink, 'European Contract Law: A Matter of Consumer Protection, Citizenship, or Justice?' (2007) 15 *European Review of Private Law* 323, 327.

The imperative of the realization of the internal market demands specific requirements that go beyond the features of nation-state citizens. This results, however, in no competence norm to equip the confident consumer with all kinds of rights, as this would lead to unlimited competences of the EU in consumer protection legislation.[108] One shall be reminded that the concept of the functional consumer has always been tied to and may henceforth not go beyond the level of realization of the internal market.[109] The 'social law' of the EU internal market mainly materializes through justifications for infringements of fundamental freedoms.[110] The case law of the CJEU on these justifications hence serve as a starting point for determining which legitimate expectations may be protected in consumer law.[111]

15.2.4 The "New Approach"[112]

The new harmonization method introduced by the *Cassis de Dijon* case triggered also a switch in secondary legislation in product safety law. As there was huge uncertainty about the constitutional basis of EU product safety regulation, the only method that seemed justifiable at the time before *Cassis de Dijon* was the application of classic, problem-related command-and-control measures, which harmonized existing Member State regulation in this respect.

Such a method was at that time undoubtedly justified by Art. 36 TEEC (now Art. 36 TFEU), which allowed the Union to establish measures that hindered the free trade of goods which were harmful to the health and life of human beings.[113] The harmonizing measures were to be adopted according to Art. 100 TEEC (now Art. 114 TFEU), which then 'europeanised' these protective measures.[114]

With regard to consumer products, Art. 36 TFEU and the *Cassis de Dijon*—judgment could hence be interpreted as asserting that the freedom of goods is only applicable to products that do not form a hazard to the health and safety of

[108] W-H Roth, 'Europäischer Verbraucherschutz und BGB' (2001) *Juristenzeitung* 479.

[109] Weatherill, 'The evolution of European consumer law', 423 f.

[110] Case C-112/00 *Eugen Schmidberger, Internationale Transporte und Planzüge v Republik Österreich* [2003] ECR I-5659, at para 82; V Trstenjak and E Beysen, 'The growing overlap of fundamental freedoms and fundamental rights in the case-law of the CJEU' (2013) 53 *European Law Review* 293.

[111] K Purnhagen, 'United We Stand, Divided We Fall? Collective Redress in the EU from the Perspective of Insurance Law' (2013) 21 *European Review of Private Law* 493.

[112] This section is a revised version of a subchapter I already published in Purnhagen, *The Politics of Systematization*, 6–15, 21–23.

[113] See for the exciting contrast between Art 30 EEC (now Art 28 TFEU) and Art 36 EEC (now Art 36 TFEU) L Gormley, *Prohibiting Restrictions on Trade within the EEC. The Theory and Application of Articles 30–36 of the EEC Treaty* (Amsterdam, Elsevier, 1985); P Oliver, *Free Movement of Goods in the EEC under Articles 30 to 36 of the Rome Treaty*, 1st (old) ed (London, European Law Centre, 1982).

[114] See to this end Joerges et al., *Die Sicherheit von Konsumgütern*, 273.

consumers.[115] To this end, harmonizing measures by the EU according to Art. 100 TEEC (now Art. 114 TFEU) needed to reflect this change in the understanding of the European market with regard to the free movement of goods, as it obliges the Union to establish measures within the European market for goods which safeguard the rights mentioned in both Art. 36 TEEC (now Art. 36 TFEU) and the *Cassis de Dijon* judgment. However, as the ECJ made clear through its clear statement for a preference for information-related over content-related rules,[116] these measures have to be in conformity with the EU's market-establishing agenda, which also led to understand the 'new approach' as an efficiency-driven instrument rather than focusing on individual protection. This change in approach of the ECJ has hence provided the basis for the introduction of more conceptual and systematic EU product safety regulation, for example through the 'new approach' at European level.[117]

The 'new approach' went into full swing after the ECJ explicitly approved this type of regulation in 1980.[118] It thereby opened the doors for the wider risk-based concept of the 'new approach' to apply to other areas and paved the way for the 'new approach' to become the systematic logic behind a significant body of EU legislation on product safety. Thus, the 'new approach' was the first systematic regulation to be applied to several product groups.[119]

The new understanding of the European constitution after the Dassonville and Cassis de Dijon judgments furthermore triggered systematization of EU product safety regulation at post-market level. As to the principle of home-country control, systematic post-market control has never been perceived as feasible. However, even before the introduction of the 'new approach' there was an increasing realization that only pre-market measures such as those in the 'new approach'[120] would not suffice and could not ensure European product safety at EU level as a precondition for wider markets. European regulation that also governs the lifecycle of the product after its introduction to the market—so-called post-market regulation—has hence been envisaged.

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[115] See Joerges et al., *Die Sicherheit von Konsumgütern*, 294 with further reference.

[116] See JA Usher, 'Disclosure Rules (Information) as a Primary Tool in the Doctrine on Measures Having an Equivalent Effect' in Grundmann, Kerber and Weatherill (eds), *Party Autonomy*, 152–153.

[117] See to this end Joerges et al., *Die Sicherheit von Konsumgütern*, 309 ff.

[118] Case 123/76 *Commission v. Italian Republic* [1977] ECR 1449.

[119] See to this end also the Communication from the Commission, 'Follow-up to the Sutherland Report—Legislative Consolidation to Enhance the Transparency of Community Law in the Area of the Internal Market', COM(93) 361 final, 3; for a list of these product groups see C Hodges, *European Regulation of Consumer Product Safety* (Oxford, University Press, 2005) 22–25; for further details also N Reich and H-W Micklitz, *Europäisches Verbraucherrecht*, 4th ed (Baden-Baden, Nomos, 2003) paras 25.27–25.34.

[120] The 'new approach'—system as described above essentially focused on pre-market compliance with essential requirements, see to this end also Hodges, *European Regulation of Consumer Product Safety*, 61.

The then new 'Cassis de Dijon'-logic provided a means of understanding the European economic constitution to facilitate systematized regulation also at the post-market level. Supporters of this idea highlighted the fact that the enabling of a free market for virtually all products in Europe through the 'Cassis de Dijon'—judgment came about in response to the need for European measures to facilitate the removal of hazardous products from the market.[121] Art. 36 TFEU and the 'Cassis de Dijon'—judgment have made clear that the freedom of goods is only applicable to products that do not constitute a hazard to the health and safety of consumers. As the aforementioned critics claim, if it was left to the Member States to establish post-market measures, the result would be a divergence of the marketing of hazardous products. Such divergence would be contrary to the goal of the single-market integration, which enabled the free movement of goods only to the extent that they did not impose a hazard to consumers.[122]

The Council finally adopted this view and, at the same time the 'new approach' was introduced broadly to EU product safety regulation, enacted, on the proposal of the Commission in 1985, the 'Product Liability Directive' 85/374/EEC.[123] Within this Directive, the Council understood post-market control in a wide sense, covering not only classical post-market administrative supervision, but also, and in line with the 'regulation through litigation'—approach,[124] rules on product liability. It hence introduced a strict liability regime for the producer of a defective product,[125] and its application was widened to apply to agricultural and fishery products in the aftermath of the BSE scandal.[126]

In addition to these acts on litigation, the Council adopted Directive 92/59/EEC on General Product Safety in 1992 after a proposal from the Commission.[127] While the previous pushes into systematization at European level had either been the drawing of non-binding conceptions such as the 'new approach' or the setting of cautious horizontal benchmarks such as the 'Product Liability Directive', this Directive introduced for the first time binding horizontal measures for the whole European market system of consumer products. According to its Art. 3, manufacturers of products have been obliged to produce only 'safe' products. In order to effectively enforce this obligation, the General Product Safety Directive also introduced classic regulations on administrative market surveillance. Besides some action towards pre-market regulation, the Directive obliges Member States to supervise the safety

[121] See Joerges et al., *Die Sicherheit von Konsumgütern*, 294 with further reference.

[122] Joerges et al., *Die Sicherheit von Konsumgütern*, 294 ff.

[123] Dir 85/374/EEC concerning liability for defective products, [1985] OJ L 210/29 last amended by Dir 1999/34/EC, [1999] OJ L 141/20.

[124] See to this end inter alia A Morris, B Yandle and A Dorchak, *Regulation by Litigation* (New Haven, London, Yale University Press) 2009; K Viscusi (ed), *Regulation through Litigation* (Washington DC, Brookings Institution Press, 2002); W Wagner, 'When All Else Fails: Regulating Risky Products Through Tort Litigation' (2007) 95 *Georgetown Law Journal* 693.

[125] See for details and the background discussion on the Directive Joerges et al., *Die Sicherheit von Konsumgütern*, 298 ff.

[126] Dir 1999/34/EC.

[127] Dir 92/59/EEC on general product safety, [1992] OJ L 228/24, no longer in force.

of products and empowers them to take specific measures. Inter alia, these measures included the issuance of warnings and the withdrawal of products. It also introduced a notification system to the Commission and a Union-wide system of withdrawal of products in case of urgency,[128] which has been affirmed by the ECJ.

The European institution's political agenda to widen the "new approach" also to enforcement came fully to light when the Commission issued a 1994 Communication to ensure the uniform enforcement of Union legislation across all Member States.[129] As a result, several measures were taken in order to assure coherency in the enforcement of Member State action.[130] Most notably in the areas of 'new approach'-products and foodstuffs, a communication system between Member State and European authorities was established, which also involved the establishment of common frameworks.[131] Furthermore, a consistent approach to product testing by laboratories in the area of 'new approach'-products was introduced,[132] and the exchange[133] or unofficial cooperation[134] of staff was facilitated.

By the end of the twentieth century, EU institutions widened this new approach of product safety to areas that in nation states regularly belong to their private or civil law systems. Art. 2 (1) of Directive 1999/44/EC[135] required the seller to "deliver goods to the consumer which are in conformity with the contract of sale". Conformity was according to Art. 2 (2) of Directive 1999/44/EC presumed if they met certain objective criteria such as compliance with the description of the product by the seller. Again, Directive 1999/44/EC makes use of the 'new approach's incentive mechanism to ensure the safeness of products. The seller has a general duty to deliver only products which are in conformity with the contract. However, he benefits from a switch in the burden of proof if he is able to make clear that he fulfils the requirements set out in Art. 2 (2) of Directive 1999/44/EC. It is interesting to note that this 'new approach' rationale has not been realized in the implementing

[128] See for on overview N Reich, *Understanding EU Law*, 2nd ed (Antwerp, Intersentia, 2005) 226.

[129] Commission Communication on the Development of Administrative Co-operation in the Implementation and Enforcement of Community Legislation in the Internal Market, COM(94) 29 final; adopted by Council Resolution on the Development of Administrative Co-operation in the Implementation and Enforcement of Community Legislation in the Internal Market, [1994] OJ C179/1.

[130] See for a comprehensive overview Hodges, *European Regulation of Consumer Product Safety*, 181 ff.

[131] Council Resolution on Co-ordination with Regard to Information Exchange Between Administrations, [1994] OJ C 181/1.

[132] Provisional working document 'New Approach Directives: Official Market Control', Doc Certif 92/2, 4/3/1992.

[133] Council Decision 92/481/EEC on the Adoption of an Action Plan for the Implementation of Community Legislation Required to Achieve the Internal Market, [1992] OJ L 286/65, amended by Commission Decision 94/818/EC, [1994] OJ L 337/89.

[134] See the coordination activities by the Product Safety Enforcement Forum of Europe (PROSAFE).

[135] Dir 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees, [1999] OJ L 171/12.

measure of any of the Member States, who have interpreted this Directive as granting mainly consumer rights.

In 2001 the Parliament and the Council on the proposition of the Commission took the chance to widen the scope of application of the 'new approach' to nearly all kinds of consumer products and the introduction of new post-market measures by adopting Directive 2001/95/EC,[136] which amended Directive 92/59 "in several aspects".[137] The system of post-market measures was intensified, as it introduced, inter alia, a recall system for products already being on the market, and a consumer's right to information, as well as providing the Commission with more power to act in case of emergencies. With regard to its pre-market application, the 'new approach' system—with minor modifications—was widened to apply to nearly all products of consumer safety through Directive 2001/95/EC on 'general product safety' (see especially Art. 3 Directive 2001/95/EC). However, products that were already successfully and comprehensively regulated on account of a different standardization process, for example foodstuffs, pharmaceuticals and chemicals, were left out of the scope of regulation of the 'new approach',[138] even after it was widened to apply to most consumer products (see Art. 1 (2) Directive 2001/95/EC).

In cases where consumer products that are not supervised by European agencies or where supervisory competences of these agencies fall behind the respective requirements set out in Directive 2001/95/EC, there is a need for supervision by Member State institutions. This principle was first introduced by Directive 92/59/EEC and then amended nearly 10 years later through Directive 2001/95/EC. According to Art. 6 (2, 3) of Directive 2001/95/EC Member States need to

> "establish or nominate authorities competent to monitor the compliance of products with the general safety requirements and arrange for such authorities to have and use the necessary powers to take the appropriate measures incumbent upon them under this Directive". They shall furthermore "define the tasks, powers, organisation and cooperation arrangements of the competent authorities".

The next step of intensification of the "new approach" was taken in 2008, when the Union introduced the 'New Legislative Framework for the marketing of products'.[139] To this end, the European Parliament and the Council issued several acts in 2008.[140] Although, the 'new approach' had already introduced systematic regulatory

[136] Dir 2001/95/EC on general product safety, [2002] OJ L 11/4.

[137] Recital 1 of Dir 2001/95/EC.

[138] Tricker, *CE Conformity Marking*, 4.

[139] See to this end the website of the Commission on the 'new legislative framework', available at http://ec.europa.eu/enterprise/policies/single-market-goods/regulatory-policies-common-rules-for-products/new-legislative-framework.

[140] The respective acts are Reg (EC) No 764/2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State, [2008] OJ L 218/21; Reg (EC) No 765/2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products, [2008] OJ L 218/30, and Decision No 768/2008/EC on a common framework for the marketing of products, [2008] OJ L 218/82. See for further information regarding the modernization of the 'new approach' the website of the European Commission on the 'new legislative framework', available at http://ec.europa.eu/enterprise/

logics to the respective product areas, this 'new legislative framework' emphasized their horizontal application with legally binding force to each agent of the 'new approach' regime. Decision No. 768/2008/EC and Regulation (EC) No 765/2008 are of special importance in this respect. Art. 1 (2) of Decision No. 768/2008/EC clearly emphasises the economic operator's responsibility to only market safe products. Art. 2 of Decision No. 768/2008/EC then indicates that this Decision forms a constructed model for the governance of this really responsive regulation:

> This Decision sets out the common framework of general principles and reference provisions for the drawing up of Community legislation harmonising the conditions for the marketing of products (Community harmonisation legislation).
> Community harmonisation legislation shall have recourse to the general principles set out in this Decision and to the relevant reference provisions of Annexes I, II and III. However, Community legislation may depart from those general principles and reference provisions if that is appropriate on account of the specificities of the sector concerned, especially if comprehensive legal systems are already in place.

Likewise, Art. 1 (1) of Regulation (EC) No 765/2008 highlights its function as constructing a model for the operation of conformity assessment bodies:

> This Regulation lays down rules on the organisation and operation of accreditation of conformity assessment bodies performing conformity assessment activities.

Furthermore, the framework Regulation (EC) No. 765/2008 also stipulated general requirements for the post-market surveillance system. It introduced basic requirements for the institutional organization of surveillance bodies (Art. 18 of Regulation (EC) No. 765/2008) and for the measures they need to be equipped with (Art.19 of Regulation (EC) No. 765/2008). Additionally, it stipulates information requirements for European bodies (Art. 17, 22, 23 of Regulation (EC) No. 765/2008) and provides for a cooperation network between Member State and European entities (Art. 24-26 of Regulation (EC) No. 765/2008).

15.3 Conclusion

In this contribution I was able to validate the thesis formulated by Hans Micklitz in his early years. The Cassis de Dijon case, with a little help from the Commission, has indeed fundamentally changed the concept of internal market regulation and continues to do so today at various levels. It built the cornerstone of a new understanding of harmonization at European level.[141] It provided the EU legal system for the first time to develop specifically autonomous EU legal concepts such as the '(conditional) principle of mutual recognition', the 'confident consumer', and the 'information paradigm', which could neither be explained by the EU law's heritage from international law, nor through functional comparison as one of the

policies/single-market-goods/regulatory-policies-common-rules-for-products/new-legislative-framework/.

[141] P Craig and G de Búrca, *EU Law*, 594 ff.

prevailing methods for law interpretation in the EU. The concepts derived from Cassis de Dijon hence provided EU law for the first time with its own identity and regulatory logic.

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Chapter 16
Who Does What? On the Distribution of Competences Among the European Union and the Member States

Jan M. Smits

Abstract The aim of this contribution is to investigate how viable criteria can be found for the optimal distribution of competences among the EU and the member states. The question of 'who does what' belongs to the most important questions one can ask in multilevel legal orders such as the European Union. It is a question that goes to the root of thinking about not only the foundations of European private law, but also of law in general in a globalising society. My starting point in discussing the issue is that the debate on distribution of competences in the EU should not be seen as merely a sign of Euro-scepticism. It would be wrong if the British and Dutch governments have the preconceived view that certain competences surely do not belong at the European level. But this is, unlike the reading of the German and French governments, not my interpretation of these initiatives. Cameron and Rutte seem to aim for an objective assessment of the question at which level a competence belongs. This is confirmed by the first six reports published as part of the British review of competences. These reports are rather positive and generally highlight the benefits of European integration for the UK.

16.1 Introduction

On 23 January 2013 the British Prime Minister David Cameron gave his much publicised speech on the future of the European Union.[1] Next to the announcement that the United Kingdom will hold a referendum on its membership of the

[1] D Cameron, *EU Speech at Bloomberg* (2013). A transcript of the speech is available at www.gov.uk/government/speeches/eu-speech-at-bloomberg.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_16,

EU,[2] Cameron pleaded for a fundamental debate on the distribution of competences among the European Union and the member states. The goal of this debate would be 'to examine thoroughly what the EU as a whole should do and should stop doing.' This message did not come as a surprise. Already in September 2012 the UK Foreign and Commonwealth Office had launched a so-called 'review of the balance of competences' on the question to what extent membership of the European Union is beneficial or not to the British national interest.[3] This audit should be completed at the end of 2014.[4]

The United Kingdom does not stand alone in its desire to consider which competences belong where (the 'who does what'-question). In June 2013 the Dutch government headed by Prime Minister Mark Rutte published an 'inventory' of 54 topics that should preferably be dealt with at either the national or the European level, inspired by the motto that things should be dealt with 'European if necessary, national if possible.'[5] This 'subsidiarity exercise' had been announced as a precursor to a 'common debate in the European Union on the extent to which the current distribution of competences among the EU and national governments is fit for the future.'[6] The leader of one of the main parties in Dutch Parliament had in a previous stage even proposed his own list of competences belonging to The Hague and not to Brussels, including topics as diverse as pregnancy leave, cookie-legislation, procurement of smaller projects and various aspects of environmental law.[7] The list of the Dutch government itself includes, among many other things, insurance of natural and man-made disasters, harmonisation of criminal procedure and substantive criminal law, a ban on refillable olive oil jugs in restaurants, school milk and fruit programmes, freedom and pluralism of the media, tunnel safety and gender balance of non-executive directors of companies.

The question of 'who does what' belongs to the most important questions one can ask in multilevel legal orders such as the European Union. It is a question

[2] A referendum on the question 'Do you think that the United Kingdom should remain a member of the European Union?' should be held after the elections for the House of Commons in 2015 and before 2018. See draft European Union (Referendum) Act 2013 of 14 May 2013.

[3] See Secretary of State for Foreign and Commonwealth Affairs, *Review of the Balance of Competences between the United Kingdom and the European Union*, presented to Parliament, July 2012, Cm 8415 and www.gov.uk/review-of-the-balance-of-competences. The Review claims: 'Now is the right time to take a critical and constructive look at exactly which competences lie with the EU, which lie with the UK, and whether it works in our national interest.'

[4] The 32 reports will become gradually available at www.gov.uk/review-of-the-balance-of-competences.

[5] Letter of Dutch Minister of Foreign Affairs, 21 June 2013, MIN-BUZA-2013.184321; Inventory EU-legislation for subsidiarity and proportionality—Dutch list points of action.

[6] Letter of Dutch Prime Minister Rutte and Minister of Foreign Affairs Timmermans of 29 January 2013, DIE-2013.5904.

[7] List of Sybrand Buma, MP. See J. Visser, 'Buma: een sterk en zelfbewust Europa weet ook wat het niet moet doen' ('a strong and self-conscious Europe also knows what it must not do'), *De Volkskrant* 5 February 2013.

that goes to the root of thinking about not only the foundations of European private law, but also of law in general in a globalising society. This makes it an excellent topic to be discussed in a *liber amicorum* for someone whose work always aims to take up fundamental issues of the transforming European legal order.[8] My starting point in discussing the issue is that the debate on distribution of competences in the EU should not be seen as merely a sign of Euro-scepticism. It would be wrong if the British and Dutch governments have the preconceived view that certain competences surely do not belong at the European level. But this is, unlike the reading of the German and French governments,[9] not my interpretation of these initiatives. Cameron and Rutte seem to aim for an objective assessment of the question at which level a competence belongs. This is confirmed by the first six reports published as part of the British review of competences. These reports are rather positive and generally highlight the benefits of European integration for the UK.[10]

The aim of this contribution is to investigate how viable criteria can be found for the optimal distribution of competences among the EU and the member states. There is every reason for taking up this question. When the Eurozone crisis was at its peak, both German Chancellor Merkel[11] and President of the European Commission Barroso[12] pleaded, against Cameron, for far-going European integration in the form of a political Union. With so much political dispute on the desired level of integration, it seems highly useful to establish what it is that academia can contribute. This was rightly seen by the Royal Netherlands Academy of Arts and Sciences that, in 2011, published a list of 49 questions that should in the coming years be given priority when doing research. Only two questions were of direct relevance for legal scholars, including the question formulated as 'Will we soon live in the United States of Europe?'[13] The 'who does what'-question seems to come close to this one.

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[8] See e.g. R Brownsword, H Micklitz et al., *The Foundations of European Private Law* (Oxford, Hart Publishing, 2011).

[9] German Chancellor Angela Merkel and French President Francois Hollande rejected Cameron's request to participate in the study. See George Parker, 'Cameron snubbed over Brussels review' *Financial Times* 1 April 2013.

[10] Review of the Balance of Competences between the United Kingdom and the European Union: report on The Single Market, 2013 ('That integration has brought to the EU, and hence to the UK, in most if not all observers' opinions, appreciable economic benefits'); report on Health, 2013 ('Overall, based on the evidence submitted, stakeholders felt that the current balance of competence between the EU and the UK was considered to be broadly appropriate.'), available at www.gov.uk/review-of-the-balance-of-competences.

[11] See e.g. 'Germany's Chancellor Merkel urges EU political union', *BBC News Europe* 7 June 2012.

[12] JM Barroso, 'The speed of the European Union can no longer be the speed of the most reluctant member', *The Observer* 13 November 2011.

[13] KNAW, *Nederlandse wetenschapsagenda* (Amsterdam, KNAW, 2011).

16.2 State-of-the-Art: Focus on Subsidiarity and Federalism

16.2.1 Introduction

It is generally assumed that the European Union can be best described as a multi-level legal system.[14] With increasing European integration the creation of rules has to a large extent become a shared competence of both national legislatures and the European Union. The national competence to be active in a certain field often overlaps to such an extent with the European competence that only qualifications such as 'fusion' of regulatory levels[15] or 'network governance'[16] still do justice to reality. This is not only caused by a greater significance of 'Europe', but also by increasing assignment of competences to the sub-national, supranational and functional level.

The existing literature concentrates on two main aspects of Europe as a multi-level polity. First, political scientists aim to *describe* the emergence of authority beyond the State and to *explain* it in terms of political theories.[17] Second, legal scholars seek to *classify* the competences as laid down in the European treaties.[18] In addition, they work on how *conflicts* between the different levels of government should be solved in the absence of an overarching institution responsible for ensuring coherence and unity of law—the EU Court of Justice having only limited ability to fulfil this role.[19] The *normative* question of which competences belong at which level of government has thus remained largely uncharted territory. The state-of-the-art on this question can be best described by reference to what legal academics (2.1), economists (2.2) and political scientists (2.3) have to say on this.

[14] See e.g. L Hooghe and G Marks, *Multi-Level Governance and European Integration* (Lanham, Rowman & Littlefield, 2001); H Enderlein, S Wälti and M Zürn (eds), *Handbook on Multi-level Governance* (Cheltenham, Edward Elgar, 2011); W van Gerven and S Lierman, *Algemeen deel 40 jaar later* (Antwerpen, Kluwer, 2010).

[15] See e.g. W Wessels, 'The Constitutional Treaty: Three Readings from a Fusion Perspective' (2005) 43 *Journal of Common Market Studies* 11.

[16] See e.g. M de Visser, *Network-Based Governance in EC Law* (Oxford, Hart Publishing, 2009).

[17] For an overview: A Benz and C Zimmer, 'The EU's competences: the "vertical" perspective on the multilevel system', (2010) 5 *Living Reviews in European Governance* No. 1, www.livingreviews.org/lreg-2010-1.

[18] See B de Witte and G De Burca, 'The delimitation of powers between the EU and its member states' in A Arnull and D Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford, Oxford University Press, 2002) 201.

[19] Cf. for example C Joerges, 'Interactive adjudication in the Europeanisation process? A demanding perspective and a modest example' (2000) 8 *European Review of Private Law* 1; JM Smits, 'Plurality of Sources in European Private Law, or: How to Live with Legal Diversity?' in R Brownsword et al (eds), *The Foundations of European Private Law* (Oxford, Hart Publishing, 2011) 323.

16.2.2 The Legal Approach: Distribution of Competences and Subsidiarity

The 'who does what'-question does not emerge in a traditional view of law, in which the nation-state is the natural *locus* to create rules. The traces of this approach are still visible in European law. Despite the ever-increasing influence of European law on national legal orders, the treaties do not give criteria for the attribution of competences to the European Union. On the one hand, the Treaty on the Functioning of the European Union (TFEU) lists three types of competences: next to exclusive competences (as in the field of customs union and competition: art. 3), the Treaty mentions shared competences (as in internal market, environment and consumer protection: art. 4) and supporting competences (such as protection of human health, culture and education: art. 6). On the other hand, art. 5 of the Treaty on European Union codifies three classic principles of European law. The principle of conferral makes explicit that the EU only has the competences attributed to it by the treaties and that any other competences remain with the member states. In addition, the exercise of these competences by the Union is governed by the principle of proportionality and, in so far as shared competences are concerned, the principle of subsidiarity.[20] Nothing can be concluded from this about the optimal distribution of competences.

This justifies the conclusion that the underlying reasons for attributing a competence to the European level are highly political.[21] However, the decision of the EU on *how* it decides to exercise its non-exclusive competences is clearly governed by law and in particular by the principles of subsidiarity and proportionality. Under the principle of subsidiarity, the EU shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member states (art. 5 (3) TEU). Yet, in the 20 years since this principle was codified—it was inserted into the Treaty of Maastricht (1992) in order to ease concerns of the member states about increased powers of the EU—it did not develop into a useful criterion for the vertical distribution of competences. Subsidiarity suggests that decisions are to be taken at the lowest appropriate level of government, but it remains unclear what is 'appropriate.' The EU Protocol on the application of the principles of subsidiarity and proportionality (1997) indicates that subsidiarity is a dynamic concept that should be applied in the light of the objectives set out in the Treaty and that legislation should be enacted 'as closely as possible to the citizens of the Union', but this does not offer much guidance either. Subsidiarity was therefore criticised for not provid-

[20] On all this: PP Craig and G De Búrca, *EU Law: Text, Cases, and Materials*, 5th edn (Oxford, Oxford University Press, 2011) 73 ff.

[21] In this sense also GA Bermann, 'Taking subsidiarity seriously: federalism in the European Community and the United States' (1994) 94 *Columbia Law Review* 331 and E Noam, 'The Choice of Governmental Level in Regulation' (1982) 35 *Kyklos* 278.

ing an 'effective limit',[22] being 'empty'[23], leading to an 'exercise in speculation',[24] and was even referred to as a 'weasel word'.[25]

The present lack of clarity about the meaning of subsidiarity is also not solved by the Court of Justice of the European Union, which has exercised self-restraint in developing practical criteria for the appropriate degree of centralisation: although it does exercise a procedural review of the grounds brought forward by the European legislature to justify the proposed measure, it does not see itself as suited to develop substantive criteria.[26] This 'light touch review'[27] by the Court makes it relatively easy for the European Commission to take the initiative for legislative action. It remains to be seen to what extent this will change as a result of the European Commission's Impact Assessment Guidelines,[28] asking to examine for each measure whether European action is justified.[29] With this, the importance of subsidiarity lies primarily in the fact that it forces the European legislature to give reasons for its intended actions and to consider whether other norm-givers would not be better suited to deal with a given problem.

In the context of the so-called 'European Convention' (2002–2003), an extensive debate took place regarding competences in the failed draft European Constitution (2003). The approach was to first identify categories of competences (legislative and non-legislative) and then to assign policy areas to each of these. However, also in the context of this well-documented[30] process, there was no real discussion about the substantive reasons for assigning a certain competence to one of the relevant levels of government. The same can be said of subsequent treaty revisions, including the latest major reforms brought about by the Lisbon Treaty (2009).

The preliminary conclusion is therefore that it is fair to say that at the moment there are no viable substantive legal criteria for the allocation of competences within the European polity. Although the TEU and TFEU succinctly indicate what are the competences of the EU, it remains unclear what are the exact criteria for conferring exclusive competences to the EU and how the subsidiarity principle is to serve as an effective mechanism to allocate concurrent and supporting competences. This

[22] P Craig, 'Institutions, power, and institutional balance' in P Craig and G De Búrca (eds), *The Evolution of EU Law*, 2nd edn (Oxford, Oxford University Press, 2011) 41.

[23] A Estella de Noriega, *The EU Principle of Subsidiarity and its Critique* (Oxford, Oxford University Press, 2002).

[24] Bermann, 'Taking subsidiarity seriously', 335.

[25] F Easterbrook, 'Federalism and European Business Law' (1994) 14 *International Review of Law and Economics* 125, 126.

[26] Cf Case C-84/94 *UK v Council* [1996] ECR I-5755 and A Portuese, 'The principle of subsidiarity as a principle of economic efficiency' (2011) 17 *Columbia Journal of European Law* 231.

[27] Craig, 'Institutions, power, and institutional balance', 41.

[28] European Commission, *Impact Assesment Guidelines*, 15 January 2009, SEC (2009) 92.

[29] The ever-increasing use of impact assessments will surely contribute to a better application of subsidiarity. Cf. A Meuwese, *Impact Assessment in European Union Lawmaking* (Alphen aan den Rijn, Kluwer Law International, 2008).

[30] Available through www.european-convention.eu.int/EN/bienvenue/bienvenue2352.html?lang=EN.

raises the question whether these criteria can be derived from other disciplines than the law.

16.2.3 The Economic Approach: The 'Economics of Federalism'

Unlike legal scholars, economists have extensively dealt with the 'who does what'-question. The theory of (fiscal) federalism provides a general normative framework for the assignment of functions to different levels of government. According to this theory, things must be dealt with at a higher level if they create cross-border effects (as with certain types of environmental pollution) or if economies of scale can be achieved.[31] This means, for example, that the central government must take the responsibility for macroeconomic stability and income redistribution through taxes and for public goods like defence. Lower levels of government must provide goods and services of which the consumption is limited to the own jurisdiction because the efficient level of output of a local public good will vary across jurisdictions.

Several arguments plead in favour of this allocation at the lowest possible level of government.[32] The first is that local governments are closer to their constituency and have therefore better knowledge of the preferences of local people and of other local conditions. Decentralised regulation will thus also allow for better citizen involvement in the democratic process. The second argument is that the central government cannot vary levels of public output across jurisdictions because it is expected to treat everyone as equal, an argument already made by De Tocqueville[33]: the national legislator has to uniformly apply laws, which does not suit the diversity of customs and districts. A third argument is that decentralisation provides an effective mechanism for constraining government: competition among decentralised governments can limit monopolist behaviour by the central government and make government more responsive.[34] The legal diversity resulting from this will usually also better facilitate experimentation with innovative solutions.[35]

Despite the importance of these general insights, they do not offer much guidance as to which level of regulation is best for dealing with a certain topic. The conclusion that Kerber[36] reaches on basis of a survey of economic criteria similar to

[31] Benz and Zimmer, 'The EU's competences'.

[32] WE Oates, 'Toward a Second-Generation Theory of Fiscal Federalism' (2005) 12 *International Tax and Public Finance* 349.

[33] A de Tocqueville, *De la démocratie en Amérique* (1835, edn Paris, Gallimard, 1961).

[34] G Brennan and JM Buchanan, *The power to tax: analytical foundations of a fiscal constitution* (Cambridge, Cambridge University Press, 1980).

[35] FA Hayek, *Der Wettbewerb als Entdeckungsverfahren* (Kieler Vorträge N.S. 56, 1968).

[36] W Kerber, 'European system of private laws: an economic perspective' in F Cafaggi and H Muir-Watt (eds), *Making European Private Law* (Cheltenham, Edward Elgar, 2008) 64. See also R van den Bergh, 'Private law in a globalising world: economic criteria for choosing the optimal regulatory level in a multilevel government system' in M Faure and A van der Walt (eds), *Globalization and Private Law* (Cheltenham, Edward Elgar, 2010) 57.

those just discussed, is that the optimal solution depends completely on the specific circumstances: we lack easy and clear answers. In addition, it has always remained controversial whether theories of federalism can be applied to the European context: the European Union is not a federal state and this calls for cautiousness in relying on federalist theories of competence assignment.

16.2.4 The Contribution of Political Science

In so far as the political science literature deals with the assignment of competences, it bases itself on the economics of federalism or on theories of multilevel governance. However, the normative question of the optimal distribution of competences is not a particularly thriving part of academic political science. Taking this scarcity in to account, Scharpf notes that the conceptual tools of political science are ill suited to deal with multilevel interactions.[37] Political scientists working on the European Union usually find the main reason for decentralisation in the democratic deficit at the European level, pointing in the direction of making use of national democratic procedures.[38] This is in line with the thesis of Schumacher that 'Small is Beautiful', pointing out that, when designing institutions, it is better to have many small autonomous units combined with a large-scale coordination, than one supranational regulator.[39] However, political science also recognises that the coordinating and regulatory functions are the most effective if taken up at the EU-level. This inherent tension is difficult to solve in general terms. Benz and Zimmer therefore rightly claim that 'the recommendations for the allocation of competences between nation states and the EU remain rather abstract and rarely refer to particular policies.'[40]

Frey and Eichenberger have sought to replace the territorial allocation of competences by a functional one.[41] In their model of functionally overlapping competing jurisdictions (FOCJ), they assume that the need and demand for public services do not run parallel to the organisation of nation-states. They therefore argue that overlapping functional jurisdictions should not only exist, but also ought to compete for the support of citizens. But trading in territorial for functional governance does not necessarily solve the question of how to distribute the relevant competences. Treisman (2007) was therefore able to conclude that political scientists find it 'hard to

[37] Cf. FW Scharpf, 'Notes towards a theory of multilevel governing in Europe' (2001) 24 *Scandinavian Political Studies* 1.

[38] See e.g. P Salmon, 'Assigning powers in the European Union in the light of yardstick competition among governments' in MJ Holler et al (eds), *Jahrbuch für Neue Politische Ökonomie* (Tübingen, Mohr Siebeck, 2003) 197.

[39] EF Schumacher, *Small is Beautiful: a Study of Economics as if People Mattered* (London, Blond & Briggs, 1973).

[40] Benz and Zimmer, 'The EU's competences', 8.

[41] B Frey and R Eichenberger, *The new democratic federalism for Europe: functional, overlapping and competing jurisdictions* (Cheltenham, Edward Elgar, 1999).

reach any general conclusion whether (…) decentralisation will improve or impair the quality of government or economic performance.'[42]

16.3 Gaps in Present-Day Scholarship and a Search for Criteria

16.3.1 Introduction: Problems of the Present Approach

The above overview shows that the disciplines of law, economics and political science provide only little information on the optimal distribution of competences within the European polity. The academic focus is on classification of existing (politically established) competences and on explaining shifts from the national to the European level rather than on finding an answer to the assignment question. And in so far as the literature does deal with optimal allocation of competences, it suffers from three major deficiencies.

First, it provides only very general criteria that, if being applied to concrete policy fields, give little guidance or point at best in different directions. The way in which the subsidiarity principle is applied, namely to a large extent as an empty concept only lightly reviewed by the EU Court of Justice, is exemplary. This gives the entire debate about the optimal distribution of competences a highly abstract character. No doubt there are advantages of decentralised law making and a case for central regulation can be made if a measure is to be sufficiently effective or is to address external effects or economies of scale, but this does not tell us much about *when exactly* this is the case. Clearer guidelines are needed to transform the abstract into practical terms.

Second, the available literature does not sufficiently distinguish between different policy fields. It is not likely that the optimal level of decentralisation should be the same in fields as divergent as, e.g., consumer protection, financial regulation, environmental policy and labour law. Each of these fields aims to pursue different goals and it is likely that these goals will shape the optimal distribution of authority. There is therefore little hope of finding new ex ante (top-down) criteria *of a general nature* to delineate European from national competences. This calls for a thorough discussion of assignment in specific fields.[43]

Third, the available theories largely leave open what is to be understood under 'competences', 'government,' 'governance' or 'regulation.' Yet, it is clear that a discussion of which level of decentralisation is appropriate for each kind of ac-

[42] D Treisman, *The architecture of government: rethinking political decentralization* (Cambridge, Cambridge University Press, 2007) 274.

[43] D Wildason, 'Comment on "Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects" by Vito Tanzi' in M Bruno and B Peskovic (eds), *Annual World Bank Conference on Development Economics* (Washington D.C., World Bank, 1996) 323; Estella, *EU Principle of Subsidiarity*; Portuese, 'The principle of subsidiarity'.

tivity requires a clear view of what the government intervention exactly consists of.[44] This, again, differs from one field to another. While the debate in European consumer law is mainly about methods to achieve a more coherent and more uniform European *acquis* (e.g. by aiming for more maximum harmonisation or by creating optional instruments), the discussion in criminal justice focuses on institutions (such as the establishment of a European Public Prosecutor's Office) and in financial services on supervisory mechanisms and the tightening of rules on risky financial transactions. This prompts the need for identifying different dimensions of competence.

16.3.2 How to Make Progress?

The above raises the question how to make progress in the search for criteria on an optimal distribution of competences. This is also the question that prime ministers Cameron and Rutte—in my perhaps naïve reading of their plans—will have to ask themselves if they are after an objective assessment of who should do what in the European polity. In this section I will sketch the framework that forms in my view the way forward and that consists of two separate elements.

First, the *existing* distribution of authority among the European Union and the member states must be mapped in a better way. At present, authority is usually described in terms of the EU-competences as laid down in the European treaties. This may lead to an adequate description in the rare situation in which the EU has exclusive powers (although also in that case the member states still have a role to play), but reliance on formal texts is certainly not an effective means to describe shared and supporting competences. In these two situations, the treaties do not provide guidance on who does what. This calls for an alternative method to describe the existing distribution of authority, preferably by way of objective indicators that inform us about the extent to which a certain policy field is shaped by European and national sources. A quantitative description could be based on the work of Osterkamp and Eller,[45] who measure the degree of decentralisation in a certain field on basis of the sub-national actors' share of total public expenditures in a certain field. This description can be supplemented with a qualitative analysis of the de facto use of authority by the European Union and the member states. This is not only useful to compare the present situation with the normative findings. It also has self-standing importance as giving more insight into the actual European influence in some important policy fields.

Second, *normative* criteria for the optimal assignment of competences must be developed for various policy fields. There are two methodological challenges in doing so. The first is that what is 'optimal' always depends on a valuation of the relevant policy goals that one aims to achieve in a certain field. There will always be a

[44] Cf. JAW van Zeben, *Competence Allocation and Regulatory Functioning: A Study of the European Union Emissions Trading Scheme* (PhD-thesis, University of Amsterdam, 2012) 22 ff.

[45] R Osterkamp and M Eller, 'How decentralised is government activity?' (2003) 1 *Journal for Institutional Comparisons* 32.

tension between, e.g., internalising externalities or achieving economies of scale on the one hand, and the realisation of local preferences or legitimacy through citizen participation on the other. One can reasonably argue about which of these goals is more important in the circumstances of the case. Second, particular objectives may rise and fall in prominence over time, changing economic and social circumstances and changing visions of Europe. Hence, it is far from it that an optimal distribution of competences can be codified for once and for all. However, I do believe that it is possible to develop parameters with which one can work in any field, but that have to be weighed differently in the various policy fields.

These parameters can be found in (1) the *dimensions* of competence, (2) the *factors* relevant to the assignment of a competence, (3) the *techniques* to balance these factors against each other and (4) the *goals* of European integration in the policy field in question. Finally (5), it is important to involve the extent to which it is burdensome to change the existing division of competences (*path dependence*). The interaction between these five parameters provides a flexible framework for optimal distribution. Each of these parameters will now be briefly discussed.

The first parameter consists of the various dimensions of competence. These can be found in rule setting, implementation and enforcement (including supervision). It was already made clear in the above that a clear view of what the government intervention exactly consists of must be an essential element of the discussion on competences.

The second parameter consists of the factors relevant to the assignment of the competences. These 'assignment indicators' are local preferences (in case these are too divergent, there is less room for European intervention), responsiveness (including the extent to which information can be made available to different regulators: if it is difficult for the EU to obtain the necessary information, this calls for regulation at a lower level), the desire to internalise externalities, the capacity of governments at different levels to effectively set, implement and enforce rules, achieving economies of scale, the desire to experiment with different solutions, the risk of a race to the bottom, legitimacy (including citizen participation) and legal-systematic arguments. This last factor is particularly interesting in the field of private law: European influence in this field is often regarded as having adverse affects on the informative value and transparency of the law, prompting the need to avoid fragmentation by a greater role of either the national or the European legislatures and courts.

Third, special attention must be paid to the question of how to balance the various assignment indicators. In traditional views of balancing, it is impossible to do so without a common metric. For example, if the value of experimentation with diverse solutions is to be weighed against the benefits of centralised law making, one would need a common standard that may be difficult to find. However, this does not mean that rational reasoning is impossible. Even if criteria providing a definitive method for resolving conflicts between competing values cannot be found, it is still possible to define the steps that are necessary to reach the optimal outcome.[46]

[46] J Bengoetxea, L Moral Soriano and N MacCormick, 'Integration and integrity in the legal reasoning of the European Court of Justice' in G De Búrca and J Weiler (eds), *The European Court of Justice* (Oxford, Oxford University Press, 2001) 43.

This is likely to lead to a greater coherence of the decision to assign a task to a given level of government.

The fourth parameter concerns the goals of European integration that are to be achieved in the specific policy field. The question of how to balance the assignment indicators ultimately depends on alternative views of the European polity as a whole. It is obvious that a Europe primarily driven by market integration and economic efficiency will weigh the assignment indicators in a different way than a Europe driven by concerns of social justice. Put differently: normative ideas about a legitimate political order will influence the outcome. This calls for relating the question of optimal allocation to different models of the (future development of the) European polity.[47]

The fifth and final parameter concerns the extent to which the existing division of competences stands in the way of achieving an optimal distribution. Even if balancing of the first four factors would lead to the result that existing European competences—after treaty change or renegotiation of regulations and directives—must be 'repatriated', this is not always desirable. Rules of European origin have often become so much part of the national legal order that they are difficult to separate there from. In addition, the mere fact that the European Union would 'give back' a competence does of course not mean that the existing law changes automatically. European legislation, the national implementations thereof and the case law of the EU Court of Justice and national courts remain intact and will have to be amended by legislatures and possibly the courts. This can be expensive[48] and, more importantly, it can be questioned whether the new rules will substantively differ very much from the present law. For example, in the Dutch discussion an oft-mentioned example of a topic that should not be dealt with by the EU is maternity leave. However, Dutch law protects women better than the 14 weeks that European law offers them.[49] This makes the discussion about competences in this field largely obsolete.

16.4 Finally: The Academic Challenge

Robust criteria for the distribution of competences in the European Union are needed in order to investigate for different policy fields whether more or less European integration is needed. A lack of criteria tends to lead to unrealistic expectations on what the European Union can achieve. The typical reaction in times of economic

[47] M Jachtenfuchs, T Diez and S Jung, 'Which Europe? Conflicting Models of a Legitimate European Political Order' (1998) 4 *European Journal of International Relations* 409.

[48] See on this 'path dependence' also B de Witte and A Thies, 'Why Choose Europe? The Place of the European Union in the Architecture of International Legal Cooperation' in S Blockmans et al (eds), *The Legal Dimension of Global Governance: What Role for the EU?* (Oxford, Oxford University Press, 2013) 23.

[49] Dir 92/85/EC on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding, [1998] OJ L 348/1.

crisis is for example to plea for more and deeper integration. Barroso spoke of 'either unite or face irrelevance',[50] while Habermas claimed that 'more Europe' is the only right answer to the Eurocrisis.[51] However, these are highly debatable theses. Transfer of more competences to the EU is not only politically difficult (as the recent example of the Banking Union proves), it is probably also not required. It is not the size of the political community that is decisive for effectively solving a problem, but the extent to which a goal can be achieved in the most effective way.[52] In this respect Cameron is right: in the last few decades, too little thinking was put into the optimal assignment of competences.[53] This contribution is a plea to take this view seriously. The proposed framework for assignment of competences would allow to apply a uniform set of parameters to different policy fields in order to answer the 'who does what'-question. The further elaboration of such a framework should rank high on the academic agenda.

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[50] Barroso, *The Observer*.

[51] J Habermas, 'Bringing the Integration of Citizens into Line with the Integration of States' (2012) 18 *European Law Journal* 485.

[52] Cf. G Majone, 'Patterns of Post-national Europe: the Future of Integration after the Crisis of Monetary Union' (unpublished paper presented at the conference Democracy and Law in Europe, University of Helsinki, 27–28 September 2012), who mentions 'social and cultural cohesion, clear objectives, and great flexibility.'

[53] Cameron, EU Speech at Bloomberg: 'Let us not be misled by the fallacy that a deep and workable single market requires everything to be harmonised, to hanker after some unattainable and infinitely level playing field.'

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Chapter 17
Do We Need 'Consumer Protection' for Small Businesses at the EU Level?

Jules Stuyck

Abstract I will discuss the protection of small businesses (SMEs) along the lines of consumer protection, i.e. the protection of the weaker business party against the stronger business partner. I will limit my essay to Union law initiatives and in particular my questioning of the necessity of such protection will only relate to this level. Obviously that question is linked to the internal market. At the EU level the protection of small (and medium sized) businesses is rather new. As will be seen hereafter, this protection is taking shape in the form of an extension of existing consumer protection measures to SMEs and sometimes to all businesses. The adoption of further consumer protection type of measures for small businesses is on the agenda of the Commission in at least two respects: unfair commercial practices and unfair contract terms, although the proposals made or contemplated in both area's amount to try to remedy the same phenomenon: the imbalance in bargaining power between large and small businesses. In this essay I will briefly look at these new instruments in the light of the only objective that could justify them: the approximation of the laws of the Member States which have as their object the establishment and functioning of the internal market (Article 114 TFEU).

17.1 Introduction

Hans has been a friend for many years. Not so long ago he reminded me and the consumer law community that we first met in 1983 or 1984 and that we have worked together and still work together in many projects.[1] I have always admired Hans for his solid theoretical background, his tremendous workforce and productivity and

[1] H-W Micklitz, 'Unfair Contract Terms—Public Interest Litigation before European Courts—C-415/11' in E Terryn, G Straetmans and V Colaert (eds), *Landmark Cases of EU Consumer Law* (Antwerp, Intersentia, 2013) 615.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_17,

the creativity of his mind.[2] He has also been and still is my bad conscience. Since I am perhaps (more) easily seduced by critical arguments against the way consumer protection is legally organised, I need people like Hans to remind me of the consumer as a market participant who is intrinsically weaker than his counterpart, the business, and of the fact that Europe unfortunately houses a great number of vulnerable consumers who should not be excluded from the benefits of the welfare state.

Hans and I do not always agree, and Hans may not even agree with this contribution to his *liber amicorum*, but we largely concur on the necessity to take care of a good balance of forces in the market and to recognize the social and societal dimension of consumer law.

Hans has written extensively on consumer law, the internal market and regulatory private law. In my contribution to this book that is written in Hans' honour I would like to discuss a matter in which I think he is very much interested in but which we have not (often) discussed: the protection of small businesses (SMEs) along the lines of consumer protection, i.e. the protection of the weaker business party against the stronger business partner. I will limit my essay to Union law initiatives and in particular my questioning of the necessity of such protection will only relate to this level. Obviously that question is linked to the internal market.

Apart from exemptions from competition and state aid rules for SMEs the only genuine Union legislative instrument in the area of small business protection so far is the commercial agency directive.[3] The commercial agent is identified as the weaker party and therefore is granted contractual protection in particular with regard to the unilateral termination of the agency agreement by the principal. This directive is very limited in scope: it only concerns the commercial agent who is active in the distribution of goods.

More recently legislation with a broader scope has been adopted or proposed to protect small and medium sized enterprises: the Services Directive[4] (Articles 20 and 22), the proposal for a Regulation on a Common European Sales Law (CESL) and the recent Green Paper on Unfair Trading Practices. These different instruments will be discussed hereafter. The provisions I mentioned of the Services Directive (non-discrimination of recipients of services and information duties on service providers) actually apply irrespective of the quality of the recipient: consumers and businesses (large and small) alike.

The idea to protect SMEs on the market is rather novel at the EU level but it is already present in several Member States. Especially in Germany, Hans' country of origin, the idea that honest businesses (typically the small incumbent trader) should be protected against their less honest competitors and professional contract parties lives very much, and probably more than any other EU country.

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[2] H-W Micklitz, 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?', *Gutachten A zum 69. Juristentag* (Munich, CH Beck, 2012).

[3] Dir 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents [1986] OJ L 382/17. One could also mention the Late Payments Directive (Dir 2011/7/EU); however its aim is not specifically to protect SMEs but creditors in cross-border commercial transactions.

[4] Dir 2006/123/EC on services in the internal market [2006] OJ L 376/36.

This is clear when one looks at unfair competition law and the law of unfair contracts terms.

The German Law on Unfair Competition (Gesetz gegen unlauteren Wettbewerb of 1909, the mother of all laws on unfair competition, including the Austrian and the Belgian), contained a very strong protection against unfair competition, in particular with a view to protecting small business (Mittelstand). In 2004 this law has been replaced by a more modern one, stressing the virtues of effective competition. Later, in 2008, the UWG of 2004 was amended in order to transpose into German law the UCPD (Directive 2005/29/EC on B2C unfair commercial practices). At the same time Germany is one of the countries where apart from effective antitrust rules (Gesetz gegen Wettbewerbsbeschränkungen, GWB) and strict rules on unfair competition there are specific statutes to protect weaker businesses against discrimination and other forms of abuse of bargaining power.[5]

As said above, at the EU level the protection of small (and medium sized) businesses is rather new. As will be seen hereafter, this protection is taking shape in the form of an extension of existing consumer protection measures to SMEs and sometimes to all businesses.

The adoption of further consumer protection type of measures for small businesses is on the agenda of the Commission in at least two respects: unfair commercial practices and unfair contract terms, although the proposals made or contemplated in both area's amount to try to remedy the same phenomenon: the imbalance in bargaining power between large and small businesses.

The first initiative is the proposal for a Regulation on a Common European Sales Law (CESL),[6] containing an optional instrument for cross-border B2C contracts and for B2B contracts if at least one of those parties is a small or medium-sized enterprise ('SME') (Article 7(1) 'Chapeau').[7] The second one is the proposed amendment of the Misleading and Comparative Advertising Directive[8] and the third one the Green Paper on Unfair Trading Practices in the Supply Chain.[9]

In this essay I will briefly look at these new instruments in the light of the only objective that could justify them: the approximation of the laws of the Member States which have as their object the establishment and functioning of the internal market (Article 114 TFEU).

17.2 The Proposal For A Common European Sales Law and the Protection of SMEs

The Explanatory Memorandum of the Proposal for a Common European Sales law (hereafter CESL) starts with the following paragraph:

[5] § 20 GWB.

[6] COM(2011) 635 final.

[7] Art 7(2), see further in the text.

[8] COM(2012) 702 final.

[9] COM(2013) 37 final.

'Differences in contract law between Member States hinder traders and consumers who want to engage in cross-border trade within the internal market. The obstacles which stem from these differences dissuade traders, small and medium-sized enterprises (SME) in particular, from entering cross border trade or expanding to new Member States' markets. Consumers are hindered from accessing products offered by traders in other Member States.'

This optional instrument (the body of uniform provisions on sales law that the proposal contains would only apply—instead of the national law that would normally apply—where parties have agreed on its application) is indeed primarily designed to facilitate cross-border business by SMEs (large businesses very often have a subsidiary in the countries where they sell and hence are fully integrated in the local legal environment) where these SMEs are sellers. It also aims at raising consumer confidence. It is believed that both small businesses (as sellers) and consumers (as buyers) will be more confident in engaging in cross-border transactions where they are not confronted abroad (especially when selling, respectively buying online) with rules that are different from those they know, i.e. those of their own Member State. But CESL also aims at the protection of small businesses as buyer in a cross-border transaction.

Article 7 of the "chapeau" reads as follows:

'Parties to the contract

1. The Common European Sales Law may be used only if the seller of goods or the supplier of digital content is a trader. Where all the parties to a contract are traders, the Common European Sales Law may be used if at least one of those parties is a small or medium-sized enterprise ('SME').
2. For the purposes of this Regulation, an SME is a trader which

   a. employs fewer than 250 persons; and
   b. has an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million, or, for an SME which has its habitual residence in a Member State whose currency is not the euro or in a third country, the equivalent amounts in the currency of that Member State or third country.'

According to Article 13(b), Member Sates may decide to make the CESL provisions available to contracts where all the parties are traders but none of them is an SME within the meaning of Article 7(2).

Notwithstanding Article 7(2), the significance of CESL for SMEs is not identical to its significance for consumers. Indeed CESL contains a certain number of provisions that are only mandatory where the buyer is a consumer, not when the buyer is an SME (examples).

Sometimes the protective regime is different for consumers and SMEs.

The most notable example is chapter 8 on Unfair contract terms with provisions that are similar to those of the consumer acquis, ie Directive 93/13/EEC on unfair contract terms in consumer contracts:[10] an unfair term is not binding on the contract

[10] [1993] OJ L 95/29.

party of the party who has supplied it. In a contract between a trader and a consumer a contract term supplied by the trader which has not been individually negotiated is unfair where it causes a significant imbalance in the parties' right and obligations to the detriment of the consumer, contrary to good faith and fair dealing. Contrary to Directive 93/13/EEC, which only contains a general clause and an indicative list of terms that can be considered unfair, CESL contains a list of contract terms which are always unfair and a list of contract terms which are presumed to be unfair in B2C relations. While Directive 93/13/EEC applies to B2C contracts only, CESL contains a specific provision (Article 86) on unfair contract terms in contracts between traders, Article 86:

'Meaning of "unfair" in contracts between traders

1. In a contract between traders, a contract term is unfair for the purposes of this Section only if:
   a. it forms part of not individually negotiated terms within the meaning of Article 7; and
   b. it is of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing.
2. When assessing the unfairness of a contract term for the purposes of this Section, regard is to be had to:
   a. the nature of what is to be provided under the contract;
   b. the circumstances prevailing during the conclusion of the contract;
   c. the other contract terms; and
   d. the terms of any other contract on which the contract depends.'

However in B2B relations there is no black or grey list.

This idea to protect businesses against unfair contract terms is clearly influenced by German law.[11]

17.3 The Reform of the MCAD

After the adoption of a full harmonisation directive on B2C unfair commercial practices in 2005, the UCPD,[12] which integrated the rules on misleading advertising towards consumers in a broader set of rules on 'commercial practices', the orphan provisions on misleading advertising towards businesses and those on comparative advertising of the initial misleading advertising Directive 84/450/EEC[13] as amended by Directive 97/55/EC on misleading and comparative advertising,[14]

[11] On the German law on standard terms see P Ulmer, E Brandner and H Hensen, *AGB-Recht*, 11th ed (Cologne, Otto Schmidt, 2011).

[12] [2005] OJ L 149/22.

[13] [1984] OJ L 250/17.

[14] [1997] OJ L 290/23.

have been consolidated in Directive 2006/114/EC on misleading and comparative advertising.[15] The rules on B2B misleading advertising are minimum harmonisation provisions.

In its Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions entitled 'Protecting Businesses against Misleading Marketing Practices and ensuring Effective Enforcement',[16] the Commission proposed a review of Directive 2006/114/EC concerning misleading and comparative advertising. Contrary to the unfair commercial practices Directive 2005/29/EC that applies to B2C relations and covers all unfair commercial practices, Directive 2006/114/EC only prohibits misleading advertising vis-à-vis businesses and does not address other forms of unfair conduct between businesses.

In this Communication the Commission states that its assessment of problems around the Misleading and Comparative Advertising Directive (MCAD) shows that legislative action is necessary as the current legislative framework has several deficiencies, both as regards substantive rules and enforcement (procedural rules). The Commission therefore intends to table a proposal to strengthen the protection of businesses against cross-border misleading marketing practices. This proposal, to amend the Misleading and Comparative Advertising Directive, will be complemented by a forthcoming initiative addressing unfair trading practices between businesses in the retail chain.[17]

The revision of the MCAD will target specific areas of concern. It will clarify the interplay of the Directive with the Unfair Commercial Practices Directive. It will also focus on improving the effectiveness of cross-border enforcement, and strengthening the key substantive provisions.

One of the innovations proposed by the Commission is the introduction of a black list: a list of the most harmful misleading marketing practices that are prohibited in all circumstances, i.e. without necessity of an *in concreto* appraisal in the light of the general standard on what is misleading.

In its Communication the Commission mentions a certain number of practices. It proposes to black list practices relating to misleading payment forms, offers to extend internet domains, misleading directory companies etc.

In a Report adopted on 22 October 2013, the European Parliament adopted a resolution on this Communication.[18] It welcomes the initiative and supports more in particular the Commission's intention to investigate the possibility of introducing, on the basis of validated criteria, an EU-wide black list of misleading marketing practices. The Parliament also recommends that such a blacklist should be coherent with that which already exists under the UCPD, it should be exhaustive and should include clear definitions of misleading marketing practices.[19]

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[15] [2006] OJ L 376/21.

[16] COM(2012) 702 final.

[17] See COM(2013) 37 final.

[18] 2013/2122(INI).

[19] See point 7 of the Resolution.

One may question the approach consisting in black listing practices, as in the UCPD: the list will never be conclusive and, as the UCPD shows, even per se prohibitions (practices that are prohibited in all circumstances) will generally require an *in concreto* analysis by the judge. In B2B relations restrictions to the freedom of contract should always be well thought of. Too many restrictions to protect small businesses may lead to inefficiencies and to a stifling of competition.

17.4 The Green Paper on Unfair Trading Practices in the Supply Chain

More incisive are the proposals on which the Commission has launched a consultation in its Green Paper on Unfair Trading Practices in the Business-to-Business Food and Non-Food Supply Chain in Europe.[20] One will remember that the unfair commercial practices directive of 2005, the UCPD, only applies to B2C relations. However in recital 8 of the UCPD it is said that the Commission should carefully examine the need for Union action in the field of unfair competition beyond the remit of this Directive and, if necessary, make a legislative proposal to cover these other aspects of unfair competition.

From the examples given by the Green Paper it appears already that the unfair trading practices the Commission is addressing are not similar to the unfair commercial practices that are the subject of Directive 2005/29/EC on B2B unfair commercial practices. In its Green Paper the Commission is concerned about a situation of imbalance by a stronger party (be it the supplier or the purchaser) and a weaker one. The UTPs identified by the Commission are mainly practices of powerful retail chains vis-à-vis suppliers in pre-contractual negotiations that are subsequently imbedded in contract terms (see p. 6).

In other words the Green Paper is not about unfair competition or unfair commercial practices in business relationships, but rather about the protection of SMEs against unfair contract terms. The protection of businesses, in particular SMEs, against unfair contract terms imposed by powerful contract parties, is rather uncommon in the law of the Member States. The notable exception is Germany, where the general clause of the AGBG (now § 307 BGB) also applies in B2B relations. It has been mentioned above that CESL also provides for a protection of against unfair contract terms, but it only contains a general clause and no black list.

The Green Paper in fact shares the same concern as the CESL proposal as discussed above. It is also telling that the unfair trading practices mentioned as examples by the Commission are mainly based on the experience of national antitrust authorities. Existing rules on the protection of suppliers or retailers in, for example, Germany and France seem more connected to antitrust law, in particular the prohibition of abuse of a dominant position (as in Article 102 TFEU), which by definition requires a dominant position. However in the supply chain dominant positions are rare.

[20] COM(2013) 37 final.

The Commission rightly observes that the competition rules of the Treaty do not deal expressly with exploitative conduct if it is not an abuse of a dominant position. It could be added that the fight against exploitative conduct (as opposed to exclusionary conduct) is not even a policy priority of the European Commission in applying the competition rules.[21]

Member States' legislation against some of the practices that are pinpointed in the Green Paper (such as discriminatory conduct by large retail chains vis-à-vis suppliers) is in fact very close to antitrust law (as laid down in Articles 101 and 102 TFEU) but these practices are not caught by antitrust law proper because antitrust law only addresses unilateral conduct by a *dominant* firm.

A specific regulation of B2B unfair commercial practices at the EU level reminds us also of the existence in several Member States, of a law of unfair competition, which was also at the basis of the regulation at the EU level of misleading and comparative advertising and ultimately B2C unfair commercial practices at the EU level.

Three years ago I presented a Briefing Paper on "Addressing unfair commercial practices in business-to-business relations in the internal market" to the IMCO Committee of the European Parliament.[22] I argued that while competition law in the strict sense is not sufficient to ensure fair commercial practices in B2B relations, there is no strong case for harmonisation of this law at the EU level, in particular since there is no convincing evidence that disparities between the laws of the Member States in this field create (important) obstacles for the internal market. Failing the existence of obstacles to trade or the likelihood of the emergence of such obstacles resulting from multifarious development of national laws, The Treaty (Article 114 TFEU) does not provide for a sufficient legal basis for harmonisation.[23] I also entertained doubts about the utility of such harmonisation for B2B relations in the area of unfair commercial practices within the meaning of Directive 2005/29/EC, since that directive already covers B2B commercial practices that are also directed at consumers.[24] I also argued that the prohibition of certain B2B commercial practices could lead to restrictions of competition that would conflict with the objectives of antitrust law or to the extension of the protection of I.P. rights beyond the limits of the protection organised by specific I.P. statutes. Admittedly the Green Paper does not deal with the type of practices I had in mind, but, as indicated above, rather with unfair contract terms between businesses. My reservations regarding the legal basis remain. There is no widespread legislation in the Member States in the field concerned and it is far from obvious that the existing differences form an obstacle to cross-border trade. Be that as it may be, EU competition law, namely Article 3(3) of Regulation (EC) No 1/2003 does not oppose to the existence of diverg-

[21] See the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty [2009] OJ C 45/7.

[22] European Parliament, IP/A/IMCO/NT/2010-18, May 2011.

[23] Case C-380/03 *Germany v Parliament and Council* [2006] ECR I-11573.

[24] See Case C-304/08 *Plus Warenhandelsgesellschaft* [2010] ECR I-217; Case C-504/08 *Mediaprint* [2010] ECR I-10909.

ing rules to protect traders against abusive practices that have another objective that of the EU competition rules (i.e. the protection of weaker traders against economic against trading partners on which they are dependent).

It can be doubted that, failing the existence of obstacles to trade or the likelihood of the emergence of such obstacles resulting from multi various development of national laws,[25] the Treaty (Article 114 TFEU) provides for a sufficiently solid legal basis in this area.

Even if there would be sufficient evidence that disparities between national laws are an obstacle for the internal market (which I submit is far from certain), there may be doubts about the effective possibility of a detailed regulation at the EU level. If one looks at Directive 2005/29/EC on B2C unfair commercial practices, it appears that the black list contained in the Annex to the Directive is not much more than the added shopping lists of the Member States. If the Commission would propose a Directive or a Regulation in the area of B2B unfair trading practices, it may be advised to follow the approach of CESL, which is confined to a general clause prohibiting practices that (grossly) deviate from good commercial practice (contrary to good faith and fair dealing). Another question is how far the EU should intervene in order to protect SMEs (as it already did in the Commercial Agency Directive and the Directive on Late Payments). For one thing the distinction between big companies and SMEs is to a large extent arbitrary. But of course the approach of the Commission in its Green Paper focuses on certain types of practices rather than on bargaining power. Practices that look unfair may however be efficient. Arguments that are sometimes put forward against measures of consumer protection, that is, that they may seem right but are at the end of the day inefficient, will have an even stronger weight in the debate about the introduction of legislation at the EU level to protect businesses against unfair trading practices.

But apart from the question of legal basis and EU competence, other questions arise with regard to the possibility and the desirability of an EU legislative intervention in this area.

The first is whether in particular a *legislative* action is desirable, or whether a soft law approach would not be preferable. Second, if legislative action at the EU level would be taken, it could be questioned whether it would be feasible and appropriate to set up a list of prohibited UTPs (as suggested by the Commission).

The reactions I found so far from Member States (Netherlands and the UK) do not seem to favour a legislative approach, or at least not a legislative approach consisting of *black listing* B2B unfair trading practices.

The approach taken by the Commission in its Green Paper is both horizontal and detailed. The approach of CESL, mentioned above, is horizontal but not detailed. The Commission rightly observes that there is already in EU law a regulation, i.e. Regulation (EU) No 261/2012 as regards contractual relations in the milk and milk product sector. That regulation contains detailed rules on contractual negotiations in the milk and milk products. The Commission also mentions in its Green Paper that in the context of the legislative proposals of the reform of the Common Fisher-

[25] cf. Case C-380/03 *Germany v Parliament and Council*.

ies Policies, it has also taken a series of sector initiatives to promote a fair dealing in B2B relationships in the Fishery and Aquaculture Area. But these initiatives are sector specific. Enacting rules that apply to all sectors is something different and more incisive.

17.5 Outlook

The design of SME protection along the principles that already exist in consumer law and which is advocated by certain scholars,[26] seems to be a new trend that is likely, sooner or later, to generate a new body of EU law.

This article has not questioned the action of the EU to protect consumers. It is safe to assume that there is a quasi consensus concerning the need to protect consumers against unfair contract terms and unfair commercial practices. One may differ on the way to organise this protection and the laws of the Member States do indeed show important differences at least in respect of unfair contract term. The key difference is the choice between just a general clause, supplemented as in Directive 93/13/EEC by an indicative list, or a general clause as a safety net for those contract terms that are not black or grey listed. In the field of unfair commercial practices the UCPD, with its character of full harmonisation directive, has dictated a uniform regime: a grand general clause, two specific general clauses (on misleading and aggressive practices) and a black list. The CJEU has repeatedly stressed the basic idea behind the Unfair Contract Terms Directive namely that the consumer is in a weak position vis-à-vis the trader as regards both his bargaining power and his level of knowledge, which leads to the consumer agreeing to terms drawn up in advance by the trader without being able to influence the content of those terms.[27]

Admittedly this may also often be the case with SMEs, but, as the proposal for a CESL rightly suggests, the need of protection is therefore not the same. The regime on B2B unfair terms in CESL does not only differ from the one for B2C by the absence of a black and grey list, but the general clause sets a higher threshold of unfairness for B2B than for B2C. A term in a contract between businesses is only unfair if it is of such a nature that its use *grossly deviates from good commercial practice*, contrary to good faith and fair dealing. This approach is right, and should, it is submitted, also be followed, at the EU level in relation to B2B unfair commercial practices. Businesses, even if they are small, take an entrepreneurial risk

[26] See forcefully M Hesselink, 'SMEs in European Contract Law' in K Boele-Woelkie and W Grosheide (eds), *The Future of European Contract Law. Essays in honour of Ewoud Hondius* (Alphen aan den Rijn, Kluwer, 2007) 359.

[27] See recently CJEU, judgment of 26 April 2012, Case C-472/10 *Invitel*, not yet reported, with references to former case law.

and they are repeat players. Protecting them too much can lead to exaggerated risk aversion and to stifling competition.[28]

In the Member States that are familiar with the doctrine of unfair competition it is nowadays accepted that acts of competition should not too easily be qualified as unfair because they are contrary to what is usual or because they harm the interests of other economic operators. The general clause of the new German UWG of 2004, in its 2008 version (i.e. after implementation of the UCPD) is even limited to unfair practices that are likely to appreciably ('spürbar') prejudice the interests of competitors, consumers or other market participants. Of course as far as consumers are concerned this high threshold norm is supplemented by provisions implementing the prohibition of misleading, respectively aggressive commercial practices of the UCPD as well as its black list. But for B2B relations this is what it is (except for the provisions of the GWB on abuse of relative market power, see above).

The thresholds in the proposed rules on fairness in B2B relations with regard to contract terms (CESL) on the one hand and 'unfair trading practices' (Green Paper) on the other are fairness threshold while the threshold in the German UWG, like in antitrust law, is one of harm (or effect). But the common idea is clear: not every conduct that is unfair is prohibited in B2B relations. This is actually also the case with the unfairness of contract terms in B2C relations: the general fairness clause of Directive 93/13 indeed refers to contract terms that, contrary to the requirement of good faith, cause a *significant* imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

However in case of conduct on a black list (as under the UCPD and as proposed by the Commission in its MCAD reform and suggested in its Green paper on B2B unfair trading practices), the effect of the practice or the contract term on the weaker party does not have to be shown: a term or conduct that is blacklisted is prohibited in all circumstances, ie irrespective of its effect. A black list therefore can lead to the prohibition of conduct that in the circumstances of the case is not grossly unfair or significantly harmful. It is submitted that in B2B relations a black list should, as a matter of principle, not be contemplated.

No one will dispute that businesses have to act fairly both vis-à-vis consumers and other businesses. But a per se prohibition of certain forms of conduct in B2B relations should only be adopted where there is a general interest at stake, such as the maintenance of effective competition (cf. antitrust law) and general fairness in commercial transactions, not the protection of economic interests, be they the interests of small businesses. Providing favorable conditions for setting up SMEs is a legitimate policy objective (and it makes part of the policy of the EU) but protecting small businesses against bigger businesses cannot be the rule. Businesses are supposed to take risks and excessive protection of (small) businesses will be

[28] See J Stuyck, 'Consumer Protection and Fair Competition—One Fight?' in L Thévenoz and N Reich (eds), *Droit de la consommation—Konsumentenrecht—Consumer Law. Liber Amicorum Bernd Stauder* (Baden-Baden, Nomos, 2006) 497.

detrimental to heir sense of initiative and may, at the end, weaken their resistance against exploitative behavior of larger businesses.

It is for the Member States to decide whether they want a protection of SMES against big business with regard to contract terms and trading practices. However there is no sufficient case for further action at the EU level, going beyond the existing protection against misleading advertising and a general clause on unfair contract terms. The completion of the internal market does not make such intervention necessary.

Before continuing on the path it seems to have chosen, the European Commission should not only duly examine whether the EU legislature has the power to act in this field, but it should also consider how far it wants to go in limiting the freedom of contract and the freedom to do business where no apparent general interest is involved. It may be reminded that the Court of Justice has never accepted that the protection of businesses could be a sufficient reason for *Member States* to depart from the principles of the internal market (see the long standing case law since *Cassis de Dijon*).[29]

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[29] Case 120/78 *Rewe-Zentral v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

Chapter 18
European Social Constitution: Between Solidarity and Access Justice

Kaarlo Tuori

Abstract Is there a social dimension in the European constitution or—if you prefer another expression—a European social constitution? And if there is, what are its characteristic features? On the basis of existing case law of the CJEU, I will weave the respective two concepts of social justice in the European Union. The first of these is market justice or allocative justice: whatever is the outcome of market mechanisms is just. Here the role of the state or the transnational polity is reduced to securing the general framework conditions for market mechanisms, such as right to property and freedom of contract. This is the realm of F. A. Hayek's rules of just conduct or Robert Nozick's libertarianism. The second alternative is access justice, as Micklitz has termed it. As a rule, functioning markets do not emerge spontaneously but presuppose particular market constructing measures by a polity. I will emphasise that both concepts have some complementary effect, depending on the level on which they are applied. Transnational markets are supposed to produce increased prosperity, while national redistributive mechanisms were supposed to ensure just allotment of that prosperity. However, both concepts have also exclusionary effects: Denationalisation and deterritorialisation of social security and healthcare in the name of access justice may threaten the solidaristic foundations of national welfare regimes.

18.1 The Problem of the European Social Constitution

Is there a social dimension in the European constitution or—if you prefer another expression—a European social constitution? And if there is, what are its characteristic features?

In Treaty law, we find provisions on social values and objectives, social policy competences and even social rights. Ever since the Treaty of Rome, social values and objectives have occupied a prominent place in 'surface level' constitutional law, alongside economic values. In the Preamble to the Treaty of Rome, the Signatory

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_18,

States declared their resolution 'to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe' and affirmed 'as the essential objective of their efforts the constant improvement of the living and working conditions of their peoples'. In line with the Treaty of Rome, the Preamble to the TEU-Lisbon evokes the promotion of both economic and social progress, and assures that advances in economic integration will be accompanied by parallel progress in other fields. The value basis of the EU, as defined in Art 2 TEU, comprises values relevant for social policy, such as justice, solidarity and equality between men and women. Furthermore, Art 3 TEU includes social objectives and, in defining economic objectives, refers to their social implications as well. The Treaty of Rome also included a Social policy Title, which has gradually been amended into the shape it received in Lisbon. Social rights are a later addition; here the decisive breakthrough was only made with the Lisbon Treaty, which explicitly confirmed the legal effect of the Charter of Fundamental Rights of the European Union, including its Solidarity Chapter.

But, arguably, an agglomeration of individual provisions at the surface level of constitutional law does not yet justify talk of a social dimension in the European constitution. Should these provisions not be united by some underlying principles, a rationale which would lend the putative social constitution a degree of coherence? Starting in the late 1980s, *l'espace sociale Européen*, social Europe, European social self or the European social model have been intensively discussed, not only among European academics and NGOs, but within EU institutions and in their policy documents as well. Still doubts remain whether a distinct and commonly shared basic normative understanding of social policy, capable of sustaining individual Treaty provisions, has emerged from these debates. For many observers, socially oriented Treaty provisions, as well as secondary legislation, are of a patchwork character and not animated by a coherent social policy view. I largely agree with this assessment, especially with regard to the policy fields which lie at the core of national welfare regimes, such as social security and healthcare.

Another consideration also seems to negate the existence of a European social constitution. The emphasis in the European project has been and to a large extent still is on economic integration. This has left its mark on European constitutionalism; here, too, the focus has been on the economic aspect. Thus, so the argument goes, social policy issues have remained subordinated to the needs of economic integration and economic constitutionalism. This has prevented the development of a distinct social dimension to the European constitution: at the constitutional level, too, social policy issues have been constrained into a framework imposed by the economic constitution.

I concede the pertinence of both arguments: the lack of an underpinning normative vision of social Europe and the subjugation of social policy considerations to the needs of economic integration and constitutionalism. Yet they tell not so much of the absence of a social constitution as of two of its main characteristic features: the primacy of the national welfare state within the social dimension and the subordination of the social to the economic constitution.

The European constitution is a relational entity. It should be examined, not only in the relationship between surface level Treaty law and its underpinning rationale

or in the relationship between diverse constitutional dimensions, such as the economic and the social, but also in the relationship between the transnational European constitution and the national Member State constitutions.[1] The role of the social dimension for European integration and European constitutionalism can only be caught if we do not restrict our gaze merely to the European level but extend it to the presuppositions and repercussions of advancing transnationalisation at the national level.

Those pointing to the fragmented and patchy nature of European social legislation have mainly focused on the core fields of national welfare policy; namely, social security and healthcare. But, arguably, the particular contribution of the EU social legislator has concentrated on areas which in the national setting lie on the fringes of the welfare state: on what Hans-W. Micklitz has called European regulatory private law. And, if we accept Micklitz' argument, European regulatory private law is supported by a definite normative vision, a particular notion of justice; what Micklitz terms access justice.[2]

Doubts about the existence of a social dimension in the European constitution often arise from use of the national welfare state as a self-evident template. Our preliminary discussion shows that the social dimension of the European constitution does display distinct features and principles; these, however, are not identical to those characteristic of a national welfare state. Inclusion of the Member State level in the discussion also enables us to perceive the basic tensions permeating the European social constitution: the tension between the primacy of the national welfare state and the prevalence of the economic over the social, and the tension between European access justice and the solidaristic social justice underpinning national welfare regimes. These tensions will structure the following tentative exposition of the European social constitution.

18.2 Primacy of the National Welfare State

Member States have jealously guarded their sovereignty in social policy, especially as regards core welfare services with a redistributive effect, such as social security and healthcare. The primacy of the national welfare state in these areas has been explicitly enshrined in Treaty law. Thus, the provisions which the Union may adopt within its limited legislative competence under Art 153 TFEU 'shall not affect the right of Member States to define the fundamental principles of their social security systems and must not significantly affect the financial equilibrium thereof'. In turn, Art 168(7) TFEU assures that 'Union action shall respect the responsibilities of the

[1] K Tuori, 'The Relationality of European Constitution(s)' in U Neergaard and R Nielsen (eds), *European Legal Method: Towards a New European Legal Realism?* (Copenhagen, DJØF, 2013) 23.

[2] H-W Micklitz, 'Introduction' in H-W Micklitz (ed), *The Many Concepts of Social Justice in Private Law* (London, Edward Elgar Publishing, 2011).

Member States for the definition of their health policy and for the organisation and delivery of health services and medical care'; 'the responsibilities of the Member States shall include the management of health services and medical care and the allocation of the resources assigned to them'. Accordingly, ever since the Treaty of Rome, provisions on social policy have emphasised soft measures of coordination, instead of legislative competences. In Art 4(2) TFEU, social policy is included in shared competences, but only 'for the aspects defined in this Treaty'. For other aspects, Union competences are confined to coordinating Member State policies (Art 5 TFEU). Union legislative competences, granted by the Social policy Title of the Treaty, focus now as before on labour law issues; in other areas, the clear accent is on coordination.

The justifications and explanations for the primacy of the national welfare state are many. They relate to democratic legitimacy and the bounded nature of solidarity; cultural, ideological and economic differences among Member States; and the fiscal resources that welfare policies presuppose.

Social policy, especially in the key areas of social and healthcare services, is about redistribution based on value choices, and such redistribution entails an enhanced need for democratic legitimacy. As long as the EU is afflicted by the notorious democratic deficit, this need can only be met at the national level. A shift of emphasis in social policy from national to European level would engender a new legitimacy deficit. Moreover, it could jeopardise the overall legitimacy of national political regimes which in post-war Western Europe has largely derived from the fair (re)distribution of increasing prosperity through welfare-state mechanisms.

Redistributive welfare policy is underpinned by a solidaristic notion of social justice. Solidarity as a moral or ethical principle is intimately linked to solidarity as a sociological fact. Redistributive social policy draws on and presupposes solidarity among the members of the polity. In turn, solidarity—in the sociological sense of the term—builds on common history, values and identity. In spite of increasing and intensifying cross-boundary ties among European citizens, up to now the necessary cultural basis for such solidarity has only existed at the national level. Consequently, the post-war welfare state has inevitably been a national project. Cultural divergences and particular national historical trajectories and traditions also account for differences in welfare-state ideologies and normative commitments. These differences are manifest in, for instance, varying perceptions of the respective tasks of the state, the market and the 'third sector', as well as in the respective weight of financial transfers and public services in kind as instruments of social policy.

Comparative research has shown the great variance of the ideological, institutional and financial choices of Member States in defining and organising their welfare regimes. The relative homogeneity among the six original Bismarckian welfare states has long since been broken. Member States' welfare regimes do not make up a uniform European Social Model. Scholars have proposed diverse groupings, starting from Gosta Esping-Andersen's already classic division into Anglo-Saxon liberal, Central and Southern European corporatist, and Nordic social democratic

welfare states.[3] Cultural diversity, resulting in 'bounded' solidarities and divergent conceptions of social policy, goes a long way to explaining the tenacity with which Member States try to shield their welfare regimes, both within the Union constitutional and ordinary legislature and before the ECJ as the Union constitutional court.

Redistribution through welfare state measures would be impossible without sufficient fiscal resources. A central principle of the European economic constitution is Member States' fiscal sovereignty, which covers the right of taxation. The Maastricht Treaty and introduction of the Economic and Monetary Union left this principle intact. The Eurozone crisis has opened inroads into Member States' sovereignty, but the decisive step in the direction of fiscal federalism has not (yet) been taken. Hence, the EU simply does not possess the indispensable fiscal means to act as a transnational welfare state. As the German Constitutional Court noted in its Lisbon decision, fiscal-policy and social-policy competences are inextricably bound together. For the Constitutional Court, both these policy fields belong to the core competence which the principle of democracy prohibits from being transferred to the transnational level.[4]

Even where the EU possesses legislatives competences in social policy, outside the coordination of cross-border social security and healthcare their use has been scarce. Member States' concerns about their sovereignty, the cultural, ideological, institutional and financial variance of their social-policy regimes and their economic differences, greatly accentuated by the latest enlargements, make it extremely difficult to reach consensus on legislative measures, in particular outside such fields of 'encapsulated federalism' [5] as labour law and antidiscrimination law. This not only explains for its part the primacy of the national welfare state, but forms the backdrop to the structural asymmetry which in the EU favours judicial before legislative decision-making and negative before positive integration.[6] It also explains why social policy, especially in those fields central for national welfare states, belongs to the favoured province of the open method of coordination, lending EU social policy in the core welfare fields its voluntaristic label.[7]

From the very beginning, the primacy of national welfare states has been a pivotal principle of the European social constitution. Still, this does not mean that national redistributive mechanisms would have been indifferent to the European integration process. Economic integration has been premised on the existence of national welfare states. As Florian Rödl has argued, the European project was underpinned by

[3] G Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton, Princeton University Press, 1990).

[4] BVerfG, 30/6/2009, 123 *Entscheidungen des Bundesverfassungsgerichts* 267.

[5] W Streeck, 'Neo-Voluntarism: A New European Social Policy Regime' (1995) 1 *European Law Journal* 31.

[6] FW Scharpf, *Governing in Europe—Effective and Democratic?* (Oxford, Oxford University Press, 1999); FW Scharpf, 'The asymmetry of European integration, or why the EU cannot be a "social market economy"' (2010) 8 *Socio-Economic Review* 211.

[7] Streeck, 'Neo-Voluntarism'. See on open method of coordination in the social dimension KA Armstrong, *Governing Social Inclusion: Europeanization through Policy Coordination* (Oxford, Oxford University Press, 2010).

the fundamental idea of economic integration leading to increased prosperity which national public and corporative mechanisms would then (re)distribute in a socially fair way. Leaving national mechanisms of distribution and redistribution intact was an integral part of the social compromise between capital and labour which supported the European project.[8]

However, the primacy of national welfare states has proved to be difficult to reconcile with another central principle of European constitutionalism: the prevalence of the economic over the social. The European economic constitution both presupposes and limits Member State autonomy and responsibility in welfare policy.

18.3 Restrictions and Justifications of Free Movement

The European economic constitution comprises two layers: a microeconomic one, centred around free movement and competition law, and a macroeconomic one, centred around the EMU provisions and principles and introduced in Maastricht. In what follows my emphasis will be on the repercussions for the social constitution of the microeconomic constitution. Suffice it to say that the macroeconomic constitution, too, both presupposes national redistributive policies and imposes restrictions on them. The fiscal constraints of the Maastricht macroeconomic constitution reduced the latitude for national social policy. On the other hand, the Maastricht macroeconomic principles assumed that Member States would create sufficient room for manoeuvre for their automatic stabilisers, which on the public expenditure side are largely identical to legal entitlements to social benefits. The recent crisis has at least partly repudiated this assumption: instead of relying on the automatic-stabiliser function of social expenditure, the worst hit Member States in particular have resorted to cutting social benefits.[9]

The microeconomic constitution may inflict limitations on national welfare regimes in two different ways: first, by treating national social policy measures as restrictions on free movement or competition, and, secondly, by subjecting national welfare services themselves to internal market law. The jurisprudence of the ECJ has been crucial in staking out the boundaries of Member State sovereignty in social policy. As is well known, through the doctrines of the primacy and direct effect of Community Law, introduced by *Van Gend en Loos* and *Costa v Enel*,[10] the ECJ constitutionalised internal market law and established itself as a constitutional court vis-à-vis Member State legislation. The next step was to specify the implications

[8] F Rödl, 'The Labour Constitution' in A von Bogdandy and J Bast (eds), *Principles of European Constitutional Law* (Oxford, Hart, 2010).

[9] Klaus Tuori and I have discussed the two layers of the European economic constitution as well as the impacts of the Eurozone crisis in the social dimension in Kaarlo Tuori and Klaus Tuori, *Eurozone Crisis—A Constitutional Analysis* (Cambridge, Cambridge University Press, 2014).

[10] Case 26/62 *Van Gend en Loos v Administratie der Belastingen* [1963] ECR 1; Case 6/64 *Flaminio Costa v Enel* [1964] ECR 585.

of Treaty-based internal market law and to eradicate obstacles to the functioning of the internal market perceived as deriving from Member State measures. Through the prism of negative integration, the Court even examined Member State socially oriented legislation as a potential restriction on fundamental economic freedoms or undistorted competition.

In applying free movement law, the crucial questions are: First, what constitutes a restriction on free movement? And, secondly, what constitutes an acceptable justification for such a restriction? The first wave of ECJ case law focused on free movement of goods, where *Dassonville* and *Cassis de Dijon* summarised the Court's position.[11] Art 34 of the Treaty of Rome (now Art 34 TFEU) prohibited 'quantitative restrictions on imports and all measures having equivalent effect'. The *Dassonville* formula, adopted by the ECJ in 1974, adopted a wide definition of national measures which could have an effect equivalent to that of quantitative restrictions. The definition encompassed 'all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade are to be considered as measures having an effect equivalent to quantitative restrictions' (para 5). Through the *Dassonville* doctrine, the ECJ extended its constitutional jurisdiction to socially motivated national legislation in the fields of, say, consumer or worker protection or public health, where the Community did not at that moment have any legislative competence. Judicial legislation pursuing negative integration did not acknowledge the boundaries which circumscribed legislative competence for positive integration.[12]

As acceptable justifications for restricting free movement of goods, Art 36 of the Treaty of Rome (now Art 36 TFEU) listed 'grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic historic or archaeological value; or the protection of industrial and commercial property'. In *Cassis de Dijon*, the ECJ adopted the concept of mandatory requirements and stretched its scope beyond the wording of the Treaty provision to include 'in particular (…) the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer' (para 8). With the qualification 'in particular', the formula intimates the openness of the mandatory requirements.[13] Hence, even if social rights or other social viewpoints were not expressly invoked in *Cassis de Dijon*, the ECJ may still recognise them as mandatory requirements, too. Indeed, especially after Maastricht, the ECJ has conceded

[11] Case 8/74 *Procureur du Roi v Benoît and Gustave Dassonville* [1974] ECR 837; Case 120/78 *Rewe-Central AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

[12] Consequently, the ECJ has assessed national legislation on, for instance, working hours and price regulations as restricting free movement of goods.

[13] *Cassis de Dijon* is memorable for introducing the doctrine of not only mandatory requirements but also mutual recognition. The latter doctrine opened the way for regulatory competition among Member States with its potential 'horizontal' impact on national welfare regimes, see in more detail K Purnhagen, 'The Virtue of Cassis de Dijon 25 years later—It is Not Dead, it Just Smells Funny', in this volume.

the relevance of social policy justifications; it has referred to Treaty provisions on social objectives and argued that the Union serves not only an economic but also a social purpose. However, like other mandatory requirements social viewpoints have yet to prove their force in the proportionality test—a 'cost-benefit' assessment—which constitutes the final phase in the Court's argument.[14] It is worth noting that the ECJ has not included in the proportionality test any democracy or sovereignty premium containing second-guessing national legislation by a transnational court.

After the internal market programme and the SEA were adopted in the second half of the 1980s, the Court's attention shifted to free movement of services. In this field, too, the ECJ has established itself as a constitutional court, competent to assess and, after a proportionality test, strike down socially oriented national legislation or comparable measures which it deems an unjustifiable restriction on free movement. The structure of the Court's argument has been analogous to that formulated for free movement of goods in *Dassonville* and *Cassis de Dijon*. The Court has treated as a restriction any measure which is liable to hinder or make less attractive the provision or receipt of cross-border services or the exercise of the right of establishment. Analogously to the interpretation of free movement of goods, no discriminatory purpose or effect is needed.[15] Corresponding to the notion of mandatory requirements introduced in *Cassis de Dijon*, the Court has departed from the wording of the relevant Treaty provision and adopted a broader concept of imperative reasons which may justify restricting free movement of services and which may include considerations of social policy, too.[16] In the widely debated

[14] In 1995, *Gebhard* formulated the proportionality test in the context of freedom of establishment as follows: 'national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it'. Case C-55/94 *Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, para 37.

[15] In *Säger*, the Court pointed out that Art 59 of the Treaty on the freedom to provide services 'requires not only the elimination of all discrimination against a person providing services on the ground of his nationality but also the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another Member State where he lawfully provides similar services'. C-76/90 *Säger v Dennemeyer & Co*., [1991] ECR I-4421, para 12.

[16] In *Säger*, the Court stated as 'a fundamental principle of the Treaty' that 'the freedom to provide services may be limited only by rules which are justified by imperative reasons relating to the public interest and which apply to all persons or undertakings pursuing an activity in the State of destination, in so far as that interest is not protected by the rules to which the person providing the services is subject in the Member State in which he is established. In particular, those requirements must be objectively necessary in order to ensure compliance with professional rules and to guarantee the protection of the recipient of services and they must not exceed what is necessary to attain those objectives.' (para 15). With regard to the right to establishment see *Gebhard*. Roth and Oliver note that 'the case law of the Court of Justice, starting in the 1980s and more so in the 1990s (…) brought a definite move towards a broader concept of restrictions that are to be abolished', see P Oliver and W-H Roth, 'The Internal Market and the Four Freedoms' (2004) 41 *Common Market Law Review* 407, 411.

Viking and *Laval* rulings the Court explicitly recognised the relevance of social purposes as a potential justification.[17]

18.4 Extension of Internal Market Law to Welfare Services

Viking and *Laval* applied a proportionality test, not to national legislation, but to collective trade union action. This gave the rulings a specific flavour, and in the Nordic countries they were largely experienced as threatening the exceptionally vital role which trade unions and collective agreements have played in those countries, not only in determining terms of labour in a narrow sense, but labour-related social policy in general. Still, in standard cases socially oriented measures which the Court examines as potential restrictions on free movement consist of state legislative or administrative measures. Usually these are not located in the core area of the national welfare state but remain on the outer ring of labour and consumer law and general measures promoting public health.[18]

A potentially much more serious threat to Member State autonomy in the choice of national welfare models arises from constitutional case law which deals with healthcare and social security as themselves subject to internal market law. In its rulings on social security or healthcare services, the ECJ habitually refers to Treaty provisions confirming Member State sovereignty in these crucial areas of national welfare regimes. However, the Court has not considered these provisions an obstacle to subjecting core welfare services to constitutional internal market law, thus establishing an internal hierarchy within EU constitutional law under the primacy of the economic constitution.[19]

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[17] In *Viking*, the Court stated that 'since the Community has … not only an economic but also a social purpose, the rights under the provisions of the Treaty on the free movement of goods, persons, services and capital must be balanced against the objectives pursued by social policy, which include, as is clear from the first paragraph of Article 136 EC, inter alia, improved living and working conditions, so as to make possible their harmonisation while improvement is being maintained, proper social protection and dialogue between management and labour'. C-438/05 *International Transport Workers' Federation and Finnish Seamen's Union* [2007] ECR I-10779, para 79. See also C-341/05 *Laval un Partneri* [2007] ECR I-11767, paras 104–105.

[18] *Cassis de Dijon* itself concerned national legislation with a public health objective.

[19] In *Watts*, for instance, the Court first invoked the present Art 168(7), confirming Member State sovereignty in the field of public health, but then added an important qualification: 'That provision does not, however, exclude the possibility that the Member States may be required under other Treaty provisions, such as Article 49 EC, or Community measures adopted on the basis of other Treaty provisions, such as Article 22 of Regulation No 1408/71, to make adjustments to their national systems of social security'. C-372/04 *Watts v Bedford Primary Care Trust and Secretary of State for Health* [2006] ECR I-04325, paras 146 f. In the rulings on social security schemes, the refrain is that 'according to settled case-law, Community law does not detract from the power of the Member States to organise their social security systems'. This is followed by the qualification that 'the Member States must comply with Community law when exercising that power'. See, eg,

In applying internal market law to welfare services, the two issues of the existence of a restriction and its justification are preceded by qualification of the service at issue: is it an economic service for the purposes of free-movement and competition law? According to present Art 57 TFEU, 'services shall be considered to be "services" within the meaning of this Treaty where they are normally provided for remuneration'. For the ECJ the essential characteristic of remuneration is that it constitutes consideration for the service in question. Remuneration need not necessarily be paid by the recipient but can, for instance, be covered by insurance. In turn, competition law is applied to 'undertakings'. For the Court, an undertaking is any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed. In turn, an activity is economic if it is, or could be, performed in a competitive market. The scope of application of free movement and competition law is largely identical: if a service is considered economic for the purposes of competition law, it is provided for remuneration and falls under free movement law, too.[20] In the context of both free movement and competition law, the decisive dividing line runs between economic and non-economic services. Most of the case law of the ECJ specifying this line in healthcare focuses on free movement, while the categorisation of social security services has primarily been discussed under competition law. Yet, competition law is relevant for healthcare, too, as is free movement law for social security.

An important string of healthcare cases has dealt with cross-border healthcare; more specifically, the right of a patient to reimbursement from the social security scheme of the country of affiliation for treatment received in another Member State. In a number of cases, the Court has held that both ambulatory healthcare and treatment received in hospital are services for the purposes of free movement. After affirming the applicability of free movement law, the Court has proceeded to discussing refusal of reimbursement as a potential restriction on freedom to provide—and receive—services. The fact that the country of affiliation has adopted a National Health Service (NHS) system, based on publicly owned hospitals providing health service free of charge or for symbolic compensation, does not affect the relevance of freedom of service for cross-border healthcare. What is essential is the character of the service received in the other Member State. Services in a NHS system are not of an economic character, nor are public hospitals providing them undertakings for the purposes of competition law.[21] This does not, however, relieve a NHS country from its obligation to reimburse costs of healthcare services of an economic nature received in another Member State. I shall come back to this case law when discussing coordination of cross-border welfare services.

C-157/99 Geraets-Smits v.Stichting Ziekenfonds and Peerbooms v Stichting CZ Groep Zorgverzekeringen [2001] ECR I-05473, paras 44 f.

[20] G Davies, 'The Process and Side-Effects of Harmonisation of European Welfare States' (2006) *NYU School of Law, Jean Monnet Working Paper 02/06*, http://www.jeanmonnetprogram.org/papers/06/060201.html, 15–17.

[21] Case T-319/99 *FENIN* [2003] ECR II-357, paras 39 f.

The issue of locating social security schemes with regard to the boundary separating non-economic from economic services has arisen in cases where a person or a company covered by a compulsory scheme has refused to pay a contribution, claiming that compulsoriness violates constitutional competition law. Starting from *Poucet and Pistre*,[22] the Court has developed a set of criteria for judging whether or not a social security fund is an undertaking and subject to competition law. Social purpose as such does not exclude a fund from the scope of competition law; social purposes can be realised through both economic, market-oriented, and non-economic action. By contrast, the principle of solidarity, adhered to in financing the scheme and determining the benefits, appears to be the decisive criterion. Solidarity may take diverse forms. It may be internal and confined to the clients of the fund; that is, its beneficiaries and contributors. But solidarity may also extend beyond the clients and be manifest in external subsidies from the state—taxpayers—or from other funds. What is crucial for both internal and external solidarity is that financing is not based on 'capitalisation'[23] and that the benefits clients receive are not directly linked to the contributions they have paid. Social purpose and non-profit making are relevant but not decisive criteria.

If the Court has found a social security fund to be an undertaking, it has then examined whether the compulsoriness of the scheme amounts to an exclusive right within the meaning of Art 106(1) TFEU (previously Art 90(1) TEC) and, if it does, constitutes an unjustified restriction on competition. Art 106(2) TFEU (Art 90(2) TEC) allows for restrictions of competition in favour of 'undertakings entrusted with the operation of services of general economic interest' if restrictions are necessitated by the undertakings' particular tasks. In *Albany*, the Court held it to be decisive whether a restriction on competition deriving from the exclusive right of a social security fund had been 'necessary for the performance of a particular social task of general interest with which that fund has been charged'.[24]

The social function or traits of solidarity of a social security fund have not sufficed to exclude it from the concept of undertaking. By contrast, the Court has deemed these features relevant when assessing the justifiability of the restriction of competition which the compulsory nature of a social security scheme entails. In *Albany*, the Court first invoked the essential social function of the supplementary pension scheme at issue within the country's pensions system. Secondly, in the Court's assessment the fund displayed a high level of (financial) solidarity, which rendered its services less competitive than comparable services provided by insurance companies and went towards justifying the exclusive right granted to the fund. The Court inferred that 'the removal of the exclusive right conferred on the Fund

[22] Joined cases C-159/91 and C-160/91 *Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon* and *Pistre and Caisse Autonome Nationale de Compensation de l'Assurance Vieillesse des Artisans* [1993] ECR I-637.

[23] In the Court's case-law, 'capitalization' refers to dependence of entitlements on contributions paid and the financial results of the scheme.

[24] C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie*, with joined cases C-115/97, C-116/97 and C-117/97 [1999] ECR I-5751, para 98.

might make it impossible for it to perform the tasks of general economic interest entrusted to it under economically acceptable conditions and threaten its financial equilibrium' (paras 109–111).

The treatment of core welfare services in EU law and Commission documents is labelled by notable conceptual fuzziness. Thus, bringing social security schemes under the concept of services of general economic interest, introduced by Art 106(2) TFEU (Art 90(2) TEC), may seem somewhat surprising. The standard reading of the concept primarily invokes infrastructure services vital for the economy in general, such as telecommunications and other network industries or postal and transport services. In its characterisation of the rationale of the exemption established by Art 106(2) TFEU (Art 90(2) TEC), the Court, too, has stressed considerations of economic and fiscal policy.[25] In contrast, the general interest welfare services promote is primarily non-economic rather than economic in character.

The Court's argument for treating social security schemes as services of general economic interest has been rather sparse. In *Albany*, decisive for the justifiability of the restriction on competition was whether the exclusive right of the pension fund and the ensuing restriction of competition 'may be justified under Article 90(2) of the Treaty as a measure necessary for the performance of a particular social task of general interest with which that fund has been charged'. This intimates that 'performance of a particular social task of general interest' would suffice to bring the service under 'services of general economic interest'. This would in effect entail collapsing 'social' into 'economic'. But another reading is possible, too: when privileging undertakings entrusted with services of general economic interest, Member States are free to pursue other, including social policy, objectives.[26] But even if social interests can legitimately be pursued, should one not, as a precondition for applying the exemption provided by present Art 106(2) TFEU, first establish that the undertaking also fulfils general economic interests as well? It may well be that compulsory social security funds can be shown to further not only social but also general economic interests. However, in *Albany*, for instance, the Court by-passed this issue. It is hard to avoid the impression that in order to strengthen the application of internal market law to services, the Court has preferred to employ a rather wide definition of 'economic activity' and 'undertaking', but, as a counter-balance, has also wanted to acknowledge the relevance of Member States' solidarity-related

[25] 'In allowing, in certain circumstances, derogations from the general rules of the Treaty, Article 90(2) of the Treaty seeks to reconcile the Member States' interest in using certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and preservation of the unity of the common market.'

[26] Indeed, in for instance *Brentjens* the Court has argued that 'in view of the interest of the Member States thus defined they cannot be precluded, when determining what services of general economic interest they entrust to certain undertakings, from taking account of objectives pertaining to their national policy or from endeavouring to attain them by means of obligations and constraints which they impose on such undertakings'. Joined cases C-115/97 to C-117/97 *Brentjens' Handelsonderneming BV v Stichting Bedrijfspensioenfonds voor de Handel in Bouwmaterialen* [1999] ECR I-6025, para 104.

justifications for their compulsory social security schemes. This has required a liberal interpretation of the concept of services of general economic interest and the exemption from competition law provided by present Art 106(2) TFEU.

In many Member States the ECJ's application of internal market law to services raised concerns about their sovereignty over the organisation and financing of core welfare services. The amendments introduced by the Treaty of Amsterdam responded to those concerns, but did not diffuse the conceptual haziness surrounding welfare services; rather the contrary.

The Treaty of Amsterdam included services of economic interest among the shared values of the Union and pointed to their role in promoting social and territorial cohesion. It also obliged the Union and the Member States to secure that "such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions" (Art 16 TEC-Amsterdam). The Lisbon Treaty amended this provision by entrusting the ordinary legislator with the task to "establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services" (Art 14 TFEU). An additional Protocol attached to the Lisbon Treaty introduced into constitutional law the concept of services of general interest, already employed in Commission documents. The obvious implication is that services of general interest fall into two groups: those of non-economic and those of economic general interest, the latter addressed by Arts 16 and 106(2) TFEU. Art 2 of the Protocol assures that 'the provisions of the Treaties do not affect in any way the competence of Member States to provide, commission and organise non-economic services of general interest'. This was intended to alleviate Member State worries about their autonomy vis-à-vis core welfare services. However, the legal significance of the concept of non-economic services of general interest and the guarantee provided by Art 2 of the Protocol remains unclear.

In its effort to ensure the implementation of internal market law in the service sector, the Court has enjoyed the full support of the Commission, expressed in Commission Communications and legislative initiatives, largely aiming at codifying the Court's jurisprudence. The most controversial legislative initiatives have been the proposals for the 2006 Services Directive and the 2011 Patients' Rights Directive. Several Member States pushed for excluding welfare services from the Services Directive. In the end, social security schemes, in contrast to healthcare, were not explicitly left out, which means that if they meet the criteria of economic services the Directive is relevant. As regards healthcare, the Preamble to the Services Directive states that cross-border healthcare would be addressed in another legal instrument (Recital 21). That instrument turned out to be the Patients' Rights Directive.[27] The background of both the Services Directive and the Patients' Rights Directive in internal market law rather than social policy considerations is manifest in the fact

[27] Dir 2006/123/EC on services in the internal market [2006] OJ L376/36; Dir 2011/24/EU on the application of patients' rights in cross-border healthcare [2011] OJ L88/45.

that both directives were issued under Art 114 TFEU, allowing harmonisation for the purpose of the establishment or functioning of the internal market.[28]

18.5 Welfare Services of Mobile Workers and Citizens

Above, we have discussed two instances where Member State social policy has been subjected to constitutional internal market law: case law where national social policy measures have been treated as restrictions on free movement and case law where national welfare services have themselves been assessed under the micro-economic constitution. Our brief overview of constitutional developments promoting negative integration has shown the central role of judicial legislation. As the Services Directive and the Patients' Rights Directive exemplify, political legislation has mainly stepped in only ex post, for the purpose of codifying the constitutionally anchored case law of the ECJ.

The distinction between negative and positive integration does not necessarily coincide with that between market construction and market correction. Thus, positive integration can aim at, not only market correction, but market construction as well. And this, arguably, is the case with much of the EU secondary legislation pursuing either coordination or harmonisation of national welfare regimes.

In the negotiations paving the way for the Treaty of Rome, harmonisation of social security was expressly rejected, while transnational legislative competence for coordinating national social security was only granted to the extent deemed necessary for establishing the common market. Coordination did not aim at 'independent' social aims but was seen in instrumental terms, as a means of serving economic integration. Tellingly enough, the only specific social legislative competence in the Treaty of Rome was located, not in the Social policy Title but in the Free movement Title; that is, among provisions of economic rather than social constitutional law. The instrumental tone is conspicuous in the wording of Art 51 (now Art 48 TFEU), which obliged the Community legislator to adopt 'such measures in the field of social security as are necessary to provide freedom of movement for workers'.

The wording of the Treaty provision also implies that it does not possess direct effect but presupposes secondary legislation. Still, through its rulings on this secondary legislation, the ECJ has played an important role in developing constitutional law on cross-border social security, too. In turn, the Court's case law has induced legislative amendments. In cross-border social security, the ECJ has pursued the integrationist line which has in general labelled its reading of the core provisions of the economic constitution. However, perhaps slightly paradoxically, the Court's

[28] The conceptual situation has been further complicated by the concept of social services of general interest which the Commission has employed in its documents but which does not appear in Treaty rulings or ECJ rulings. See Communication from the Commission, Implementing the Community Lisbon programme: Social services of general interest in the European Union, COM(2006) 177 final.

liberal interpretation of primary and secondary legislation has also contributed to detaching cross-border social security from the internal market perspective.

The Court has adopted an extensive interpretation of both the personal and substantive scope of the central legislative instrument issued under Art 51 of the Treaty of Rome: Social security Regulation (EEC) No 1408/71.[29] The Court gradually expanded the personal reach of the Regulation from migrant workers and their dependants to all economically active persons, as well as future and former workers, such as students and pensioners. In the Court's interpretation, the substantive scope, in turn, comprises not only the traditional 'Bismarckian' labour-related benefits, mostly of a contributory character, but reaches out to non-contributory benefits as well.

Originally, the *Leitbild* of social security coordination was the mobile worker.[30] The inclusion of students in the early 1990s already diverged from the initial *Leitbild*, but the decisive turning point came with the introduction of European citizenship through the Treaty of Maastricht. The mobile European citizen emerged as the new dominant *Leitbild* guiding the cross-border right to social security. In spite of the loosening of dependence on the economic constitution, this development did not signal a triumph of 'genuine' social policy objectives. Even after the citizenship turn, social policy was made on other than social policy premises, and again coordination of social security schemes was conceived of in instrumental terms. Now the general aim was to promote the mobility not merely of economically active persons for the sake of economic integration but of European citizens in general for the sake of broader societal integration.

Introduction of European citizenship was due to the constitutional speech act of the constitutional legislator, but the Court was responsible for drawing the social policy conclusions. Acting as a constitutional court, the Court in its case law on cross-border social security rights set aside Regulation 1408/71 and invoked the right of EU citizens 'to move and reside freely within the territory of the Member States', explicitly enshrined in the Treaty (now Art 21(2) TFEU). As the ECJ ruled in *Baumbast*,[31] this Treaty provision possessed direct effect; hence, realisation of the citizenship right of free movement did not depend on secondary legislation. When an EU citizen exercises her Treaty-based right of movement, this brings her within the scope of the Treaty provision prohibiting discrimination on the grounds of nationality (now Art 18 TFEU) as well. This line of argument opened access for mobile European citizens to social security benefits in the Member State of residence. However, the Court has also shown understanding towards Member States' wish to ward off 'welfare tourism' and consequent strain on their welfare systems. The Court has made the eligibility of foreign nationals for social benefits dependent on additional criteria, related to the firmness of the bond with the state of residence.

[29] Reg (EEC) No 1408/71 on the application of social security schemes to employed persons and their families moving within the Community [1971] OJ L149/2.

[30] I have borrowed the term *Leitbild* from Hans Micklitz' writings.

[31] C-413/99 *Baumbast and R v Secretary of State for the Home Department* [2002] ECR I-7091.

Still, all restrictions on mobile citizens' social rights are subject to a proportionality test, which ultimately decides their justifiability.

The substantive reach of the right to social benefits derived from European citizenship is larger than the cross-border rights granted under Art 51 of the Treaty of Rome and Regulation 1408/71. It covers in principle all social benefits, including social assistance, which was expressly excluded from the scope of Regulation 1408/71. The constitutional basis is different, too. Citizens' rights derive directly from Treaty provisions on citizens' freedom of movement and non-discrimination, while workers' rights are dependent on secondary legislation, though presupposed by explicit Treaty law. Still, complementary secondary legislation has been issued on citizens' freedom of movement and adjacent rights to social benefits, too. Secondary legislation, though, does 'little more than codify the jurisprudence of the European Court of Justice', as Damjanovic and de Witte have put it in their clear exposition of the development of rights to cross-border social services.[32] The Court has formulated its doctrines as a constitutional court and based them directly on the Treaty, so that the doctrines narrow the leeway of the political legislator. Furthermore, because of the direct effect of the Treaty provisions on citizens' freedom of movement and non-discrimination, the list of rights expressly guaranteed to citizens by secondary legislation is not necessarily exhaustive.

Healthcare belongs to the core welfare areas where Member States have been especially attentive to their sovereignty and where the clear emphasis in Union policy lies in soft law and the open method of coordination. Here, coordination of cross-border healthcare forms an exception and constitutes a parallel case to coordination of social security. Again, social policy decisions have been taken outside the Treaty framework for social policy and primarily on other than social policy premises. And again, the institutional driving force has been the ECJ, while the contribution of the political legislator has mainly been reduced to codifying case law. The Treaty basis for the Court's activism has, though, been different. Instead of the provisions on worker or citizen mobility, primary Treaty support has been the provision on freedom to provide services (now Art 56 TFEU).

As long ago as 1984, in *Luisi and Carbone*,[33] the ECJ established that the Treaty-guaranteed freedom to provide services implies the freedom to receive them. However, in cross-border healthcare the main legal issue has not been freedom to receive healthcare services in another Member State as such, but the obligation of

[32] D Damjanovic and B de Witte, 'Welfare Integration through EU Law: The Overall Picture in the Light of the Lisbon Treaty' in U Nielsen and R Roseberry (eds), *Integrating welfare functions into EU law—from Rome to Lisbon* (Copenhagen, DJØF, 2009). The relevant directives are Dir 2004/38/EC on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States [2004] OJ L58/77, which replaced residence directives dating from pre-Maastricht time, and Reg (EC) 883/2004 on the coordination of social security systems [2004] OJ L166/1, which not only amended Reg (EEC) 1408/71 but extended the scope of the provisions to economically non-active European citizens exercising their freedom of movement.

[33] Joined cases C-286/82 and 26/83 *Luisi and Carbone v Ministero del Tesoro* [1984] ECR 377.

the home country to reimburse those services from its public insurance system. In 1998 in *Kohll* and *Decker*,[34] the Court ruled that healthcare which is funded by a public insurance system is covered by free movement law. EU citizens are entitled as service recipients to cross-border healthcare financed by their home country's insurance system, provided that the service in question is in general covered by this system. Acting once more as a constitutional court, the ECJ set aside the restrictions that Regulation 1408/71 imposed on export of healthcare benefits and based its rulings directly on Treaty law on free movement.[35] Subsequently, the Court has specified the main principles defining cross-border access to healthcare services, thereby progressively adjusting and widening the conditions originally laid down by the EC legislator in Regulation 1408/71. The Court has formulated all the crucial parameters of the scope, conditions and funding of cross-border healthcare. Again, what has remained for the Union legislator is codification of case law; this was accomplished through the Patients' Rights Directive.[36] In line with the Services Directive, the Patients' Rights Directive was issued under Art 114 TFEU, 'since the majority of the provisions of this Directive aim to improve the functioning of the internal market and the free movement of goods, persons and services' (Recital 2 of the Preamble).

The Preamble to the Directive pays lip service to Member States' responsibilities for both 'healthcare to citizens on their territory' and 'the definition of social security benefits relating to health and for the organisation and delivery of healthcare and medical care and social security benefits, in particular for sickness'. The Directive also declares that it respects and is without prejudice to the freedom of each Member State to decide what type of healthcare it considers appropriate. Furthermore, any objective of encouraging patients to seek treatment outside their Member State of affiliation is denied. Yet, in a rather contradictory way, the Preamble also defines the Directive's objective in terms of establishing rules for facilitating access to safe and high-quality cross-border healthcare and ensuring patient mobility in accordance with the principles established by the ECJ (Recitals 4, 7 and 10). And, indeed, patients' rights as defined in the Directive are rights of mobile patients and aim at transforming patient mobility within the Union from legal principles set out

[34] Case C-120/95 *Decker v Caisse de maladie des employés privés* [1998] ECR I-1831; C-158/96 *Kohll v Union des caisses de maladie* [1998] ECR I-1931.

[35] Under the Regulation reimbursement by the home insurance system presupposes urgency of treatment and prior authorisation from the patient's competent insurance institution. In *Kohll* and *Decker*, the Court found the requirement of prior authorisation justified only if it is meant to address 'the risk of seriously undermining the financial balance of the social security system' or if it pursues the protection of public health by 'maintaining a balanced medical and hospital service open to all', while ensuring 'the maintenance of a treatment facility or medical service on national territory'. This has led to a distinction between hospital care and *ambulance care*. As a rule, prior authorisation can still be required for the former but not for the latter.

[36] The main codificatory purpose was openly spelled out in the Preamble. The objective of the Directive was stated to be 'to achieve a more general, and also effective, application of principles developed by the Court of Justice on a case-by-case basis' (Recital 8).

in ECJ case law into a living reality. Empirical research has shown that in spite of ECJ jurisprudence, starting from *Decker* and *Kohll* in 1998, patient mobility has remained relatively low and has had but a minor financial impact on Member States' social security and health care systems. It remains to be seen whether the Directive and its implementation will bring about a more significant change.

18.6 Denationalisation and Deterritorialisation of Welfare Services

As many observers have remarked, expansion of rights to cross-boundary welfare services has led to a tendency of denationalising and deterritorialising national welfare regimes, with potentially grave consequences. The impact of this tendency varies according to the chosen welfare model.[37]

The familiar general groupings of European welfare states, starting from Esping-Andersen's well-known typology, are of limited help here; what is decisive is the method of financing and organising social and healthcare services. In healthcare, the main dividing line goes between National Health Service (NHS) and insurance-based systems. In the former, healthcare services are publicly funded and delivered, with patients paying merely nominal or symbolic remuneration. In the latter, public insurance schemes reimburse to patients the costs of publicly or privately delivered and financed services. In social security, a related distinction separates residence-based from insurance-based systems. In a residence-based welfare model, a person is entitled to social benefits on the basis of citizenry or habitual residence. Most benefits are universally granted and financed through taxation; they are not dependent on individual contributions. In a social insurance model, employees are insured against basic risks in accordance with the principle of *lex loci laboris*. Entitlements to social benefits are primarily financed by and dependent on individual contributions.[38] In practice, distinctions between NHS and insurance-based systems of healthcare or residence-based and social-insurance models of social security are not necessarily clear-cut, so that one and the same system may combine features from both sides of the dividing line.

Although in its rulings on cross-border social security and healthcare the ECJ habitually pays lip service to Member State sovereignty in choosing welfare models, it is evident that denationalisation and deterritorialisation affect different models in different ways. Denationalisation manifests itself in the opening of national welfare services for non-nationals: first to mobile workers and their family members; then

[37] See in particular DS Martinsen, 'The Europeanization of Welfare—The Domestic Impact of Intra-European Social Security' (2005) 43 *Journal of Common Market Studies* 1027; DS Martinsen, 'Towards an international health market with the European Court' (2005) 28 *West European Politics* 1035; AJ Menéndez, 'European Citizenship after *Martínez Sala* and *Baumbast*—Has European law become more human but less social?' (2009) *ARENA Working Paper No. 11*.

[38] Martinsen, 'Europeanization', 1038–1039.

to other economically active nationals of other Member States moving across borders; and finally even to economically non-active European citizens exercising their Treaty-based right of movement. This has particularly affected residence-based social security, traditionally a hallmark of Nordic welfare states, which have been forced to modify their rules on eligibility for social security benefits; first of all, to drop the nationality requirement within the scope of application of Social security Regulation 1408/71. Member States have also been obliged to extend the coverage of both NHS and insurance-based systems of public healthcare beyond their own nationals and long-time residents. As the ECJ put it in *Grzelczyk*, cross-border rights to welfare services have entailed 'a certain degree of financial solidarity between nationals of a host Member State and nationals of other Member States'.[39]

Denationalisation is accompanied by deterritorialisation. If denationalisation has opened national social security and healthcare systems for non-nationals, deterritorialisation has allowed participants of national systems to receive social security benefits or healthcare services in other Member States. Regulation 1408/1971 adopted the principle of exportation within its field of application and facilitated cross-border healthcare, but only after authorisation by the Member State of affiliation. The case law of the ECJ, starting with *Kohll* and *Decker* and codified in the Patients' Rights Directive, gradually expanded the possibility of exit. If residence-based models have been under particular pressure in social security, in healthcare insurance-based systems seem to be more easily adaptable than NHS systems to the combined effects of expanded possibilities of entry and exit.

Denationalisation and deterritorialisation have involved EU-induced amendments to national legislation and modifications in national models of social security or healthcare. Still, indirect impacts may be more important than legal obligations. EU law does not oblige Member States to reject their fundamental choices between residence- and insurance-based social security or between a NHS system and healthcare based on social insurance. But, arguably, insurance-based social security and healthcare can be more flexibly geared up for the liberalisation driven by the Court and the Commission. Liberalisation backed up by the Court's constitutional jurisprudence has given a boost to trends in organising and financing welfare services which the Commission labels modernisation in its Communication in 2006[40] and which Gareth Davies has characterised as a shift from provision to regulation.[41] Denationalisation and deterritorialisation may affect the substantive reach and level of welfare services, too. The prospect of non-nationals entering publicly financed welfare regimes with the ensuing additional financial liabilities or the enlarged territorial exit of nationals at the expense of the Member State of affiliation may function as an efficient break to introducing new benefits or enlarging the scope or raising the level of existing ones. Instead of upgrading, the general tendency in Member States seems rather to be towards downgrading.

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[39] Case C-184/99 *Grzelczyk v Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve* [2001] ECR I-6193, para 44.

[40] Commission Communication, Social services of general interest.

[41] Davies, 'Process and Side-Effects of Harmonisation', 53.

At the most fundamental level, denationalisation and deterritorialisation may strike at the solidarity foundations of national welfare regimes. 'Solidarity' is a polyvalent term, with diverse conceptual meanings. For the purposes of the present discussion, it is vital to draw a distinction between two significations. The first of these has been prevalent in the rulings of the ECJ on the economic or non-economic character of social services: solidarity in the technical sense of financial redistribution among the participants of a healthcare system or a social security scheme, or among taxpayers at large. Financial solidarity is grounded in, and reflects, solidarity in a deeper, ethical and sociological sense: solidarity as a bond of mutual allegiance among members of society. In healthcare, NHS and insurance-based system are both premised on solidarity, in the sense of both financial redistribution and an underlying socio-ethical bond. Accordingly, in social security financial solidarity is evident in both residence- and insurance-based systems. By contrast, solidarity in the socio-ethical sense is, arguably, more manifest in a residence- than insurance-based system. This is due to the bounded nature of the solidarity which has underpinned the welfare state project: a solidarity uniting nationals living in the territory of a nation state. The future of the welfare state is overshadowed by the danger that denationalisation and deterritorialisation of core welfare services will undermine the ethical and sociological foundations of national welfare states, without introducing any compensating developments at the European level.[42]

Denationalisation and deterritorialisation expand financial solidarity beyond national citizenry and territory. This may corrode the socio-ethical solidarity which has made financial solidarity—and the welfare state in general—possible in the first place. Of course, no a priori obstacles exist to extending the boundaries of the solidarity community, too. But this cannot be done overnight, by fiat, but requires arduous social and cultural developments. And here European integration still has a long way to go.

18.7 Regulatory Private Law

In many respects, Union social policy measures—at least those executed through hard law means—reverse the order of binaries typical of national welfare states. In the context of national welfare states, we are used to thinking of social policy in terms of market correction and decommodification. By contrast, EU social policy, too, seems to be subjected to the purposes of market construction, promoting commodification rather than decommodification. In this section, we discuss another reversal: that of centre and periphery.

The credo of the national welfare state is to guarantee basic welfare services, such as social security and healthcare, to the citizenry as a whole. If we are in general entitled to talk about the EU's independent contribution in social policy, its focus lies elsewhere: not on redistributive services as in the kernel of national wel-

[42] See also Menéndez, 'European citizenship'.

fare regimes but, rather, on regulative measures on their outer ring. Instead of redistribution, the emphasis is on regulation: on regulatory private law. Diverging from a typical nation state, in the EU this branch of law, too, is constitutionally anchored.

Four particular fields of regulatory private law have gradually stood out: labour law, consumer law, antidiscrimination law and law on universal services. In these fields, European law has advanced to positive integration through harmonisation of Member State legislation. The political legislator has played a central role, although in particular in antidiscrimination law the ECJ has also been able to assert itself. Compared to market constructing negative integration through judicial legislation or equally market constructing coordination of cross-border social security and healthcare, positive integration through regulatory private law has gained greater independence from internal market considerations.[43]

The general market dependence of Union social policy, though, explains its characteristic labour orientation, noticeable already in the Treaty of Rome. This orientation was conspicuous, not only in the provisions on migrant workers, but also in the Social policy Title. The Title did not, however, establish any specific legislative competence. Harmonisation of labour law, or other socially oriented legislation, was possible only under Art 100 of the Treaty (now Art 114 TFEU); that is, merely on condition that it could be justified as promoting the establishment or functioning of the common market or, put differently, in terms of realising the economic constitution. This was in harmony with the intentions of the drafters of the Treaty. The main impetus for social policy provisions had lain in presuppositions of economic integration, such as guaranteeing equal conditions of competition for Member State industries. Still, Art 100, which on its face confirmed the subordination of the social dimension to economic integration, was able to provide the competence basis for legislation pursuing a more independent transnational social policy, too. Practically any step in harmonising labour law or other social legislation could be argued to further the functioning of the common market. However, especially as the relative social policy homogeneity of Member States had broken down after the first enlargement in 1973, the requirement of unanimity in the Council was an effective impediment to extensive social policy harmonisation.

In spite of this political hurdle, in the wake of widespread labour unrest the first wave of labour directives was adopted in the 1970s under Art 100, pursuant to the Commission's first Social Action Programme of 1974.[44] The second wave was facilitated by the Single European Act of 1987, which introduced qualified majority voting in the Council for harmonising measures which aimed at completing the internal market (Art 100a). Moreover, the SEA created a particular competence ba-

[43] In the following exposition, I have greatly benefited from Hans-W Micklitz' writings, in particular Micklitz, 'Introduction' and H-W Micklitz, 'Universal Services: Nucleus for a Social European Private Law?' in M Cremona (ed), *Market Integration and Public Services*, *Collected Courses of the European Academy of Law* (Oxford, Oxford University Press, 2011).

[44] Council Resolution concerning a social action programme [1974] OJ C 13/1.

sis for minimum directives in the field of worker health and safety (Art 118a(2)).[45] Still, persistent disagreements among Member States on the ideological, institutional and financial basics of social policy hampered consensus on far-reaching objectives and measures. Nevertheless, the social policy achievements of the Delors era include the Community Charter of Fundamental Social Rights of Workers (1989). The Charter was only adopted as a Declaration of the European Council, with the UK opting out, and lacked immediate legal effect. It proved, though, instrumental for development of the social dimension through further harmonising labour law directives.[46]

The Social Protocol and the adjacent Agreement on social policy, attached to the Maastricht Treaty, gave a further boost to labour law harmonisation. By the same token, the rather peculiar constitutional arrangement manifested the difficulty of obtaining consensus among Member States on ideologically sensitive social issues. The Social Protocol initiated the last intensive period in the development of European labour law. The Agreement significantly expanded the scope of minimum-harmonisation directives, requiring merely qualified majority in the Council, and created, under the requirement of unanimity, new legislative competences in the field of, for example, social security and social protection of workers.[47] The Treaty of Amsterdam not only incorporated the Agreement into the Treaty but also added to it a new Employment Chapter. This signalled a shift of focus from labour law to employment policy, and, by the same token, from hard law to soft law and the open method of coordination.[48] At the time of drafting the Charter of Fundamental Rights of the European Union the heyday of European labour law had already ended. Still the weight of labour-related social issues in the EU is evident in the Solidarity Chapter of the Charter, which is headed by six labour-oriented articles.

Labour law was already an established field of law in Member States when the Community instigated its legislative activism. Still, in particular in the period from the middle 1970s until the late 1990s, European support for the efforts of typical national labour law coalitions, consisting of social democratic parties, trade unions and academic labour lawyers, was essential. Particularly in the 1990s, European labour law occupied an important position in the programme(s) for Social Europe.

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[45] The 1989 framework directive on health and safety of workers was based on this provision. Dir 89/391/EEC on the introduction of measures to encourage improvements in the safety and health of workers at work [1989] OJ L183/1.

[46] In order to achieve the objectives set out in the Charter, the Commission adopted a Social Action Programme, COM(89) 568 final. This led to a number of labour-related directives, adopted under Art 118a.

[47] Between 1994 and 1997 four directives were adopted under the Protocol, among them Dir 94/45/EC on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees [1994] OJ L64; Dir 96/71/EC concerning the posting of workers in the framework of the provision of services [1996] OJ L18/1; and Dir 97/81/EC concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC [1998] OJ L14/9.

[48] See also the assessment of Catherine Barnard, C Barnard, 'EC Social Policy' in P Craig and G de Búrca (eds), *The Evolution of EU Law*, 2nd ed (Oxford, Oxford University Press, 2011) 657 f.

In turn, anti-discrimination law is an 'independent' EU contribution to regulative private law. In a sense, it is an accidental offshoot of labour-oriented constitutional law. The Social policy Title of the Treaty of Rome included a provision on equal pay (Art 119; now Art 157 TFEU), which, in line with other provisions in the Title, was originally intended to promote economic integration by equalising Member State conditions of competition. Its subsequent destiny was to provide the constitutional basis for gradually widening anti-discrimination case law and secondary legislation. Constitutionally anchored antidiscrimination law is a primary example of social constitutional law's severing its roots in the economic constitution and adopting a more independent teleology. Differing from labour law, the main credit for this development is due, not to the political legislator, but to the ECJ as a judicial legislator. This fact may balance an over-straightforward view of the ECJ as a champion of negative integration and economic constitutionalisation.

In the mid 1970s *Defrenne* cases, the ECJ assigned direct effect to the Treaty provision on equal pay. The Court also at least partly detached the provision from the logic of economic constitutionalism and argued that it had both economic and social functions. A quarter of century later, in 2000 in *Deutsche Post*, the Court finally established the primacy of social over economic objectives.[49]

Until Amsterdam, the Treaty basis for combating other than nationality-based discrimination remained meagre, consisting only of the equal pay provision, which the Court, though, interpreted rather liberally. The provision did not establish any legislative competence. The anti-discrimination directives which the Community legislator issued, starting from the mid-1970s, were based on market-harmonising competence (now Art 114 TFEU) and the auxiliary competence established by the so-called flexibility clause (now Art 352). The Amsterdam Treaty signified a turning point in the constitutionalisation of anti-discrimination law and its definition in wider terms. The Treaty obliged the Community (Union) to aim to eliminate inequalities and to promote equality between men and women in all its activities (present Art 8 TFEU). It also laid down a wider obligation to "combat discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation" (present Art 19 TFEU).[50] Finally, the EU Charter of Fundamental Rights includes a particular Equality Title.[51] Reinforcement of the constitutional

[49] C-43/75 *Defrenne v Sabena* [1976] ECR 455; joined cases C-270/97 and C-271/97 *Deutsche Post v Sievers and Schrage* [2000] ECR I-929.

[50] Legislative measures, however, were retained behind the threshold of unanimity in the Council. This did not concern measures aiming at equality between men and women with regard to labour market opportunities and treatment at work which were included in the social-policy legislative competence under Art 137 TEC (at present Art 151 TFEU). Under the present Art 19 TFEU, only harmonizing measures still require unanimity.

[51] In addition to general provisions on equality before the law (Art 20) and prohibition of discrimination (Art 21), the Title comprises specific provisions on cultural, religious and linguistic diversity (Art 22); equality between women and men (Art 23); the rights of children (Art 24) and elderly (Art 25); and integration of persons with disabilities (Art 26). The prohibition of discrimination contains the same list of forbidden grounds as the provision at present in Art 19(1) TFEU, but, diverging from the latter provision, keeps it open-ended. Open-endedness also separates the

basis has been followed by renewed legislative and judicial activism.[52] A distinctive strand in the case law of the ECJ consists of rulings on age discrimination, with *Mangold* as the most hotly-debated.[53]

In line with labour law, consumer law existed at least in some Member States before the Community's entry into this field of regulative private law. Here the Community contribution was to provide a fledgling and insecure area of legislation with new impetus. The Treaty of Rome was silent on consumer policy and, consequently, Art 100 was resorted to as a competence basis for the first harmonising directives. The Commission White Paper on Completing the internal market in 198[54] and subsequent adoption of the SEA were decisive for the constitutionalisation of consumer policy, too. Completion of the internal market was seen to require flank support from not only labour law but consumer law as well. Art 100a TEEC, which introduced qualified majority voting for harmonising measures aiming to realise the internal market, expressly enshrined the objective of a high level of consumer protection. The Maastricht Treaty introduced a particular Consumer policy Title, consisting of one article, which in slightly modified form has been incorporated in the TFEU as Art 169. In accordance with its predecessors, Art 169 TFEU not only establishes a specific legislative competence but in addition refers to general competence for harmonising measures for completing the internal market (present Art 114 TFEU). In practice, the specific competence has had minor pertinence, while most directives have been issued under the general harmonising competence. At present the constitutional foundation of consumer policy includes a provision in the Solidarity Chapter of the EU Charter of Fundamental Rights, according to which Union policies should ensure a high level of consumer protection (Art 38). Such constitutional privileging lacks correspondence at the nation-state level and testifies to the prominence of consumer protection within EU social policy.

According to Hans Micklitz, the *Leitbild* of initiatives taken between 1975 and 1985 was the weak consumer, which gave consumer policy a clear social flavour. The White Paper and the SEA linked consumer policy to the overriding objective of completing the internal market, which left its impact on the legislative activism

provision on equality between women and men in Art 23 of the Charter from the equality mandate of Art 151 TFEU.

[52] New directives include Dir 2000/78/EC establishing a general framework for equal treatment in employment and occupation [2000] OJ L 303/16; Dir 2000/43/EC implementing the principle of equal treatment between persons irrespective of racial or ethnic origin OJ [2000] L180/22; Dir 2004/113/EC implementing the principle of equal treatment between men and women in the access to and supply of goods and services [2004] OJ L 373/37; and Dir 2006/54/EC on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation [2006] OJ L 204/23. The three first Directives were adopted on the basis of Art 13 TEC, while Dir 2006/54/EC is based on the social policy legislative competence under Art 141(3) TEC.

[53] C-144/04 *Mangold v Helm* [2005] ECR I-9981 As a critique of *Mangold* see R Herzog and L Gerken, 'Stop the European Court of Justice' (2008) *Centrum für Europäische Politik*, http://www.cep.eu/fileadmin/user_upload/Pressemappe/CEP_in_den_Medien/Herzog-EuGH-Webseite_eng.pdf.

[54] COM(85) 310 final.

of the 1990s.[55] Micklitz argues that consumer law gradually lost its protective orientation, while the *Leitbild* of the weak consumer retreated in the face of the now emerging image of a 'European consumer who shops across border in a relaxed though attentive and self-responsible manner'. The Lisbon Council of 2000, which set the objective of making the EU the most competitive market worldwide, brought about yet another turn in consumer policy. The new *Leitbild* arising from the Commission's initiatives is 'the economically efficient consumer which has to operate no longer merely in a European but in an international environment'.[56] After the Lisbon Council, a number of important consumer directives have been adopted, culminating in Consumer Rights Directive in 2011.[57]

The shift of emphasis in EU consumer law is partly balanced by the social aspects of a new field of law where the Union—in line with anti-discrimination law—has played a vanguard role: law on universal services. Law on universal services is a by-product of implementation of internal market rules in the service sector, but has subsequently acquired social features which cannot be reduced to the logic of market liberalisation.

The constitutional background to law on universal services lies in the competition law provisions on public undertakings in Art 90 of the Treaty of Rome (now Art 106 TFEU), which were amended in Amsterdam by the Treaty provisions on services of general economic interest and in Lisbon by the Protocol on services of general interest. The provisions in Art 106 TFEU lay down a general prohibition for Member States to enact or maintain in force any measure concerning public undertakings and undertakings with special or exclusive rights which would be contrary to Treaty rules, in particular competition law and the prohibition of discrimination on the basis of nationality. However, Art 106(2) TFEU makes an exemption for services of general economic interest. Undertakings which have been entrusted with operating such services are subject to the Treaty rules, in particular on competition, only 'in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them'. Still, the privileged position of these undertakings may not affect the development of trade to such an extent as would be contrary to the interests of the Union. As may be recalled, the Treaty does not include a definition of 'services of general economic interest'. In practice, typi-

[55] This activism produced an impressive number of directives, such as Dir 90/314/EEC on package travel, package holidays and package tours [1990] OJ L 158/59; Dir 93/13/EEC on unfair terms in consumer contracts [1993] OJ L 95/29, Dir 94/47/EC on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis [1994] OJ L 280/83*;* Dir 97/7/EC on the protection of consumers in respect of distance contracts, [1997] OJ L 144/19; Dir 98/27/EC on injunctions for the protection of consumers' interests [1997] OJ L 166/51; and Dir 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees [1999] OJ L 171/12.

[56] Micklitz, 'Introduction', 30–33.

[57] Directive 2011/83/EU on consumer rights [2011] OJ L 304/64. Another distinct feature of the last phase in the development of consumer law is replacement of minimum with full harmonisation. This has not only been the policy of the Commission, but was also embraced by the ECJ in its *Gysbrechts* ruling. C-205/07 *Gysbrechts and Santurel Inter* [2008] ECR I-9947.

cal examples treated as services of general economic interest are network industries, such as telecommunications, electricity and gas; postal services; water supply and waste water services; treatment of waste; and transport services.[58]

Following adoption of the SEA, the Commission's urge to complete the internal market in the service sector, too, did not spare services of general economic interest. These services had, under the protection of Art 90 of the Treaty of Rome, been provided by public undertakings and undertakings with special or exclusive rights. A major justification for such arrangements had been guaranteeing universal access to services. Resorting to its general market constructing harmonising competence under Art 100a TEEC, the Community legislator embarked on a rapid liberalisation of services of general economic interest, starting from telecommunications and other network industries. Universal service law, ensuring access to services in competitive markets as well, is meant to compensate for service providers' loss of their privileged status.

The Treaty amendments adopted in Amsterdam and Lisbon provided the law on universal services with an explicit constitutional basis. As already explained, the Treaty of Amsterdam obliged the Union and the Member States to secure that 'such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions' (Art 14 TEC), and the Lisbon Treaty introduced an additional mandate for the ordinary legislator to 'establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services' (Art 14 TFEU). As we have noted, the legal significance of the concept of services of general interest employed by the Protocol attached to the Lisbon Treaty, and the concept of non-economic services of general interest also implied by the Protocol, is ambiguous.

For services of general economic interest, the Protocol may have more legal relevance, especially in guiding the interpretation of Arts 14 and 106(2) TFEU. Art 1 of the Protocol specifies the shared values of the Union in respect of services of general economic interest within the meaning of Art 14. What is notable is that the values are mainly defined from the perspective of end users and include 'a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights'. The Protocol, together with Art 36 of the EU Charter of Fundamental Rights, has explicitly entrenched in EU constitutional law the principle of universal services. Art 36 of the Charter lays down that 'the Union recognises and respects access to services of general economic interest as provided for in national laws and practices, in accordance with the Treaties, in order to promote the social and territorial cohesion of the Union'. The provision is located in the Solidarity Chapter of the Charter, which expressly places it in the context of the social constitution.

Neither Art 36 of the Charter nor Art 1 of the Lisbon Protocol creates justiciable rights for users of services of general economic interest. However, as Micklitz has

[58] Ever since the Treaty of Rome, transport policy has been subject to particular Treaty provisions, establishing even legislative competence (now Title VI TFEU).

argued, Art 36 of the Charter should be read together with secondary legislation on services of general economic interest, such as telecommunication, postal services, electricity, gas and transport, which adopted the idea of universal services: 'The respective directives are all united in the idea that the new consumer should and must have access to the new competitive market and that access must be understood as an individually enforceable right.' Thus, a case can be made for an enforceable right of access to services of general economic interest. However, as Micklitz continues his argument, the addressee of such a right would not be the service provider but the Member State responsible for implementing the directive at issue.[59]

Another question, also discussed by Micklitz,[60] is whether the idea of universal services can be developed into a general principle of EU law. As regards services of general economic interest, Art 36 of the Charter and Art 1 of the Protocol point to an affirmative answer. Arguments can be produced to support extending the principle also to services which do not perhaps meet the criteria of general economic interest but which in contemporary society are vital for social inclusion and participation, such as financial and internet services. If these arguments were accepted, Member States would, as a general principle of EU law, be required to ensure universal coverage of such services at a certain quality level and at affordable prices even where this is not (yet) expressly spelled out in secondary legislation.

18.8 Two Notions of Justice: Complementary or Conflicting?

Comprising labour law, anti-discrimination law, consumer law and law on universal services, European regulatory private law may seem a heterogeneous legal branch. But this is a false impression: European regulatory private law is united by a social orientation and by a specific conception of justice which sets it apart from typical national welfare state legislation. This is the conception which Micklitz has coined access justice.

Whatever else the European social constitution may be about, it is also about the division between the market and decentralised, national, or centralised, transnational, public interventions. In the social dimension, the tasks assigned respectively to the markets, the Member States and the Union may be informed by three alternative, ideal typical notions of justice. The first of these is market justice or allocative justice: whatever is the outcome of market mechanisms is just. Here the role of the state or the transnational polity is reduced to securing the general framework con-

[59] Micklitz regards this situation as exemplifying what Norbert Reich has termed 'Rights without Duties', that is, EU rights which cannot be enforced against the 'correct' addressee. Micklitz, 'Introduction', 41; N Reich, 'The public/private divide in European law' in H-W Micklitz and F Cafaggi (eds), *European Private Law after the Common Frame of Reference* (Cheltenham, Edward Elgar, 2010) 56.

[60] Micklitz, 'Introduction', 41 f.

ditions for market mechanisms, such as right to property and freedom of contract. This is the realm of F. A. Hayek's rules of just conduct or Robert Nozick's libertarianism.[61] The second alternative is access justice, as Micklitz has termed it. As a rule, functioning markets do not emerge spontaneously but presuppose particular market constructing measures by a polity. Furthermore, left to themselves market mechanisms may lead to self-detrimental results by eliminating some economic agents from the marketplace and barring the (re-)entry of others. Public policy promoting access justice furthers market construction, combats exclusion and seeks to facilitate the (re-)entry of economic agents to the marketplace as entrepreneurs, workers or consumers. The third alternative is redistributive social justice which implies correction of the distributive outcomes of the markets. As redistribution through welfare policies presupposes solidarity in both a financial and a socio-ethical sense, we can also call our third alternative solidaristic social justice.

Libertarian market justice entails a minimum state with practically no social responsibilities: a social constitution based on market justice would be a contradiction in terms. The value basis of national welfare states with their emphasis on social security and healthcare consists of solidaristic social justice. By contrast, EU social law is largely tailored to pursue, not redistributive social justice, but access justice: facilitating (re-)entry to the marketplace. This objective is conspicuous in regulatory private law; especially in labour law, consumer law and law on universal services, but also in those parts of anti-discrimination law which address market participation. It is evident in the coordination of cross-border social security and healthcare as well. Originally, coordination of national social security schemes aimed at furthering worker mobility and realising the free movement of workers. The citizenship turn modified the determinants of access justice: now at issue is access to wider societal integration, redemption of the promise of European citizenship and realisation of free movement of citizens. In turn, judicial and political legislation on cross-border healthcare purport to guarantee access to services for migrant patients; their entry to the transnational marketplace of healthcare services.

The prevalence in EU social policy of access justice can be deemed yet another example of the primacy of the economic over the social constitution. Market-constructing or -maintaining social policy, manifesting access justice, supports the market-constructing and -maintaining function of economic constitutional law. If we try to identify the conception of justice underlying the microeconomic constitution, centred around free movement and competition law, in our classification this would fall under access justice. Free movement law is supposed to create Europe-wide markets and to eradicate obstacles which national policy measures might pose to that objective. In turn, competition law aims to prevent accumulation of private power which would distort the functioning of market mechanisms and shut out competitors on illegitimate grounds or prevent the entry of new market participants.

[61] FA Hayek, *Law, Legislation, and Liberty*, vol 1 (London, Routledge, 1982); R Nozick, *Anarchy, State, and Utopia* (Oxford, Blackwell, 1975).

Are national solidaristic social justice and transnational access justice complementary or conflicting principles? European regulatory private law does not affect the workings of core welfare services, left to the care of Member States. The fundamental social compact underlying European economic integration also intimates a complementary relation between the two conceptions of justice: transnational markets were supposed to produce increased prosperity, while national redistributive mechanisms were supposed to ensure just allotment of that prosperity. But things have not turned out to be so simple. Often enough, conflicts between economic constitutional law and national social legislation can be re-categorised as conflicts between, not only two types of rights—transnational economic rights established by free movement law and national social rights—but two notions of justice as well: transnational access justice and national solidaristic social justice. This is one way of depicting the essential issue in, say, *Viking* and *Laval*. The access justice of freedom of establishment and free movement of services collided with, and finally prevailed over, the Nordic welfare model; that is, the Nordic regime for promoting solidaristic social justice. We have perceived an analogous tension permeating the case law on cross-border healthcare, the constitutional anchorage of which lies in free movement of services: guaranteeing access to cross-border services for mobile patients through the obligation of reimbursement by the country of affiliation may jeopardise the solidaristic foundations of national healthcare. Similar consequences may ensue from cross-border social security, the coverage of which has expanded from mobile workers and their dependants to mobile citizens, and the subjection of social security funds to competition law. Denationalisation and deterritorialisation of social security and healthcare in the name of access justice may threaten the solidaristic foundations of national welfare regimes.

Fundamental social rights represent a newcomer in European social constitutional law, complementing provisions on social objectives and policies, which the Treaties have included ever since Rome. It is conceivable that, especially after Lisbon, European fundamental social rights would buttress the position of national welfare regimes, with their underpinning notions of solidaristic social justice, against the European economic constitution and market constructing measures. They could for instance add to the solidaristic scale in the weighing which the Court applies in assessing Member State restrictions on free movement or competition law. After all, the social rights of the Solidarity Chapter, too, are covered by Art 51(1) of the Charter, which lays down that the institutions, bodies, offices and agencies of the Union must respect the rights, observe the principles and promote the application thereof. Whether Union social rights will attain a role in the defence of national welfare regimes remains to be seen. The fact that they have been almost totally ignored by both EU institutions and Member States as a potential counterweight to the implications of the macroeconomic constitution during the recent Eurozone crisis does not give reason for much optimism among defenders of social rights.

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Chapter 19
Why There Is No 'Principle of Mutual Recognition' in EU Law (and Why that Matters to Consumer Lawyers)

Stephen Weatherill

Abstract Lately both the Court and the Commission have taken to referring to the principle of mutual recognition in the law of the EU's internal market. But there is no principle of mutual recognition in the law of the EU's internal market. There is only a principle of non-absolute or conditional mutual recognition. Put another way, EU law does not require Member States to admit on to their market products or services that comply with the regulatory requirements of the State of origin. Instead EU law requires Member States to show good reasons in the public interest when they wish to refuse admission to such products or services. Internal market law includes space for justified trade barriers. The Court and the Commission are probably not trying to re-write the law of the EU's internal market. The Court and the Commission are probably just being a bit sloppy and a bit lazy. But such imprecision carries risk. An over-emphasis in internal market law on the impetus towards the liberation of cross-border trade at the expense of the regulatory sensitivities of individual Member States carries the risk that deregulation-by-law will be driven too deep—more deeply than the Treaty envisages. And that same overemphasis on market deregulation also carries the risk of loading too much weight on to the judicial means to construct an internal market—the law of free movement—at the expense of the supplementary role performed by the EU's legislative process, most prominently in the name of harmonisation. So recognition that there is no principle of mutual recognition in the law of the EU's internal market is important in grasping the legitimate place of both Statelevel and EU-level regulation in the building of that market.

19.1 Introduction

Lately both the Court and the Commission have taken to referring to the principle of mutual recognition in the law of the EU's internal market. But there is no principle of mutual recognition in the law of the EU's internal market. There is only a

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3,DOI 10.1007/978-3-319-04903-8_19,

principle of non-absolute or conditional mutual recognition. Put another way, EU law does not require Member States to admit on to their market products or services that comply with the regulatory requirements of the State of origin. Instead EU law requires Member States to show good reasons in the public interest when they wish to refuse admission to such products or services. Internal market law includes space for justified trade barriers. The Court and the Commission are probably not trying to re-write the law of the EU's internal market. The Court and the Commission are probably just being a bit sloppy and a bit lazy. But such imprecision carries risk. An over-emphasis in internal market law on the impetus towards the liberation of cross-border trade at the expense of the regulatory sensitivities of individual Member States carries the risk that deregulation-by-law will be driven too deep—more deeply than the Treaty envisages. And that same over-emphasis on market deregulation also carries the risk of loading too much weight on to the judicial means to construct an internal market—the law of free movement—at the expense of the supplementary role performed by the EU's legislative process, most prominently in the name of harmonisation. So recognition that there is no principle of mutual recognition in the law of the EU's internal market is important in grasping the legitimate place of both State-level and EU-level regulation in the building of that market.

19.2 The Court

In recent practice the Court has regrettably taken to dropping the important nuance that EU law is no instrument for automatic market deregulation. It has instead mistakenly referred to an unconditional principle of 'mutual recognition' and 'of ensuring free access of EU products to national markets'.

In its 2009 Grand Chamber ruling in *Commission* v *Italy*, a case concerning the use of trailers in Italy, the Court referred to (what is now) Article 34 TFEU as the source of

> … the obligation to respect the principles of non-discrimination and of mutual recognition of products lawfully manufactured and marketed in other Member States, as well as the principle of ensuring free access of Community products to national markets (see, to that effect, Case 174/82 *Sandoz* [1983] ECR 2445, paragraph 26; Case 120/78 *Rewe—Zentral* ('*Cassis de Dijon*') [1979] ECR 649, paragraphs 6, 14 and 15; and *Keck and Mithouard*, paragraphs 16 and 17).[1]

But the cited paragraphs of *Sandoz* and *Cassis* are directed at the absence of justification for the trade barriers at stake in those cases, whereas the cited paragraphs of *Keck and Mithouard* concern the absence of any trade barrier in the first place. None of these rulings is supportive of the crude claim made by the Grand Chamber in *Commission* v *Italy* that there is an unqualified intra-EU principle of mutual recognition of products lawfully manufactured and marketed in other Member States.

So the Court is wrong—wrong to refer to a principle of mutual recognition and wrong to locate that principle in its pre-existing case law. Worse, it seems intent

[1] Case C-110/05 *Commission v Italy* [2009] ECR I-519 para 34.

on staying wrong. Citing *Commission v Italy*, it has on four occasions asserted that Article 34 TFEU reflects *the obligation to comply with the principles of non-discrimination and of mutual recognition of products lawfully manufactured and marketed in other Member States, as well as the principle of ensuring free access of EU products to national markets*.[2] The four tarnished judgments are *Ker-Optika*,[3] a ruling of the Third Chamber, *Ascafor* (Fifth),[4] *ANETT* (Third),[5] and *Elenca Srl* (Fifth).[6]

The type of trade barrier at stake in these cases is not the same, which makes the Court's zeal for consistency all the more peculiar. So, for example, in *Commission* v *Italy* the Court proceeded to discuss the line of case law developed through *Dassonville* and *Keck and Mithouard*, and to consider that in the light of the problem raised by the case itself, a restriction on use (of trailers towed by motorbikes in Italy). In *Ker-Optika* the Court avoided direct engagement with the question whether the impugned rule, which required sale of contact lenses to be channelled through particular types of medical premises, was one that in fact, if not in law, had a detrimental effect on products from out-of-State when compared with domestic products or whether instead it was better treated as a restriction on a method of selling which might have a considerable influence on the behaviour of consumers. *Elenca Srl* by contrast was a straightforward '*Cassis*-type' case of a 'dual regulatory burden': Italian rules required imports to meet technical standards without taking account of the regulatory environment to which they had been subject in their home State.

In each of these five cases the Court subsequently moved to consider questions of justification. I do not think the *outcome* of any of these cases is wrong. The Court correctly adopted a two-stage test—finding a trade barrier and then assessing whether it was justified. But it should assert at the first stage that there is a second stage. Otherwise there is a risk that the false notion that EU internal market law is based on a principle of mutual recognition may spread. This may lead to misunderstanding and misapplication of the law, but, even as a minimum, it is damaging to the EU's reputation if an excessively deregulatory tone is struck in describing and planning the internal market.

19.3 The Commission

The Commission's recalcitrance has a longer pedigree. In the aftermath of the *Cassis de Dijon* ruling in 1979, the Commission published a Communication concerning the consequences of the judgment.[7] Its main concern was to draw attention to the

[2] The change from 'respect' the principles to 'comply with' the principles seems to be merely a translation glitch: respecter and einhalten are used consistently in the French and German texts.

[3] Case C-108/09 *Ker-Optika* [2010] ECR I-12213 para 48.

[4] Judgment of 1 March 2012, Case C-484/10 *Ascafor*, not yet reported, paras 53, 70.

[5] Judgment of 26 April 2012, Case C-456/10 *ANETT*, not yet reported, para 33.

[6] Judgment of 18 October 2012, Case C-385/10 *Elenca Srl*, not yet reported, para 23.

[7] [1980] OJ C 256/2.

key institutional implication of the judgment. This holds that, in consequence of the Court's generous interpretation of the scope of (what is now) Article 34 TFEU in application to national technical standards, the Commission's own legislative programme of harmonisation may be focused on trade barriers which survive inspection pursuant to Article 34. Those that do not will be unlawful as a result of the application of the Court's criteria, and need not be addressed by legislative action. But the Communication is well-balanced. It does not at all conceal the key point that even if the scope of the trade barrier subject to review pursuant to Article 34 TFEU is broad, so too is it open to the regulator to justify the maintenance of that barrier—and, moreover, under a justificatory formulation that is broader than is envisaged by Article 36:

> Any product lawfully produced and marketed in one Member State must, in principle, be admitted to the market of any other Member State. Technical and commercial rules, even those equally applicable to national and imported products, may create barriers to trade only where those rules are necessary to satisfy mandatory requirements and to serve a purpose which is in the general interest and for which they are an essential guarantee.

The Communication of 1980 prominently places the *limits* of mutual recognition alongside its opportunities. Quite right!

The vision is rather different in the White Paper of the Commission on the completion of the internal market which was published in June 1985.[8] In paragraphs 77–79 in particular an emphasis on mutual recognition is absorbed by, and significantly affects, the Commission in planning its strategy for building the internal market. There is no denial that mutual recognition is conditional or non-absolute. But such qualification is voiced far more softly. It appears that the balance has altered—in favour of a greater emphasis on market deregulation achieved by the application of the free movement rules and less emphasis on the permitted space for justified national market regulation.

In June 1999 the Commission issued a communication entitled 'Mutual Recognition in the context of the follow-up to the Action Plan for the single market'.[9] The first sentence of the document's *Summary* declares that 'The principle of mutual recognition plays a central role in the Single Market by ensuring free movement of goods and services without making it necessary to harmonise national legislation'. Entirely absent from the four-paragraph *Summary* is any hint that this principle is conditional. In the document proper, that necessary caveat is not completely neglected but it is granted far less prominence than it should be—far less than in 1980—and the 'principle of mutual recognition' is consistently cited without qualification as a foundation stone of internal market law.

In similar vein in April 2006 a public consultation on the Future of the Internal Market was announced by DG MARKT. Consultation of 'stakeholders' was conducted, the results of which were released in September 2006: this was the Commission Staff Working Document, *Public Consultation on a Future Single Market*

[8] Available via http://ec.europa.eu/white-papers/index_en.htm.

[9] COM(99) 299.

Policy: Summary of Responses.[10] There are two references to 'mutual recognition', but neither admits that it is a non-absolute or conditional principle.

This misrepresentation has achieved legislative status.

Regulation (EC) No 764/2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State applies with effect from 13 May 2009.[11] It represents an important legislative impetus towards improving the practical management of the internal market. It envisages a process of curative dialogue and administrative co-operation where Member State authorities propose to close their market to imported goods.

The 'principle of mutual recognition' is cited in seven of the recitals in the Regulation's Preamble—Recitals (3), (4), (6), (21), (22), (30) and (34). But only three balance that citation with reference to scope for justification of national rules. These are Recitals (3) and (21), which serve up this important qualification only at the end of the Recital, and the only genuinely well-balanced recital is Recital (22), which serves up the full package of conditional or non-absolute mutual recognition.

As with the Court, so with the Commission—the allegation is not that the conditional or non-absolute nature of mutual recognition is denied but rather that it is being actively downplayed or at least that it is being presented in a manner that may risk a reader choosing to downplay it.

This is profoundly wrong. And this matters in the depiction and future shaping of the EU's internal market.

19.4 There Is no Principle of Mutual Recognition in the Law of the EU's Internal Market—The Basic Rules

It is worth returning to basics to recall how central is this balance between market deregulation and market regulation in EU internal market law.

Articles 34–36 TFEU are directed at scrutiny of national measures that restrict cross-border trade in goods. But they do not prohibit all such national measures. Article 36 allows derogation, so some trade barriers will survive (and fall to be addressed by the EU's legislative process). There is no *absolute* right to trade in goods across borders in the EU. The right is conditional or non-absolute, in the sense that it is always subject to the possibility that an obstructive national rule acting as a trade barrier will be shown to be justified by the regulating entity. The *Cassis de Dijon* principle famously applies new and more elaborate language to the particular case of national technical standards which restrict inter-State trade, subjecting them to (in short) a broader public interest inquiry than that envisaged by Article 36, but that landmark ruling does not alter the *structure* of the legal analysis at all.[12] The Court's explanation that obstacles to movement within the EU resulting

[10] SEC(2006) 1215.

[11] [2008] OJ L218/21.

[12] Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements is exactly in tune with the prohibition-plus-justification model asserted by Articles 34–36 TFEU. So that line of case law fully complies with the structure mapped out by Articles 34–36 TFEU: it puts trade barriers to the test, but it does not require that they automatically be set aside. True, a lot of power is granted to the Court. The wider the scope allowed to the possibility to justify barriers to trade, the more room for manoeuvre is handed back to national regulatory autonomy—and the more weight is placed on the process of legislative harmonisation at EU level as the way to advance integration. And vice versa. So there are vertical and horizontal implications to the interpretative choices made by the Court about the shape of the law of free movement. But the key point for present purposes is that simply because a product or service is lawfully made or marketed in one Member States does not entitle it unconditionally to access to the markets of other Member States. There is no unconditional right to free trade created by the Treaty. That is what the Court and the Commission are getting wrong or, at least, it is what they are downplaying. But it fundamental to the vertical and horizontal allocation of competence to build an internal market.

Making clear that mutual recognition is not automatic is vital to allowing space—space envisaged by the Treaty—for the expression of Member State regulatory autonomy via the window of justification in support of barriers to inter-State trade. And making clear that mutual recognition is not automatic is vital to allowing the EU legislative opportunities to re-shape the regulatory environment of the internal market by addressing questions of harmonisation which arise only once regulatory fragmentation persists precisely because Member States have been able to defend diverse regulatory practices as worthy of higher status than the impetus towards trade integration.

19.5 The Court—The Vertical Dimension of Why There Is no Principle of Mutual Recognition

It would admittedly be easy to survey the Court's case law and forget the importance of the conditional or non-absolute nature of mutual recognition. This is because so few regulators succeed in showing a satisfactory justification for their trade-restrictive choices. In part this is because the burden of proof rests on the regulator.[13] But in large part it is because the justifications advanced are so often absurd.

19.5.1 Justifying the Absurd

Cassis de Dijon itself is vividly illustrative. The German government sought to defend its rigid rules which suppressed choice among different types of liqueur

[13] e.g. Case 227/82 *Van Bennekom* [1983] ECR 3883; Case C-14/02 *ATRAL SA* [2003] ECR I-4431.

by claiming that the consumer needed protection from unexpectedly *weak* alcoholic drinks. In *Walter Rau v de Smedt* the Court was faced with the argument that consumers could lawfully be prevented from choosing between differently packaged margarines and that they instead should be permitted to buy only cube-shaped packs—a situation, which as the Court commented and as economic theorists would expect, led to Belgian consumers paying more for their margarine than consumers in neighbouring states.[14] *Corporación Dermoestética* concerned Italian rules prohibiting televised advertisements for certain medical and surgical treatments carried out in private health care establishments.[15] The Italian justification was rooted in protection of public health, to which the Court has long been in principle receptive—except that here, and utterly inconsistently, the ban applied to national television but not at all to local television networks.

National governments have come to the Court time and time again to defend absurdly anachronistic and often incoherent rules—probably because they are propelled to do so by the very vested interests that benefit from such protectionism. EU law cracks open such regulatory malpractice and liberalises the market for products and services, thereby expanding the consumer's choice.

It is easy enough to develop a sense that EU law is intolerant of national regulatory autonomy and thus to cast the EU as a vicious deregulatory engine. And I think that some (national) consumer lawyers have tended to depict the EU in these hostile terms. The Court was famously aggressive in *Mars*.[16] A marketing practice concerning product packaging that would not mislead a 'reasonably circumspect' consumer cannot be forbidden. The danger is that this 'confident consumer' or 'well-informed consumer' is treated as the paradigm: the lever to wrench aside national measures that attend to less robust consumers. But I think the real story here is less the ferocity of EU free movement law and more the absurdity of national regulatory eccentricity. These are cases where the conditional or non-absolute nature of the principle of mutual recognition lurks in the background, but the absurdity of the national (over-regulatory) choices ensures that the most powerful theme in the Court's judgments is market liberalisation and—on the facts of the cases—unrestricted mutual recognition. These are fact-specific cases: the confident consumer in EU free movement law is a reaction to the gross over-emphasis on national law on the stupid consumer of liqueur and margarine and chocolate as the norm. But there is room for justification. The requirement is that Member States take seriously the need to show why confident consumers should not be a lever in this way.

19.5.2 Taking Justification Seriously

It is exactly here that the crucial importance of the conditional or non-absolute nature of the principle of mutual recognition is visible and where appreciation of just

[14] Case 261/81 *Walter Rau v de Smedt* [1982] ECR 3961.

[15] Case C-500/06 *Corporación Dermoestética* [2008] ECR I-5785.

[16] Case C-470/93 *Verein gegen Unwesen in Handel und Gewerbe Köln eV v Mars GmbH* [1995] ECR I-1923.

how much it matters to the allocation of competence and the shape of the internal market is sharpened. As the Court put it in *Ahokainen and Leppik*: '(…) Member States enjoy a margin of discretion in determining, having regard to the particular social circumstances and to the importance attached by those States to objectives which are legitimate (…), such as the prevention of alcohol abuse and the campaign against the various forms of criminality linked to its consumption, the measures which are likely to achieve concrete results'.[17] A comparable permissive approach emerges in the field of free movement of services, where the Court, asked to consider the compatibility of France's *Loi Evin* with (what is now) Article 56 TFEU, concluded that the restrictions on trade consequent on the prohibition of advertisements for alcoholic drinks at sports events broadcast on television were a justified expression of concern to contain alcohol abuse.[18]

Pursuit of an integrated market under EU law does not involve the automatic disabling of national regulatory competence: consumer choice is not the inevitable result of the impact of EU 'negative law'. Regulation by the public authorities at national level remains permitted even where it obstructs cross-border trade, provided both ends and means are capable of justification against the standards recognised by EU law. *Eyssen*[19] stands as an enduringly helpful example of the Court's tolerance of justifying arguments based on regulatory difference—where they are thoughtful and sincere. Dutch rules banning the use of nisin, a preservative, in processed cheese were presented as measures of health protection, yet other states were prepared to allow the use of nisin, adopting a different view of inconclusive scientific evidence about the safety of the substance. The Court held that a state may take precautions to protect its consumers against health risks in accordance with Article 36 where there is genuine scientific doubt about the safety of the product. EU law does not depress national standards of protection to the lowest common denominator prevailing among the Member States. More recently the Court has adopted the language of the 'precautionary principle' in conceding to Member States the space to maintain rules that restrict trade in goods, especially foodstuffs, on the basis that there is doubt about the effects of particular ingredients on the health of consumers. States enjoy a 'discretion relating to the protection of public health [which] is particularly wide where it is shown that uncertainties continue to exist in the current state of scientific research'.[20]

And it is not just protection of consumer health that may provide a basis for justifying national measures. Protection of economic interests may equally form the basis of justified restraint on inter-State trading freedom—provided that the case made has coherence and weight. In *Buet v Ministère Public*[21] the Court held that a French law which prohibited 'doorstep selling' of educational material was

[17] Case C-434/04 *Ahokainen and Leppik* [2006] ECR I-9171 para 32.

[18] Case C-262/02 *Commission v France* [2004] ECR I-6569; Case C-429/02 *Bacardi v TF1* [2004] ECR I-6613.

[19] Case 53/80 *Eyssen* [1981] ECR 4091.

[20] e.g. Case C-192/01 *Commission v Denmark* [2003] ECR I-9693 para 43.

[21] Case 328/87 *Buet v Ministère Public* [1989] ECR 1235.

not incompatible with Article 34 in view of its contribution to the protection of consumer from pressure selling tactics. The ruling attaches significance to the point that the national law was designed to protect consumers behind with their education and wishing to improve it. So the Court, in assessing the compatibility of the measure with internal market law, took into account the national regulator's concern to protect a particular group of vulnerable consumers. In similar vein, in *A-Punkt Schmuckhandels v Claudia Schmidt*[22] the Court, in considering Austrian rules restraining sales achieved through the organisation of 'jewellery parties' in private homes, was prepared to accept the relevance in justifying such restrictions of the potentially higher risk to consumers of being cheated by lack of information, impossibility of comparing prices and exposure to psychological pressure to buying in such a private setting. This was context-specific consumer protection adopted at national level—and it was treated as such by the Court in sensitive assessment of its justification under the law of the internal market. Similarly the complexity of the market for financial services has prompted a relatively permissive approach by the Court to national measures designed to protect the consumer from unexpected consequences against which he or she is not able to guard effectively because of intransparency and informational asymmetry in that sector.[23]

The case law on regulation of gambling is equally illustratively helpful in showing the Court's receptivity to local concern to impose restrictions in the name of consumer protection and the prevention of fraud.[24] In its rulings the Court has openly admitted the depth of moral, religious and cultural differences between the Member States in such matters, although one might choose to reflect on the extent to which such divergent perceptions can truly be reflected in vigorous enforcement of restrictions on an activity technologically incapable of effective containment within national borders.

There is, of course, a connection here to wider questions of how to manage diversity in the building of the internal market. Landmark rulings such as *Schmidberger*[25] and *Omega Spielhallen*[26] are nothing to do with consumer protection, They pit economic interests in free movement against social and political values promoted at national level, in particular the freedom of expression and the preservation of human dignity respectively. But both rulings are *structurally* comparable to the cases on national consumer protection which impedes trade. They admit space in free movement law within which to judge whether national practices should be treated as justified even where they fragment the EU's internal market along national lines. They fully comply with the core thematic point that there is no absolute right to trade across borders in the EU.

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[22] Case C-441/04 *A-Punkt Schmuckhandels v Claudia Schmidt* [2006] ECR I-2093.

[23] E.g. judgment of 7 March 2013, Case C-577/11 *DKV Belgium SA*, not yet reported; judgment of 18 July 2013, Case C-265/12 *Citroën Belux NV*, not yet reported.

[24] E.g. Case C-42/07 *Liga Portuguesa de Futebol Profissional and Bwin International* [2009] ECR I-7633; Joined Cases C-316/07 et al *Markus Stoss* [2010] ECR I-8069; judgment of 24 January 2013, Joined Cases C-186/11 and C-209/11 *Stanleybet*, not yet reported.

[25] Case C-112/00 *Schmidberger v Austria* [2003] ECR I-5659.

[26] Case C-36/02 *Omega Spielhallen* [2004] ECR I-9609.

19.5.3 What the Court's Formula Should Look Like

The Court's case law is largely correctly open to the justification of barriers to inter-State trade and it is infused with respect for genuine and properly structured expressions of local regulatory concern. Its misplaced formula, considered above and first unfurled in *Commission* v *Italy*, is almost certainly simply unfortunate, not an attempted coup. But precision and wider understanding would be much improved were the Court to adjust its definition of Article 34 as source of *the obligation to comply with the principles of non-discrimination and of mutual recognition of products lawfully manufactured and marketed in other Member States, as well as the principle of ensuring free access of EU products to national markets* by adding at the end of this formula *subject to the possibility that the regulating authority may demonstrate an objective in the general interest which shall prevail over that in securing the free movement of goods.*

19.6 The EU Legislative Process—The Horizontal Dimension of Why There Is no Principle of Mutual Recognition

When the Court rules that a State measure that restricts trade in goods is incompatible with Article 34 TFEU, that measure shall no longer be applied to impede cross-border trade. The relevant market is de-regulated—the national law is, in effect, sacrificed to the higher demands of market integration. But the conditional or non-absolute principle of mutual recognition ensures that some national measures will survive inspection. Internal market orthodoxy holds that the promotion of an internal market passes from the free movement rules, applied by judges, to the process of legislative harmonisation, the preserve of the EU's political institutions. And where the EU legislature decides to replace diverse State measures that hinder integration by an initiative of harmonisation, the aim is to put in place common EU rules. Here too the relevant market is de-regulated, in the sense that (on the simplest model) 28 different regimes are reduced to one common regime. But the market is also *re-regulated*—that one common EU rule becomes the basis for the regulation of the sector in question. And a choice must be made about the type of regulatory regime that is to be introduced at European level. The Treaty provides some framing guidance—in particular in Articles 7, 11, 12, 114(3), 167(4), 168(1) and 169(1) TFEU—and provisions of the Charter of Fundamental Rights such as Articles 35 (public health) and 38 (consumer protection) are directly relevant too. As a matter of constitutional law harmonisation is a process that must attend to the quality of the (re-)regulated environment, not simply the creation of an integrated trading space across the territory of the EU. But in detailed elaboration this is fundamentally a political question engaging choices between regulatory styles and techniques.

The insistence that the principle of mutual recognition is conditional or non-absolute is vital precisely because it gives space for this political involvement is de-

ciding the nature and intensity of the EU (re-)regulatory landscape that will balance the impetus towards deregulation. An automatic principle of mutual recognition would radically tip that balance towards unregulated economic freedom and vicious inter-jurisdictional competition. This is not the Treaty mandate.

19.6.1 Regulating the Internal Market—Harmonisation in Particular

Areas in which the EU is competent to legislate in this 'positive' sense are fixed by its Treaty, ranging from the rather carefully and specifically drawn (such as Article 168 TFEU on public health which precludes harmonisation of national laws and the supporting competence concerning consumer protection envisaged by Article 169(2)(b) TFEU) to the much broader provisions of which the two main examples are Articles 114 and 352 TFEU.

Article 114 is the main preoccupation of the current inquiry. It provides for the harmonisation of national laws in so far as this improves the functioning of the EU's internal market. And, aside from the material limits written into Article 114(2), it is functionally driven rather than sector-specific. *Any* national measures may be harmonised, whatever their content may be, provided their existing diversity affects the shaping of the internal market.

So national measures tackling unsafe products may cause barriers to trade, but they are likely to be justified. So a harmonised regime has been introduced. This is Directive 2001/95/EC on general product safety which bans unsafe goods under a regime that operates across the whole territory of the EU, under an assumption that leaving the matter to be dealt with at national level would maintain fragmentation, since national controls over unsafe goods would certainly be justified yet diverse.[27] And adopting a harmonised ban of unsafe goods creates a unified EU market for safe goods—this is integration plus re-regulation. Similarly Directive 2005/29/EC bans unfair business-to-consumer commercial practices in order to establish a common regime within which fair practices *are* allowed.[28] Its Preamble explains that this is a choice about how to protect consumers taken against a background assumption of the need for a harmonised regime that is apt to underpin the construction of the EU's internal market. It declares that: 'The laws of the Member States relating to unfair commercial practices show marked differences which can generate appreciable distortions of competition and obstacles to the smooth functioning of the internal market'; and 'these disparities cause uncertainty as to which national rules apply to unfair commercial practices harming consumers' economic interests and create many barriers affecting business and consumers'.[29]

[27] [2002] OJ L11/4.

[28] [2005] OJ L149/22.

[29] Recitals (3) and (4).

The Court itself has approved the constitutional validity of this legislative role in the wake of the limits—the conditional or non-absolute character—of mutual recognition and free movement law in achieving a genuine internal market. Article 5(1) TEU, the 'principle of conferral', dictates that Article 114 may be used only for the purposes set out in the Treaty. It is no grant of general regulatory competence. And the practical edge to this principle is vividly illustrated by the annulment of a measure of harmonisation for failure to respect the limits set by what is now Article 114 TFEU: this is famously *Tobacco Advertising*.[30] In that case the Court held that a measure of harmonisation must actually contribute to eliminating obstacles to the free movement of goods or to the freedom to provide services, or to removing appreciable distortions of competition. And the measure in question failed to cross that threshold.

But it is fundamentally important to appreciate that the Court in *Tobacco Advertising* did *not* deny that public health policy and concern for consumer protection may legitimately inform the shaping of the harmonisation programme. Quite the reverse. The Court insisted that such concerns form a constituent part of the EU's other policies, including market-making pursued in the name of harmonisation.[31] This follows from the directions in favour of policy integration now found in Articles 12, 114(3), 168(1) and 169(1) TFEU as well as Articles 35 and 38 of the Charter. This confirms the point that in principle the EU is able, by harmonisation, to adopt a re-regulatory standard that restricts or even forbids particular forms of trading practice throughout the territory of the EU, provided that this forms part of a broader market-making regime.[32] In this vein a harmonised ban on unsafe products creates an internal market for safe products. The Court has not been lured down a path which envisages the internal market being built only on the basis of market freedoms unfettered by regulatory prohibition.

So subsequently the Court has been conspicuously more tolerant of legislative stretching of the scope of Article 114 TFEU than it was in *Tobacco Advertising*—with the consequence that it has opened up ever more widely the scope for legislative attention to be paid at EU level to the demands of market re-regulation. So in *Germany v Parliament and Council*—sometimes called '*Tobacco Advertising II*'[33]—the Court was persuaded that banning advertising in periodicals, magazines and newspapers made a contribution to opening up the wider internal market—for periodicals, magazines and newspapers, which would be subject to precisely the same harmonised rules throughout the EU governing (banning!) tobacco advertising. In its most recent judgment in this vein, *Vodafone, O2 et al v Secretary of State*,[34] the Court found in favour of the validity of the so-called 'Roaming Regulation', Regulation (EC) No 717/2007. The Regulation caps the wholesale and retail charges terrestrial mobile operators may charge for the provision of roaming services on public mobile networks for voice calls between Member States. The Court

[30] Case C-376/98 *Germany v Parliament & Council* [2000] ECR I-8419.

[31] Ibid, paras 78, 88.

[32] Ibid, paras 98, 117.

[33] Case C-380/03 *Germany v Parliament and Council* [2006] ECR I-11573.

[34] Case C-58/08 *Vodafone, O2 et al v Secretary of State* [2010] ECR I-4999.

declared that the Regulation had been adopted in response to the likelihood that national price control measures of divergent type would be adopted aiming to address the problem of the high level of retail charges for EU-wide roaming services. So this was treated as classic preventive harmonisation aimed at improving the conditions for the functioning of the internal market. The Court simply did not address the rather strong argument that national measures capping the cost of roaming were *unlikely* to be adopted because they would have the perverse effect of harming the competitive position of companies based on the regulator's territory while protecting only out-of-state consumers.[35] Regrettably this twist was completely ignored in a judgment which took at face value the claims of the EU legislature. Perhaps since the first *Tobacco Advertising* case the Court's teeth have become less sharp. Or perhaps—more pertinent—the EU legislature has been able to absorb the Court's vocabulary and readily present its initiatives as consistent with the rather wide scope of Article 114. In this sense crossing the threshold in order to bring the matter within the valid scope of Article 114 TFEU requires careful legislative drafting in order to demonstrate the necessary connection to the internal market, but in practice judicial intervention is likely to be uncommon.[36]

Crucially, however, there is plenty of scope for selecting among the types of—harmonised—market regulation that are judged politically desirable. This is space that would be shut out under an automatic principle of mutual recognition which would leave no scope for the re-regulatory bargain shaped through the legislative process. So in *Tobacco Advertising II* the Court observed that provided that the conditions for recourse to Article 114 TFEU are fulfilled, the Union legislature 'cannot be prevented from relying on that legal basis on the ground that public health protection is a decisive factor in the choices to be made', and it cited what are now Articles 168(1) and 114(3) TFEU.[37] And logically 'those measures may consist in requiring all the Member States to authorise the marketing of the product or products concerned, subjecting such an obligation of authorisation to certain conditions, or even provisionally or definitively prohibiting the marketing of a product or products'.[38]

The concession that the Treaty-conferred competence to harmonise laws is not lost where regulatory protection is 'a decisive factor' in the legislative choices made is dependent on showing an adequate contribution to the making of the internal market. But that is not a high threshold. The Court's tolerance has been consistent and the consequence is that there is plenty of room for legislative intervention in the EU's internal market.

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[35] See M Brennke, 'Annotation' (2010) 47 *Common Market Law Review* 1793, 1804–1806.

[36] See S Weatherill, 'The limits of legislative harmonisation ten years after Tobacco Advertising: how the Court's case law has become a "drafting guide"' (2011) 12 *German Law Journal* 827; D Wyatt, 'Community Competence to Regulate the Internal Market' in M Dougan and S Currie (eds), *Fifty Years of the European Treaties: Looking Back and Thinking Forward* (Oxford, Hart, 2009) 93.

[37] Case C-380/03 *Germany v Parliament and Council* [2006] ECR I-11573, para 39.

[38] Ibid, para 43.

These are cases in which the attack on regulatory intervention was driven by the—unsuccessful—claim that the competence granted by the Treaty did not extend so far as to permit protective aims to serve as a decisive factor in the adoption of market-making legislative harmonisation. They are vital in showing how the *absence* of a principle of mutual recognition in EU internal market law leads to a shift of responsibility from the Court to the EU legislative process—which then has space to select among different political choices about the appropriate intensity of (re-)regulation of and in the internal market.

19.6.2 Subsidiarity, Freedom to Conduct a Business and Other Attempts to Restrain EU Market Regulation

Appeals to subsidiarity, as a restraint on the exercise of legislative ambition even where competence exists, have prompted little interest at the Court. In *Ex parte BAT* the Court readily found compliance with the subsidiarity principle by observing that given that the challenged Directive's objective was to eliminate the barriers caused by inter-State regulatory divergence while also ensuring a high level of health protection, it followed that since such an objective could not be sufficiently achieved by the Member States individually but rather was better achieved at EU level, the dictates of subsidiarity were satisfied.[39] This approach has become the Court's norm[40] and it entails that whenever the EU sets common rules then by definition it has complied with the principle of subsidiarity. In similar vein reliance on the proportionality principle as a basis for preserving commercial freedom from legislative intervention has cut little ice at the Court. In that same ruling in *ex parte BAT*, for example, the Court insisted that the legislature 'must be allowed a broad discretion in an area such as that involved in the present case, which entails political, economic and social choices on its part, and in which it is called upon to undertake complex assessments'.[41] In consequence a measure must be manifestly inappropriate having regard to its objective before the legislative choice will be regarded as disproportionate and therefore invalid. Proportionality may have bite where administrative decisions affecting the individual are at stake but the broader the measure's scope, the less likely that proportionality will trip up the legislature. A contextual understanding of the application of proportionality is required.[42] Only legislative choices that verge on the absurd are likely to be condemned as manifestly inappropriate. A gap looms between the *principle* that these are rules of constitutional significance which place reviewable limits on EU action and the *practice* of judicial restraint.

[39] Case C-491/01 *R v Secretary of State ex parte BAT and Imperial Tobacco* [2002] ECR I-11543 paras 181–183.

[40] e.g. Case C-58/08 *Vodafone, O2 et al v Secretary of State* [2010] ECR I-4999 paras 72–80.

[41] Case C-491/01 *R v Secretary of State ex parte BAT and Imperial Tobacco* para 123. See similarly Case C-58/08 *Vodafone* para 52.

[42] T Tridimas, *The General Principles of EU Law* (Oxford, OUP, 2006) Chap. 3–5.

The connecting thread in the reticent case law dealing with judicial review in the name of proportionality and (especially) subsidiarity is the concern of the Court not to trespass on the exercise of legislative discretion. The Court's sensitivity to the proper limits of its role when asked to intrude on legislative agreement is plain.

Increasingly—inspired especially by the conferral of binding status on the Charter by the Lisbon Treaty with effect from 2009—the Court finds itself pressed to find that regulatory burdens are unlawful interferences with property rights and commercial freedoms. But here too a degree of restraint is evident.

Deutsches Weintor eG v *Land Rheinland-Pfalz* provides a helpful example of the structure and style of the analysis one may anticipate (and hope for) from the Court in such cases.[43] Regulation 1924/2006 harmonises rules governing nutrition and health claims made about food.[44] Differences between national provisions relating to nutrition and health claims may impede the free movement of foods and consequently harmonisation is required to promote the functioning of the internal market, which also implies a need to address questions of techniques designed to achieve a high level of consumer protection at EU level. Nutrition and health claims made on foods must comply with the provisions of the Regulation. Among prohibited practices are 'false, ambiguous or misleading' claims; and also those that 'encourage or condone excess consumption of a food' and 'state, suggest or imply that a balanced and varied diet cannot provide appropriate quantities of nutrients in general'. Pursuant to the Regulation use of the phrase 'easily digestible' in connection with wines was forbidden. The Court was asked whether this restriction was compatible with the Charter. On the one hand, Article 15(1) of the Charter grants the right to engage in work and to pursue a freely chosen or accepted occupation and Article 16 guarantees the freedom to conduct a business. On the other, Article 35 of the Charter requires that a high level of human health protection be ensured in the definition and implementation of EU policies and activities. (The Court did not cite Article 38 on consumer protection—it easily could have done so). The Court was therefore required 'to reconcile the requirements of the protection of those various fundamental rights protected by the Union legal order' and to strike 'a fair balance between them'.[45] These are not absolute rights.[46] The Court emphasised that alcoholic beverages 'represent a special category of foods that is subject to particularly strict regulation'[47] and cited existing case law in which *national* restrictions on advertising of such products have been held to be compatible with EU law despite their trade-restrictive effect.[48] The problem with the claim made, which highlighted *only* the easy digestion of the wine, was its likely encouragement of consumption with increased risks for consumers' health inherent in excessive consumption of

[43] Judgment of 6 September 2012, Case C-544/10 *Deutsches Weintor eG v Land Rheinland-Pfalz*, not yet reported.

[44] [2006] OJ L 404/9.

[45] Para 47, citing Case C-275/06 *Promusicae* [2008] ECR I-271.

[46] Para 54.

[47] Para 48.

[48] Especially Case C-262/02 *Commission v France*; Case C-429/02 *Bacardi v TF1*.

alcohol, and that consequently 'the prohibition of such claims is warranted in the light of the requirement to ensure a high level of health protection for consumers'.[49] This legislative regime was based on a reconciliation of the several fundamental rights at stake, striking a fair balance between them. It was compatible with EU law. The Court found that the EU legislature had respected fundamental rights when it intervened in commercial freedom by adopting the Regulation.

This is a case suggesting the increasing prominence of arguments based on fundamental rights in general and the Charter in particular which are designed to challenge the validity of the EU's regulatory intervention in the market. Freedom to conduct a business and more generally appeal to the virtue of private autonomy are becoming part of the fabric of the reasoning in cases which call into question the choices made through the legislative process. One may readily anticipate their deployment to attack EU measures on, say, consumer protection, labour market regulation and even anti-discrimination and equality. This promises an intriguing exercise in shaping priorities. And it is a task that attracts an acutely normative sensitivity: how interventionist should EU law be? How interventionist should the Court be in checking the legislative choices? Attitudes vary profoundly.[50]

The Court has a long-standing formula which grants a broad discretion to the EU legislature in circumstances where it is called on to undertake complex assessments in matters that engage political, economic and social choices. Only where a high threshold is crossed will the Court find action to be unlawful—only if the measure is manifestly inappropriate having regard to the objective which the competent institutions are seeking to pursue.[51] *Deutsches Weintor* is in this vein. So is *Sky Österreich*, in which Directive 2010/13's bite into the contractual freedom of the exclusive holder of broadcasting rights was held valid because of the public interest in permitting other broadcasters the right to use short extracts from events of high interest to the public in their own coverage.[52] Here too, as in *Deutsches Weintor*, the freedom to conduct a business recognised by Article 16 of the Charter was not treated as absolute, but instead fell to be assessed in the light of its social function. These rulings do not suggest that the Court is ready to act aggressively in curtailing legislative options for the regulation of the internal market.

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[49] Case C-544/10 *Deutsches Weintor eG v Land Rheinland-Pfalz* para 52.

[50] e.g. C Herresthal, 'Constitutionalisation of the Freedom of Contract in European Union Law' in K Ziegler and P Huber (eds), *Current Problems in the Protection of Human Rights—Perspectives from Germany and the UK* (Oxford, Hart Publishing, 2013) 89; D Leczykiewicz, 'Horizontal Effect of Fundamental Rights: In Search of Social Justice or Private Autonomy in EU Law?' in U Bernitz and X Groussot (eds), *General Principles of EU Law and Private Law* (The Hague, Kluwer International, 2014); J Basedow, 'Freedom of Contract in the European Union' (2008) 16 *European Review of Private Law* 901, and several contributions, in particular but not only those by M Hesselink, B Lurger and R Schulze, in R Brownsword, H-W Micklitz, L Niglia, and S Weatherill (eds), *The Foundations of European Private Law* (Oxford, Hart Publishing, 2011).

[51] e.g. Case C-380/03 *Germany v Parliament and Council* para 145; Case C-84/94 *United Kingdom v Council* [1996] ECR I-5755 para 58; Case C-491/01 *R v Secretary of State ex parte BAT and Imperial Tobacco* para 123.

[52] Judgment of 22 January 2013, Case C-283/11 *Sky Österreich*, not yet reported. Cf in the same vein judgment of 17 October 2013, Case C-101/12 *Herbert Schaible*, not yet reported.

If there were a principle of mutual recognition in EU law, there would be little, if any, scope for the adoption of this type of legislation, let alone its judicial review. Given that there is only a conditional or non-absolute principle of mutual recognition in EU law, such legislation is required to advance the building of the internal market beyond the stage attainable by application of the free movement rules alone, and the questions that reach the Court focus on the validity of the regulatory choices made through the political process. There is a risk of Charter-based claims running amok in the Court's diet, as well-funded commercial parties seek to use judicial review to assert shelter from socially motivated regulation, and—to broadcast the author's own normative preferences—the Court's unwillingness to be led in this direction deserves welcome.[53] Hans Micklitz has it right when, in a brilliant plea to appreciate that consumer law as a project of market-making should not neglect the need for protection from some consequences of that market-making, he argues 'in favour of a more active European Court of Justice, one which sharpens the social dimension of the EU, not only through consumer law, but also through anti-discrimination and employment law'.[54]

19.7 Conclusion

My conclusion is short and it is addressed to the Court and to the Commission. It is—'Just be a bit more careful, please'. Article 34 is the source of *the obligation to comply with the principles of non-discrimination and of mutual recognition of products lawfully manufactured and marketed in other Member States, as well as the principle of ensuring free access of EU products to national markets, subject to the possibility that the regulating authority may demonstrate an objective in the general interest which shall prevail over that in securing the free movement of goods.* That final sub-clause, which is my addition to the formula wrongly used by the Court in some recent decisions, crucially confirms that there is no principle of mutual recognition in the law of the EU's internal market. Any hint that there is damagingly obscures the rather subtle balance that has been struck between, on the one hand, the deregulatory impulse of free movement law and the regulatory autonomy of the Member States (the vertical issue) and, on the other, the role of the Court in ruling against the application of unjustified trade barriers and the role of the EU legislature in deciding how to replace justified trade barriers at national level with common EU rules apt to re-regulate and thereby to integrate the wider internal market (the horizontal issue).

[53] The only blot on the Court's record is judgment of 18 July 2013, Case C-426/11 *Alemo-Herron*, not yet reported, which adopts an inappropriately aggressive interpretation of Article 16 of the Charter in the context of protection of workers on the transfer of undertakings, and quite wrongly pretends to be in line with the rulings in *Sky Osterreich* and *Deutsches Weintor. Alemo-Herron* deserves no more than I here grant it—scornful comment in a footnote.

[54] H-W Micklitz, 'The Expulsion of the Concept of Protection from the Consumer Law and the Return of Social Elements in the Civil Law: a Bittersweet Polemic' (2012) 35 *Journal of Consumer Policy* 283.

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Chapter 20
Internal Market Law and National Language Policies

Bruno De Witte

Abstract One area in which internal market law has repeatedly clashed with national language legislation is that of consumer protection. Many national and regional laws require the use of the local language in advertising, labelling, and contracts relating to goods and services imported from other EU countries. Hans Micklitz devoted an illuminating study to this question some 10 years ago, and I am pleased to honour his academic achievements by returning to that topic on this occasion. My contribution is not limited to the area of consumer protection, as I will look more broadly at the extent to which the application of national legislation relating to the use or knowledge of a particular language is restricted by EU internal market law.

20.1 Introduction

Some years ago, in response to a written question by a member of the European Parliament who complained about the policy of the Greek government restricting the use of the Pomak and Roma minority languages in Thrace, the EU Commission member Viviane Reding stated that 'the principle of subsidiarity means that the legal status of languages within national boundaries is the competence of the individual Member States, with due regard to their obligations under international treaties.'[1] This statement is not entirely true. Limits on the Member States' language policies do not just result from international treaties (namely, human rights treaties or more specialized minority protection treaties such as the Council of Europe's Framework Convention on National Minorities), but European Union law also imposes its own

[1] Answer given by Mrs Reding on behalf of the Commission to Written Question E-1671/01 by Stavros Xarchakos, [2003] OJ C 155E/1.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_20,

limits. This contribution deals with one important type of limit, namely that which results from EU legal rules relating to the functioning of the internal market.

One area in which internal market law has repeatedly clashed with national language legislation is that of consumer protection. Many national and regional laws require the use of the local language in advertising, labelling, and contracts relating to goods and services imported from other EU countries. Hans Micklitz devoted an illuminating study to this question some 10 years ago,[2] and I am pleased to honour his academic achievements by returning to that topic on this occasion. My contribution is not limited to the area of consumer protection, as I will look more broadly at the extent to which the application of national legislation relating to the use or knowledge of a particular language is restricted by EU internal market law.

20.2 The Constitutional Context: Competences, Fundamental Values, and Common Market Freedoms

The text of EU primary law contains two kinds of provisions relating to the use of languages. On the one hand, a few articles deal with the language regime of the European Union itself,[3] and on the other hand, the Treaties and the Charter of Rights contain various references to the value of linguistic diversity which the European Union must respect and protect.[4] Furthermore, the Charter also prohibits discrimination on grounds of language.[5]

In terms of competences, the scope for EU action seems rather limited. The EU is allowed to take supplementary action in order to protect linguistic diversity, which it does, for example, by giving financial support for language training and for projects relating to what are euphemistically called 'lesser used languages'.[6] However, in addition to this modest language policy *per se*, the European Union indirectly regulates language by including the linguistic dimension in legal measures whose principal objective is of a different kind, and whose legal basis is found elsewhere in the Treaties. A recent example is the Directive on the right to interpretation and translation in criminal proceedings.[7] This directive has its legal basis in the TFEU chapter dealing with criminal law and policy, and it enacts rules on the use of languages in criminal proceedings with the aim of protecting the right to a fair trial of European citizens, rather than of harmonising national language policies. We find

[2] H-W Micklitz, 'Zum Recht des Verbrauchers auf die eigene Sprache' (2003) *Zeitschrift für Europäisches Privatrecht* 635.

[3] Art 55 TEU, Art 24 (final sentence) and Art 342 TFEU.

[4] Art 3(3) TEU, Art 165 TFEU, and Art 22 of the Charter.

[5] Art 21 of the Charter.

[6] For a survey of those measures, see Commission Staff Working paper, SEC(2011) 926, *An Inventory of Community* (sic) *actions in the field of multilingualism—2011 update.*

[7] Dir 2010/64, [2010] OJ L 280/1.

similar examples in other areas, such as internal market law, where harmonisation measures occasionally contain norms dealing with the use or knowledge of languages, as we shall see below.

Those are rather limited legislative interventions, though. There is no doubt that, in general terms, the Member States (and/or the regions within those states) retain the competence to regulate the use of languages. In particular, they decide whether, and to what extent, to allow the use of a plurality of languages for *official* purposes: in public administration and the courts, in the public service media and in public educational institutions. States can either opt for a system of rather strict linguistic uniformity (as, for example, in France and Germany) or they may give wide official recognition to regional and minority languages (as happens, for example, in Spain, Italy and the United Kingdom). The discretion of states has been limited only recently by international norms in this respect, most clearly so by two Council of Europe instruments, the Framework Convention for the Protection of National Minorities[8] and the European Charter for Regional or Minority Languages.[9] The *non-official* use of languages (that is, in the context of private and social relations) is also the object of legal regulation, albeit less universally and systematically than the official use.

And yet, in the exercise of these 'retained' national or regional competences, the Member State authorities are not entirely free to act as they please. The Treaty rules on market integration, namely the common market freedoms and the rules on state aid, act as a constraint by prohibiting certain national rules of language regulation that negatively affect the functioning of the internal market. The limited *positive* competences of the EU in this field are thus supplemented by the *negative* impact of the market freedoms and state aid rules on national language law. This impact usually consists in creating space for the unhindered use of other, non-national, European languages. For that reason, the EU's intervention is rather ambiguous from the perspective defined by both Article 3 TEU and Article 22 of the EU Charter of Rights, namely that the Union must protect linguistic diversity. By constraining national language law, the Union affects the way in which the Member States seek to protect their own languages; but at the same time, the Union facilitates the use of other languages, namely those spoken by out-of state European citizens.

20.3 The Tension Between Market Integration and National Language Law

The existing linguistic diversity in Europe makes communication across national boundaries more difficult. Therefore, it may be said that language differences act as an obstacle to the movement of persons and ideas, and that even the diffusion of

[8] Adopted on 1 February 1995, and entered into force on 1 February 1998, *European Treaty Series* No 157.

[9] Adopted on 5 November 1992, and entered into force on 1 March 1998, *European Treaty Series* No 148.

linguistically neutral images and objects is hampered by linguistic diversity, if only because they are accompanied by linguistic messages (as with text accompanying films and television programmes). In economic terms, one could say that linguistic diversity creates additional transaction costs that would not arise within a linguistically homogeneous area.

To this economic and social cost of linguistic diversity, a further political and legal cost is added by the language policies adopted by national and regional governments. Such language policies increasingly reach beyond the traditional field of official language use and extend to language use in private relations. This legal regulation of language use in economic and social life may be seen, from an economic perspective, as a *distortion* of the linguistic patterns that would spontaneously result from the informal interaction between private persons. It may also be seen, alternatively, as a useful or necessary *correction* of the dominant position occupied by some of the parties in an economic or social transaction.

The, perhaps, most prominent example of an interventionist language law is the French *Loi Toubon* of 1994, which among other things imposes the use of French (as opposed, essentially, to English) in the sale, promotion and advertisement of all goods and services;[10] and respect by private firms for this obligation is actively controlled by 'language inspectors'.[11] The application of this Law prompted the analysis of Hans Micklitz which I mentioned in the introduction of this essay. Another example, in a different sociolinguistic context, is the Catalan language law of 1998 that seeks to extend the societal use of Catalan (as opposed, essentially, to Spanish) by imposing language obligations on broad categories of private persons.[12] There are many more examples of such interventionist legislation, also and particularly in the new member states of Central and Eastern Europe.

In this context, the autonomy of the Member States and their regions is much more constrained by EU law than with regard to language use in the public sector. To the extent that persons from other EU states, or goods or services imported from other EU states, are involved, policies that regulate private language use may conflict with Union law. Let us begin by putting the nature of this tension in very general terms. The TFEU aims at removing barriers to economic activity within the internal market, and because language is the medium of practically all economic activity, the TFEU implicitly aims at removing barriers caused by the fact that the choice of the language is restricted for participants in transnational economic activities. In other words: the TFEU guarantees an implied *free movement of languages*. Linguistic policies pursued by national or regional governments that form a barrier to the cross-border trade of goods and services, and cross-border mobility of persons, are prima facie suspect.

[10] Loi no 94-665 du 4 août 1994 relative à l'emploi de la langue française, Art 2.

[11] See, for a view of the public enforcement of this linguistic obligation, the annual reports of the Délégation générale à la langue française; most recently its *Rapport au Parlement sur l'emploi de la langue française 2013*, 16–27 (www.dgif.culture.gouv.fr).

[12] See A Milian Massana, 'La réglementation linguistique dans le domaine socio-économique: perspectives catalane et comparée' (1999/2000) 33 *Revue générale de droit* 329.

This is often perceived as a 'negative' impact, when seen from the perspective of the Member States or regions: internal market law restricts their autonomy in regulating language. To situate the problem, and to illustrate the existence of the tension, I will briefly present two cases in which this type of conflict (between internal market law and national language regulations) arose, one before the European Court of Justice (ECJ) and the other before the *Conseil d'Etat*, the supreme administrative court of France.

In Case C-193/05, the European Commission brought before the ECJ an infringement action against Luxembourg in relation to the application, in that country, of Directive 98/5 on the professional establishment of lawyers in Member States other than the one in which they obtained their qualifying professional degree.[13] This directive is one of the many legislative measures designed to facilitate the free movement of persons within the EU, in this case by requiring all Member States to recognize the professional qualifications of lawyers from other EU countries. The Commission argued that Luxembourg had created a number of undue obstacles to the correct application of this directive by imposing additional barriers not expressly allowed by it. One such barrier was a language requirement. Foreign lawyers could only be registered at the Luxembourg bar if they could show their proficiency in the three national languages, French, German and Luxembourgish. It is clear that this condition, especially that of knowing Luxembourgish, acts as an effective barrier against the establishment of most if not all foreign lawyers. In its Grand Chamber judgment of 19 September 2006, the Court of Justice held that the Directive 98/5 listed all the requirements which foreign-trained lawyers had to meet in order to be allowed to practise their profession under their home title, and that the Member States could not add any other conditions such as a language knowledge requirement. That requirement was therefore held to be in breach of EU law.[14]

The second illustration of the tension between internal market and national language requirements is the *Fun Radio* case, decided by the French *Conseil d'Etat* on 8 April 1998. It concerned the compatibility with European Union law of the French radio quotas regulation, according to which at least 40 % of songs broadcast on French radio stations must be *chansons d'expression française*. This kind of linguistic requirement can, in fact, be found in many European countries. The supreme administrative court acknowledged that this constituted a restriction of intra-European trade, both of the free movement of goods (namely, of music recordings) and of the free movement of services (namely, of pre-packaged music programmes). It held, however, that these restrictions were justified for reasons of national cultural policy, and that the 40 % requirement was not disproportional. In

[13] Directive 98/5, [1998] OJ L 77/36.

[14] Case C-193/05 *Commission v Luxembourg* [2006] ECR I-8673. The same issue was raised in a preliminary reference which originated in legal action taken by a British lawyer against the Luxembourg bar; that case was decided on the same day and the Court's ruling on the language issue was identical: Case C-506/04 *Graham J. Wilson v Ordre des avocats du barreau de Luxembourg* [2006] ECR I-8613. On both these judgments, see the comments by J Vanhamme, 'L'équivalence des langues dans le marché intérieur; l'apport de la Cour de Justice' (2007) *Cahiers de droit européen* 359, 373–378.

doing so, the *Conseil d'Etat* formally applied the test formulated by the European Court of Justice for such situations, but it omitted to refer a preliminary question to the ECJ, for fear probably that the ECJ would reach a different conclusion as to the necessity of the restriction.[15]

These two cases are emblematic examples of a broader phenomenon. They show that linguistic requirements can relate both to the *knowledge* of a language (as in the Luxembourg case) and to its *use* (as in the French case); that they can affect both the free movement of *persons* (as in the Luxembourg case) and the free movement of *goods and services* (as in the French case); and that the relevant European rules can belong to *primary* law (namely, the Treaty on the Functioning of the European Union or, in pre-Lisbon days, the Treaty on the European Community) or to *secondary* law (such as the directive on the establishment of lawyers). There are many potential conflict cases of a similar nature, because there are many provisions in the language regulations of states and regions that potentially restrict the operation of the internal market. There is still a lack of clarity as to the parameters set by EU law in this respect, and, thereby the national and regional language legislators (and the persons and bodies called to enforce such legislation) face some uncertainty as to what they may or may not do, as a matter of European law.

Thus, language policy is no longer a discrete compartment of member state autonomy as it is officially claimed to be (see, for example, the statement by Commissioner Reding mentioned in the introduction of this chapter), but is yet another national policy that is exposed to the discipline of European trade law. The existence of this 'conflict zone' between language protection and free trade was revealed by a number of *court* rulings over the years. In each of those cases, the (European and national) courts were called to balance the interest of ensuring trade liberalisation and the mobility of persons within the common market, as against the competing public policy interest, advanced by the Member State concerned, to pursue the language policy of its choice. The same kind of balance must be struck by the European *legislator*, whenever an impediment to the functioning of the internal market, instead of being brought before the courts, is addressed by means of harmonising legislation at the European level. The European Union legislative bodies then have to decide the appropriate degree of deregulation or, alternatively, of Europe-wide re-regulation in matters of language use. In this context, linguistic freedom is like other freedoms: genuine freedom for all may need some degree of intervention, given the unequal starting points of those engaged in linguistic communication.

In the following sections, I will further explore this question on the basis of a distinction between three types of language regulation which one commonly finds throughout Europe: the requirement of *knowledge* of a language in order to take up a certain profession or activity; the requirement to *use* a certain language in the course of one's professional or commercial activity; and the *conditioning of financial subsidies or tax benefits* on the use of a given language.

[15] Conseil d'Etat, 8/4/1998, *Sté SERC Fun Radio*, (1999) *Revue française de droit administratif* 209 (and the conclusions of the *commissaire* Sylvie Hubac, ibid, 194).

20.4 Requirements of Language Knowledge

One consequence of the selection of one or more official languages in a country or region is that the administration and public service operating in that country or region should be capable to deal with the demands made by the citizens through the official language(s). Where there is a regime of official bilingualism (as is the case in several Spanish regions, in South Tyrol, in Ireland, in Brussels, in many areas of Wales and Finland, etc.), this requires a choice between different models of linguistic organisation of the various public services and administrations. One approach is to provide for some form of internal language specialisation, so that the *service* as a whole is able to respond in the appropriate language whereas its employees do not systematically need to be proficient in both languages. However, in many cases, national or regional laws require every *individual official* to have the capacity to work in both languages, and to communicate with the population in both languages. As a logical consequence, bilingual skills are imposed as a condition for employment or promotion in the service. There has been widespread litigation in domestic law on the validity of such linguistic conditions for access to public employment, but by and large national courts have found them permissible on the ground that they are the most efficient way of enabling the public service to function in both official languages.

The role of European Union law in this matter stems from the fact that requirements of linguistic knowledge can be a deterrent to the employment of citizens of other EU countries in public sector jobs. The fact that linguistic conditions of employment could function as indirect discrimination against foreigners was recognised already in the 1960's in Regulation 1612/68 on the free movement of workers. Article 3 of that Regulation, which is still in force today as Article 3 of the codifying Regulation 492/2011,[16] prohibits *indirect discrimination* resulting from actions having as their exclusive or principal aim or effect to keep nationals of other member states away from the employment offered. To this rule, a qualifying statement is added, namely that the prohibition does 'not apply to conditions relating to linguistic knowledge required by reason of the nature of the post to be filled'. The question, therefore, is whether a requirement of linguistic proficiency is genuinely related to the specific public employment job for which it is imposed. If not, it will be considered as a way of excluding foreigners, in particular EU citizens, from access to that job and will be contrary to the state's (or region's) European law obligations.

This issue was addressed by the European Court of Justice in a high-profile case decided in 1989, the *Groener* case.[17] Irish law imposed the requirement that candidates for a permanent teaching post in public education should demonstrate an adequate knowledge of the Irish language. A Dutch applicant for the job, Anita Groener, having failed the test, alleged that this requirement effectively excluded EU citizens from applying for any of these teaching jobs and was therefore a form

[16] Reg 492/2011 on freedom of movement for workers within the Union, [2011] OJ L 141/1.

[17] Case 379/87 *Groener v Minister for Education and the Dublin Vocational Education Committee* [1989] ECR 3967.

of indirect discrimination prohibited by Article 3 of Regulation 1612/68. There seemed to be very good reasons to hold this view given the particular facts of the case. The job for which Ms Groener applied, that of teacher of painting in the College of Marketing and Design in Dublin, did not in fact require her to speak Irish at any time, and therefore knowledge of that language was not a functional necessity. However, the Court of Justice gave a remarkably wide interpretation to the language clause of Regulation 1612/68. Because Irish was an official language of the country, Ireland was allowed to require its knowledge from all teachers, even those who would not be called to use it in the course of their work, on condition that the required level was not set too high. The Court did not read Article 3 of the Regulation as laying down a purely functional test (i.e.: is knowledge of the language necessary for the day-to-day performance of the job?), but as allowing for consideration of the broader constitutional background and the language policy priorities of the member states.

There has been much speculation about the implications of the *Groener* judgment, beyond the specific case of Ireland and of employment in public education. The judgment certainly expressed sensitivity from the side of the Court for the national identity concerns of the member states, but no blank check was given to them or to their autonomous regions. It is rather the idea of *conditional national autonomy* that prevails. Whenever a language criterion is used in recruitment for a particular job, the suspicion arises that it may be indirectly discriminating against EU citizens. If litigation starts, it is for national courts and the ECJ to decide whether the language knowledge is actually required for the post and, if so, whether or not it is set at a disproportionately high level and whether it is applied fairly in the case at hand.

The European legal norms about non-discriminatory access to employment fully apply also to *private sector* employment, as was made clear by the European Court of Justice in 2000, in the *Angonese* case that had been referred to it for a preliminary ruling by a local court in Bolzano. Access to employment in a bank in Bolzano was made dependent upon a showing of adequate language knowledge of both Italian and German, the two official languages in South Tyrol. This, the Court found, was a direct and acceptable consequence of the minority protection regime enacted in this region of Italy (even though it concerned employment in a private bank), but the additional requirement that evidence of bilingualism could be provided only by means of a local certificate and not by other means was held to be an indirect discrimination against citizens from other EU countries, and hence in breach of EU law.[18]

This judgment has become famous for its sweeping statement that the right to free movement of persons has full horizontal application, i.e. that private persons are bound to respect this freedom and hence must abstain from discrimination against EU citizens in the sphere of employment. Like in public sector employment, language skills may only be imposed on citizens of other European Union countries

[18] Case C-281/98 *Angonese v Cassa di Risparmio di Bolzano* [2000] ECR I-4083. See R Lane and N Nic Shuibhne, 'Case C-281/98, Roman Angonese v. Cassa di Risparmio di Bolzano SpA, Judgment of 6 June 2000, not yet reported' (2000) 37 *Common Market Law Review* 1237.

to the extent that they are a 'business necessity'. As a logical consequence, the European Commission has declared that the condition, frequently used in announcements of recruitment, that candidates should be 'native speakers' of a particular language is a form of indirect discrimination against citizens of other EU countries which is prohibited by EU law.[19] If, for the performance of a job, excellence in, say, English is required, applications by persons who are not native speakers of English but have acquired excellent knowledge later on in life may not be excluded.

Still in relation to the free movement of persons, language knowledge requirements may also apply to the exercise of *independent professions*. In such cases, the language condition is not the consequence of the selection of an official language for that state or region (since, by definition, private professionals do not exercise public authority), but is inspired by the need to guarantee effective communication between the professional and his or her clients or patients. In the *Haim* case decided in 2000, the European Court of Justice affirmed in general terms that the imposition of non-discriminatory language requirements on self-employed EU citizens may be justified. In the particular case of Salomone Haim (an Italian dentist seeking to practise his profession in Germany), the Court held that 'the reliability of a dental practitioner's communication with his patient and with administrative authorities and professional bodies constitutes an overriding reason of general interest such as to justify making the appointment as a dental practitioner under a social security scheme subject to language requirements. Dialogue with patients, compliance with rules of professional conduct and law specific to dentistry in the Member State of establishment and performance of administrative tasks require an appropriate knowledge of the language of that State'.[20]

The European Union legislator has now made this into a general rule for the recognition of professional qualifications. In the Directive of 7 September 2005 on the recognition of professional qualifications, which 'recasts'[21] a number of earlier specific directives on the recognition of qualifications,[22] there is an Article 53 dealing with the knowledge of languages in the following terms: 'Persons benefiting from the recognition of professional qualifications shall have a knowledge of languages necessary for practising the profession in the host Member State'. In its proposal for the directive, the Commission had added a paragraph 2 which stated that '[T]he Member States shall ensure that, where appropriate, the beneficiaries acquire the

[19] See Commission Communication of 11 December 2002, *Free Movement of Workers—Achieving the Full Benefits and Potential*, COM(2002) 694, 7: 'The Commission considers that while a very high level of language may, under certain strict conditions, be justifiable for certain jobs, a requirement to be mother tongue is not acceptable'. But the Commission's view has not yet been tested by means of an infringement procedure or private litigation before national courts.

[20] C-424/97 *Salomone Haim v Kassenzahnärztliche Vereinigung Nordrhein* [ECR] 2000 I-5123, para 59.

[21] In EU law parlance, 'recasting' means that a number of existing directives are merged together into a more encompassing directive (leading to the repeal of the earlier directives), whereas at the same time some of the substantive content of those earlier directives is being amended.

[22] Dir 2005/36 on the recognition of professional qualifications, [2005] OJ L 255/22. The directive has been amended several times since, but not on the point that is relevant here.

language knowledge necessary for performing their professional activity in the host Member State.' That phrase was rather ambiguous. It was probably not meant to imply that host states should offer free language courses to migrant professionals, but it could have been interpreted as preventing the host states from simply denying access to a profession, without further ado, to a migrant whose language competence is temporarily deficient. However, this second paragraph was eliminated from the final text of the directive.

Apart from this general system of recognition of qualifications, some specific legal regimes continue to apply, such as the regime for foreign-trained lawyers which is subject to a special Directive of 1998. In that text, there are no references whatsoever to language requirements and the European Court of Justice, in the C*ommission v Luxembourg* judgment mentioned above, held that this absence means that the EU legislator considered that language requirements were not justified in the case of lawyers, and they can therefore not be imposed unilaterally by certain states. It is interesting to note that, whereas the ECJ had held in *Haim* that the *Treaty* provisions on free movement did not exclude the possibility of imposing linguistic knowledge requirements on foreign professionals, this possibility disappears when the European legislator has 'occupied the field' by defining the conditions for the establishment of a particular category of professionals and deciding not to include language requirements among those conditions.

20.5 Requirements to Use a Given Language

Private individuals and firms are often required by law to use a particular language for a given purpose. When such requirements apply in a cross-border context, they may be analysed as restrictions to the internal market or the free movement of persons. There is no comparative study mapping this kind of language legislation, nor has the European Commission ever undertaken a systematic assessment of such rules from the point of view of their compatibility with EU law. The compatibility of the French *Loi Toubon* with EU law has been rather extensively discussed in the literature,[23] but the European Commission has so far refrained from challenging France before the European Court of Justice on this matter.

However, even though the French language law may be particularly interventionist and restrictive, one should not consider this to be a specifically 'French' problem. Many other states and regions have adopted language laws that interfere with private preferences by requiring the exclusive or supplementary use of the na-

[23] In addition to the case comment of Micklitz, 'Zum Recht des Verbrauchers auf die eigene Sprache', see also HJ Albers and C Swaak, 'The Trouble with Toubon: Language Requirements for Slogans and Messages in the Light of Article 30 EC' (1996) 21 *European Law Review* 71; N McCarthy and H Mercer, 'Language as a Barrier to Trade: The Loi Toubon' (1996) 17 *European Competition Law Review* 308; C Boch, 'Language Protection and Free Trade: The Triumph of the Homo McDonaldus?' (1998) 4 *European Public Law* 379; M Frangi, 'Le consommateur français entre loi Toubon et droit communautaire' (2003) 17 *Revue internationale de droit économique* 135.

tional or regional language. Among other examples, one may mention the 1999 Act on the Polish Language, the 1999 State Language Law of Latvia, the 2004 Act on Public Usage of Slovenian Language,[24] and the Catalan *Ley de Política Lingüística o*f 1998. Occasionally, instead of only formulating *obligations* for private parties, the law provides a *right* for individuals to use the national or regional language in particular private contexts, with corresponding obligations for the other party. A recent example of this approach is Article 34 of the 2006 Statute of Autonomy of Catalonia which formulates a general right for the users or consumers of goods and services to be addressed in the official language of their choice (that is, in Catalan or in Spanish).[25]

The kinds of transactions which are made subject to linguistic requirements in these laws are very diverse, and include the following: information provided to consumers when they acquire goods (for example, regarding the labelling of goods or instructions for their use) or hire commercial services (for example, regarding the guarantees to be provided); commercial publicity in the media or on billboards; contacts between firms and their clients or users; the drawing up of employment contracts, internal work instructions and health and safety measures in firms; communication at scientific meetings sponsored by the State; etc.

The position of EU law with regard to such legal rules is not straightforward. In the absence of specific EU legislation dealing with the matter (as exists, for example, for product labelling, on which see below), primary EU law imposes some general limits for such linguistic requirements. In fact, the *terms* of the Treaties do not deal with this question at all. What we have, rather, is a general doctrine of the European Court of Justice on national measures that restrict the operation of the internal market, and this well-known general doctrine is to be applied also in this domain. If it can be shown that a national or regional language requirement hinders, effectively or potentially, the free movement of goods, persons or services, then the state concerned is required to offer a justification for that restriction. Essentially, it has to show that the measure does not have a protectionist aim but was adopted for sound reasons of public policy. The restrictive measure will be acceptable (1) if it applies equally to both domestic and foreign goods, services or persons; (2) if it is justified by a general public interest; (3) and if it is proportional, that is, if the restriction imposed on the operation of the internal market is really necessary to achieve the public policy objective.

The tripartite test leaves, of course, a large degree of uncertainty as to its concrete application. This uncertainty is a general characteristic of this area of EU law and the issue of language regulation is very much marked by it. This can be shown by the example mentioned above of the *Conseil d'Etat* judgment in *Fun*

[24] Despite its title, this Act also deals extensively with *private* language use.

[25] The article is formulated as follows, in the Spanish language version: 'Todas las personas tienen derecho a ser atendidas oralmente y por escrito en la lengua oficial que elijan en su condición de usuarias o consumidoras de bienes, productos y servicios. Las entidades, las empresas y los establecimientos abiertos al público en Cataluña quedan sujetos al deber de disponibilidad lingüística en los términos establecidos por ley.'

Radio. In that case, the French administrative court examined the compatibility of the French radio quotas with the free movement of goods and services, and duly used the tripartite test. It found the measure to be equally applicable to French and other EU nationals or firms, it found it justified by a legitimate public policy objective, namely the protection of culture, and it found the restriction to be proportional. If the question had been put to the Court of Justice through a preliminary reference (which, in fact, it should have been), it is likely that the ECJ would have agreed with the cultural policy justification, but it might not have agreed that the 40 % quota for French language songs was a proportional measure.

We have today in the European Union many potential *Fun Radio* cases, that is, cases of national or regional laws that require the use of a given language and, by doing so, restrict the operation of the internal market and whose compatibility with EU law is uncertain. We do not have a leading judgment by the European Court of Justice, nor has the European Commission sought to offer guidance through an interpretative communication.

The legal situation is, however, different when the question of language use, in a particular domain, has been *harmonized* at the European level by means of EU legislation. This has happened mainly in the field of consumer protection, where there are several directives containing rules regulating the use of languages in relations between business firms (producers or distributors of goods or services) and consumers. The oldest and most widely known of these European law instruments was Directive 79/112 on labelling of food products.[26] Its Article 14 (now amended, as we shall see) dealt with the linguistic dimension of labelling in a rather ambiguous way. It stated that the Member States may, and must, prescribe that labelling of food products should be in a language which the consumer can easily understand, unless he or she is sufficiently informed otherwise about the characteristics of the product. Some countries had much stricter legal rules, prescribing the use of the national language in all cases and for all products without providing for an 'unless' derogation. Such strict obligations to use the local language of the territory in which the product is to be marketed creates additional packaging costs for multinational firms, and may generally hinder their cross-border marketing strategy.

The issue of compatibility of those national laws with the directive arose before the European Court of Justice in a number of cases in which the Court took a rather business-friendly view. An example of the Court's general attitude is its judgment of 12 September 2000 in the *Geffroy and Casino France* case.[27] Criminal proceedings had been brought in France against a supermarket and one of its managers (Mr Geffroy) for offering for sale cola drinks with English-language labels, rather than the required French-language labels. In its preliminary ruling, the ECJ held that the

[26] [1979] OJ L 33/1. See, for more detailed analysis of the European regulation of the use of languages for labelling purposes, Micklitz, 'Zum Recht des Verbrauchers auf die eigene Sprache'; N Nic Shuibhne, 'Labels, Locals, and the Free Movement of Goods' in R Craufurd Smith (ed), *Culture and European Union Law* (Oxford, Oxford University Press, 2004) 81, 88–95; V Bansch, *Sprachvorgaben im Binnenmarktrecht* (Baden-Baden, Nomos, 2005) 24–132.

[27] Case C-366/98 *Yannick Geffroy and Casino France* [2000] ECR I-6579.

general imposition of the use of French for the labelling of foodstuffs contravened the EC Directive of 1979, because the latter merely imposed the use of a language which is easily comprehensible to the consumer in the particular context of the sale. It must therefore be decided case by case whether, in the absence of labelling in the national language, consumers are sufficiently informed about the nature of the product. Although the judgment merely confirmed earlier Court rulings on the same question,[28] it caused quite a stir because this producer-friendly doctrine of the Court was applied for the first time in the particularly delicate French context.[29] In fact, earlier on in the same year, the French *Cour de Cassation* (criminal chamber) had confirmed the fines that had been imposed, on the basis of the *Loi Toubon*, on a distributor of electric festoons imported from Germany for having sold these products without an accompanying notice written in French. The French supreme court accepted that this was a restriction of the free movement of goods, but considered the restriction to be justified by reasons of consumer protection. In its view, this conclusion was so evident that there was no need to ask for a preliminary ruling by the European Court of Justice which is of course ironic, in light of the *Geffroy* judgment of the ECJ only a few months later.[30]

Partly as a reaction to the Court's case-law, and to the controversies unleashed by it, the European legislator decided to modify the language article of the labelling Directive, through an amendment which is now codified as Article 16 of Directive 2000/13 on the labelling, presentation and advertising of foodstuffs.[31] According to paragraph 2 of this article, the Member States are allowed to stipulate that the required information shall be given to consumers 'in one or more languages' which the State 'shall determine from among the official languages of the Community', whilst allowing for those indications to be given also in other languages. This amendment represents the recognition by the European Union legislator that linguistic impediments of the free flow of goods may be validly imposed, in this case[32] and it can be seen as an overruling of the Court's case law by the European legislator.[33] Since the enactment of this amendment, no further cases on the language of food labels have reached the Court, which seems to indicate that the issue has been solved. The

[28] The leading precedents were the two *Piageme* cases which dealt with Belgian labelling regulations: Case C-369/89 *Piageme v Peeters* [1991] ECR I-2971; and Case C-85/94 *Piageme v Peeters* [1995] ECR I-2955.

[29] See the very critical comment on this case by a French language law expert: JM Pontier, 'Le juge communautaire, la langue française et les consommateurs' (2001) 18 *Le Dalloz* 1458; see also, for a more moderate comment, Frangi, 'Le consommateur français'.

[30] Cass Crim 26 April 2000, *Nizard*, no 2600. See D Simon, 'Utilisation des langues et protection du consommateur—Les guirlandes électriques n'éclairent pas nécessairement les juges…' (March 2001) *Europe—Editions du Juris-Classeur* 18.

[31] [2000] OJ L 109/29.

[32] Indeed, a similar provision was included in Dir 1999/44 on certain aspects of the sale of consumer goods and associated guarantees ([1999] OJ L 171/12, Art 6(4).

[33] As of 31 December 2014, Dir 2000/13 will be replaced by Reg 1169/2011 on the provision of food information to consumers ([2011] OJ L 304/18) which contains an Art 15 entitled 'Language requirements' whose wording is practically identical to that of Art 16 of Dir 2000/13.

remaining problem with the new formulation is, however, that the languages whose use may be imposed on food labels are only the official languages of the European Union. Thus, the Finnish legislator may require the use of Swedish on food labels, because Swedish, although it is spoken only by a minority of Finns, is an official EU language; but it is problematic and controversial whether the use of Catalan (which is not an official EU language) may be imposed for the labelling of foodstuffs sold in Catalonia, where that language is spoken by a large part of the population. This is a rather anomalous situation.[34]

It should be noted that there are a number of more specific EC consumer directives (such as those on time-sharing and on life assurance)[35] which go further and require the contract to be concluded in the language of the state where the consumer resides, whereas still other directives regulating consumer contracts do not refer to the use of a particular language at all.[36] One may note, on this point, that the Directive on unfair terms in consumer contracts[37] requires, in its Article 5, contract terms to be drafted 'in plain, intelligible language'. Similarly, the Directive on consumer rights requires the use of plain, intelligible language in off-premises contracts and distance contracts.[38] This expression leaves considerable uncertainty as to whether, or in which circumstances, a consumer can insist on communication in his or her own language.[39]

20.6 Conditioning a Financial Benefit on the Use of a Given Language

A further, very frequent, type of language regulation consists in making the use of a particular language a condition for obtaining a financial or other benefit, such as a tax exemption or a public subsidy. Language-specific subsidies can be found in all countries of the European Union. They include for example schemes to support the translation from or towards a given language, and subsidies for the production or distribution of films made in a given language. The aim of such measures is to modify the linguistic preferences of individuals or firms so that they choose to use one language of expression rather than another, or (in the case of publishers) to

[34] On this particular issue, with respect to the use of Catalan, see A Milian Massana, 'Dictamen sobre la reglamentación de l'ús de la llengua catalana a l'etiquetatge i a les instruccions d'ús dels productes comercials' (2005) 43 *Revista de Llengua i Dret* 279.

[35] Dir 2008/112 on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts, [2009] OJ L 33/10, Art 4(3) and Art 5(1); Dir 2002/83 concerning life assurance, [2002] OJ L 345/1, Annex III.

[36] For a typology of these various language clauses see Bansch, *Sprachvorgaben im Binnenmarktrecht*, 70–79.

[37] Dir 93/13, [1993] OJ L 95/29.

[38] Dir 2011/83, [2011] OJ L 304/64, Arts 7 and 8.

[39] For an analysis of this question, see S Whittaker, 'The Language or Languages of Consumer Contracts' (2005–6) 8 *Cambridge Yearbook of European Legal Studies* 229.

undertake a translation which they otherwise, under pure market conditions, might not have decided to make.

From the point of view of EU law, public financial support to specific categories of firms may constitute *state aid*, and may be prohibited by the Commission if it is held to have a detrimental effect on the conditions of competition in the internal market. Small amounts of funding are automatically considered not to have such a detrimental effect, so that the European scrutiny of state subsidies is limited to large sums paid to individual firms, and to subsidy schemes with a large number of small beneficiaries.[40]

State subsidies to the cultural sector, or with a cultural aim such as the strengthening of the national or regional language, are not excluded from the scope of the state aid regime, but the Maastricht Treaty introduced a new clause in the relevant Treaty article (this is now Article 107 para. 3(d) TFEU) according to which financial aid to promote culture and heritage conservation will be held compatible with EU law 'where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest.' This 'culture clause' would appear to cover the various language subsidy schemes, but it does not solve all the problems, since the sentence just quoted still leaves a very wide margin of discretion for the Commission to decide which schemes are compatible with, or contrary to, the 'common interest'. However, it is undeniable that the Member State governments, when inserting this clause in the EC Treaty back in 1992, wanted to convey a signal to the European Commission that it should tread carefully when examining state subsidies in the cultural domain, and it seems that the Commission is indeed acting cautiously[41] and that language subsidy regimes in the Member States are not in danger of being challenged by the Commission.[42] It is noteworthy that the Commission drew up a general policy with regard to subsidies for film production and distribution, in which it did not raise any objection against the use of linguistic requirements for the grant of those subsidies.[43]

[40] The financial thresholds for the application of the European state aid regime are explained in Commission Reg 1998/2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid, [2006] OJ L 379/5.

[41] See the analysis of the Commission's practice in this field by E Psychogiopoulou, 'EC State Aid Control and Cultural Justifications' (2006) 33 *Legal Issues of Economic Integration* 3.

[42] See, for example, Commission Decision 1999/133/EC concerning state aid in favour of the *Coopérative d'exportation du livre français*, [1999] OJ L 44/37: the Commission did not object to a French financial support mechanism that facilitated the acquisition of French language books by customers living abroad. It accepted that the objective of this aid scheme was 'to promote culture' in the sense of (then) Art 87(3)(d) EC Treaty and that it did not unduly affect competition in the common market.

[43] Commission Communication on certain legal aspects relating to the cinematographic and other audiovisual works ([2002] OJ C 43/6); see discussion of this document by Psychogiopoulou, 'EC State Aid Control', 7–11. The Commission policy in this domain was recently revised by means of a new Communication from the Commission on state aid for films and other audiovisual works ([2013] OJ C 332/1) which is even more explicit (para 26) in accepting language requirements in national film support schemes.

The case of *tax exemptions* is more complicated than that of direct subsidies, as is illustrated by a judgment of the EFTA Court of 2002 in the *Einarsson v Iceland* case.[44] Since, in that case, the EFTA Court applied rules of EU law, its judgment is also relevant for similar situations that would occur within an EU member state rather than in the EFTA state Iceland. In Iceland, the sale of books in the Icelandic language (both original publications and translations from foreign languages) was subject to a VAT rate of 14 %, whereas the sale of foreign language books was subject to the normal VAT rate of 24,5 %. Einarsson, a private person who bought foreign language books, and was charged the higher VAT rate, complained that this constituted a breach of Article 14 of the EEA Agreement which provides that EFTA states shall not impose higher tax rates, directly or indirectly, on imported products compared to domestic products. The EFTA Court found that the language criterion created an indirect discrimination against imported books (since almost all books published in Icelandic were produced inside the country) and declared the differential rates to be contrary to the EEA Agreement. Since Article 14 of the EEA Agreements is an exact copy of (what is now) Article 110 TFEU, one could think that the legal position under EU law would be the same as outlined in the *Einarsson* judgment. This outcome may seem logical, in the light of the applicable legal rules, but it does not seem fair that European law should impede a country from taking measures to support the use of a small European language, and to protect the country's cultural distinctiveness. So, here is a specific point on which internal market law, as currently interpreted, does not leave enough room for cultural distinctiveness and linguistic diversity.

20.7 Conclusion

At present, neither the European Court of Justice nor the political institutions have dealt with the question of language barriers to trade in a comprehensive and convincing manner. The centrality of the principle of proportionality in the application of internal market law, and the large discretion left to the European Commission in the application of state aid rules, cause a considerable degree of legal uncertainty as to whether certain linguistic requirements imposed by Member States or their autonomous regions are compatible with EU law or not. Only in some limited areas (mainly with regard to consumer protection and the free movement of professionals) did the EU legislator step in to establish a Europe-wide standard of linguistic requirements. However, in assessing the legal situation, it is important to remember that linguistic diversity is a constitutional value also of the European Union itself. Therefore, linguistic requirements relating both to the public or private sector can be justified not only by the wish to protect consumers, workers or public health, but also directly by the wish to protect cultural and linguistic diversity in Europe, or in a

[44] Judgment of 22 February 2002, Case E-1/01 *Hörður Einarsson v The Icelandic State*. See the case note by G Toggenburg, 'Sprache versus Markt: is die EFTA vielfalts- oder einfallslos?' (2002) *European Law Reporter* 217.

particular area of Europe. This argument will be especially strong if it is used to justify the promotion of a regional or minority language, or a small national language, since public support is clearly needed to allow these languages to compete on the European 'market for languages'.

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Part III
Competition, Intellectual Property and Property Law

Chapter 21
Competition Law and Consumer Law: Why We Need a Common Consumer Model

Thomas Ackermann

Abstract Competition law and consumer law complement each other in ensuring that markets satisfy consumer preferences. Nonetheless, tensions may result from diverging consumer models in both areas of law. Consumer protection rules that take account of bounded rationality are incompatible with competition rules that are based on the idea of consumer sovereignty. However, as is shown in this contribution, unlike U.S. antitrust law, EU competition law, as interpreted by the European courts and by the Commission, implicitly recognizes rationality deficits on the part of consumers. It thus essentially shares the premises of paternalistic consumer protection.

21.1 Introduction

It would appear that everything about the relationship between competition law and consumer law can be said in just three sentences: Competition law protects the functioning of competition, which provides consumers with the desired variety, quality and innovation of products at competitive prices. Consumer law ensures that consumers can make use of the possibilities offered by competition without suffering any information or decision-making deficits. Competition law and consumer law therefore work together as complementary instruments in the realization of the aim to help consumers optimally satisfy their preferences in a market economy.

From the perspective of competition law, this link with consumer law is extremely attractive since it enables an area of law which is otherwise barely able to obtain

This is an amended version of a contribution that has previously been published in German under the title 'Kartellrecht und Verbraucherschutzrecht: Zur Notwendigkeit eines gemeinsamen Verbraucherleitbildes' in Forschungsinstitut für Wirtschaftsverfassung und Wettbewerb (ed), *Herausforderungen für die Wettbewerbspolitik—Kartellrecht zwischen Industriepolitik und Verbraucherschutz, Referate des 46. FIW-Symposions* (Cologne, Heymanns, 2013) 73.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_21,

the support of a lobby to connect with a politically powerful pattern of legitimation. It is therefore not surprising that competition authorities, in particular the EU Commission, but also national authorities are keen to point out that protecting competition ultimately benefits the consumer.[1] At the same time, the emphasis on the advantages of unfettered competition for consumers is pleasantly non-committal: Those who—like the ECJ—emphasize that the goal of competition law is above all an *indirect* protection of consumer interests by maintaining effective competition[2], avoid committing themselves to specific inferences which could arise from a direct utilization of antitrust law for consumer protection. In short, by referring to consumer interests, competition authorities and courts are seeking acceptance from outside without having to engage in an internal discussion of consequences for the interpretation and application of the area of law entrusted to them.

It cannot be said that this approach has met with strong resistance in the academic literature on competition law. In particular the majority of German-speaking authors concur, possibly with a sense of relief, that courts and authorities do not treat consumer matters as a separate goal of competition law, but rather see the protection of consumer interests as indirectly resulting from the guarantee of effective competition.[3] My contribution will not fundamentally call into question the prevailing view that there is a complementary relationship between consumer protection and the protection of competition. In particular, I will not try to eliminate the autonomy of competition law and degrade it to a mere annex of consumer law. I am rather more interested in why, despite the complementarity between competition law and consumer law, tensions between consumer protection and the protection of competition can occur, and how these can be resolved. At the same time it will be shown that although competition law does not directly aim at consumer protection, it cannot remain unaffected by the consumer model shaped in the area of consumer law. At least as far as EU law is concerned, I will show that competition law has indeed not remained unaffected by such a model.

In their classic book on European consumer law, Hans Micklitz and Norbert Reich have clearly seen the link between consumer law and competition law.[4] By dedicating this contribution to Hans Micklitz, I hope to re-invigorate the debate between competition and consumer lawyers and bridge the gap between two worlds

[1] See, e.g. Commission, *Report on Competition Policy 2011*, COM(2012) 253 final, 13; *Report on Competition Policy 2010*, COM(2011) 328 final; *Report on Competition Policy 2009*, 5.

[2] Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, para 125; Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331, para 106.

[3] See, e.g. J Drexl, 'Wettbewerbsverfassung' in A von Bogdandy and J Bast (eds) *Europäisches Verfassungsrecht*, 2nd ed (Berlin, Springer, 2009) 905, 951; R Zäch and A Künzler, 'Reining in the "more economic approach": Some overriding constraints from constitutional law and economics' in J Drexl et al (eds), *Technology and Competition, Contributions in Honour of Hanns Ullrich* (Brussels, Larcier, 2009) 541; W Wurmnest, *Marktmacht und Verdrängungsmissbrauch*, 2nd ed (Tübingen, Mohr Siebeck, 2012) 93; A Fuchs and W Möschel, 'Art 102 TFEU' in U Immenga and HJ Mestmäcker (eds), *Wettbewerbsrecht*. vol I, 5th ed (Munich, CH Beck, 2012) para 131.

[4] N Reich and H-W Micklitz, *Europäisches Verbraucherschutzrecht*, 4th ed (Baden-Baden, Nomos, 2003) (see in particular chapter 5 by N Reich).

that, despite ubiquitous talk of consumer welfare, seem to have been drifting apart during the last decades.

21.2 Competition and Consumer Laws as Complimentary Instruments: Attempt at a Theoretical Specification

21.2.1 The Task: Formulation of Consistent Definition of Goals for Competition and Consumer Protection Law

21.2.1.1 No Hierarchical Relationship

The relationship between competition law and consumer law is at first view characterized by a manifest divergence of their respective scopes of application: Competition law is concerned with market conditions at all levels of the supply chain, whereas consumer law concerns only the final link of the supply chain where businesses and consumers interact in B2C transactions. The much wider scope of antitrust law does not, however, indicate a subordination of one area of law to the other. In particular concerning B2C relationships, consumer law cannot be regarded as *lex specialis* that takes priority over competition law because both areas of law have different regulatory concerns (guaranteeing effective competition vs. avoiding deficient consumer decisions), even though they share the same overarching objective, which is to contribute towards the optimal satisfaction of individual preferences.

On the other hand, considering these regulatory concerns, giving priority to competition law would also be without grounds. Undeniably, any meaningful consumer protection would be unfeasible without competition law, because only effective competition (as protected by the rules of competition law) produces the possibilities of choice, the exercise of which is the object of consumer protection. However, it would be incorrect to draw normative conclusions from this purely factual 'priority'. The realization that the protection of competition is a necessary basis for effective consumer protection is nothing but the common finding that an area of law such as competition law guarantees certain factual prerequisites, on the existence of which other areas of law rely. This does not enable us to infer a hierarchical relationship in which competition law takes precedence over consumer law.

Turning to the normative level, it becomes clear that consumer law is indeed not a matter which is subordinate to competition law as an overriding 'market constitution', even if there are some antitrust scholars who would prefer a different outcome. To start with German law, the norms found in the Act against Restraints of Competition (ARC) on the one side and the consumer protection provisions of the German Civil Code (BGB) and the German Fair Trade Practices Act (UWG) on the other are all part of federal parliamentary acts and thus placed on the same level of the legislative hierarchy. Also constitutional considerations afford no higher status

to competition law than they do to consumer protection. As is well-known, the Federal Constitutional Court has always avoided making a constitutional commitment to a competition-based market economy.[5] The fundamental rights of the German Basic Law (*Grundgesetz*, GG) undeniably protect the competitive conduct of businesses as subjects of fundamental rights[6] as well as their freedom to contract as part of their general freedom to act.[7] However, these constitutional safeguards of competition and the principle of private autonomy are counter-balanced by other constitutional values, namely the welfare state principle (Articles 20(1), 28(1) GG) and the protective function of the fundamental rights which requires the state to intervene in relationships between private parties in situations of gross imparity.[8] These constitutional values allow and, at least to a certain extent, even require consumer protection measures.

The situation is no different in EU law. The competition rules in Articles 101 and 102 TFEU, the Protocol on the Internal Market and Competition, which has primary law status,[9] as well as the freedom to conduct a business in Article 16 of the EU Charter of Fundamental Rights (which, pursuant to Article 6 (1) TEU, has the same rank as the Treaties) do not afford the protection of competition a higher position than consumer protection which has primary law foundations in Article 12 TFEU, in Article 38 of the Charter of Fundamental Rights, and last but not least in Article 114(3) and Article 169 TFEU.[10]

21.2.1.2 Frictions and Their Cause

The equal positioning of competition and consumer protection in the hierarchical structure of our legal system does not allow for any frictions between the two areas

[5] See especially the German Constitutional Court's decisions: BVerfG, 20/7/1954, 4 *Entscheidungen des Bundesverfassungsgerichts* 7; BVerfG, 11/6/1958, 7 *Entscheidungen des Bundesverfassungsgerichts* 377; BVerfG, 17/5/1961, 12 *Entscheidungen des Bundesverfassungsgerichts* 354; BVerfG, 16/3/1971, 30 *Entscheidungen des Bundesverfassungsgerichts* 292; BVerfG, 1/3/1979, 50 *Entscheidungen des Bundesverfassungsgerichts* 290. The idea of economic-political neutrality of the constitution was developed by H Ehmke, *Wirtschaft und Verfassung* (Karlsruhe, Müller, 1961).

[6] See on the freedom of competition as part of the freedom of occupation under Art 12(1) GG, e.g. O Lepsius, 'Verfassungsrechtlicher Rahmen der Regulierung' in M Fehling and M Ruffert (eds), *Regulierungsrecht* (Tübingen, Mohr Siebeck, 2010) Chap. 4 paras 45 ff.

[7] See for a more detailed discussion of the constitutional guarantee of freedom of contract, M Leistner, *Richtiger Vertrag und lauterer Wettbewerb* (Tübingen, Mohr Siebeck, 2007) 289 ff.

[8] cf the German Constitutional Court's leading cases BVerfG, 7/2/1990, 81 *Entscheidungen des Bundesverfassungsgerichts* 242 (on commercial agents) and BVerfG, 19/10/1993, 89 *Entscheidungen des Bundesverfassungsgerichts* 214 (on sureties by family members).

[9] The background of this protocol is discussed in more detail by R Barents, 'Constitutional Horse Trading: Some comments on the protocol on the internal market and competition' in M Bulterman et al (eds), *Views of European Law from the Mountain, Liber amicorum Piet Jan Slot* (The Hague, Wolters Kluwer, 2009) 123.

[10] See for a more thorough analysis, L Breuer, *Das EU-Kartellrecht im Kraftfeld der Unionsziele* (Baden-Baden, Nomos, 2013) 75 ff. and 136 ff.

of law to always be resolved to the advantage of one side or the other. On the one hand, requirements of consumer protection need not necessarily comply with the general framework of competition law. On the other hand, competition law is not required to adapt to what consumer protection rules provide for B2C relationships. Creating a harmonious co-existence between provisions of both areas of law is a matter for the legislature and, as far as the legislation permits, for the courts, without the result being determined by a general rule on which provision takes precedence. This task can only be fulfilled if we appreciate why frictions can occur between competition law and consumer law despite the fact that both areas apply to different matters. An initial look at potential conflicts can therefore be helpful: On the one hand, paternalistic consumer protection can preclude possible choices for consumers (e.g. the purchase of goods at a lower price in exchange for a waiver of the consumer's remedies for defects[11] or the completion of a distance contract without the security of a withdrawal right which is ultimately paid for by the consumer)[12] which from the point of view of a liberal competition law are a legitimate expression of effective competition. On the other hand, it is possible—from the point of view of consumer protection—to take issue with competition law when it permits practices (for example vertical distribution agreements for the securing of a specific product image) with the purpose of promoting a differentiation in products and services which may result in leading consumers with limited cognitive ability to make incorrect decisions.

If we attempt to understand these tensions, the idea of the complementarity of competition and consumer protection proves to be of little help. The reference to a common overarching objective shared by both areas of law threatens to conceal contradictions instead of explaining them. The reason is easily identified: Competition and consumer lawyers often don't speak the same language when they jointly claim that the rules entrusted to them ultimately serve the individuals at the end of the supply chain. A competition lawyer committed to the ideals of freedom of competition or consumer welfare will on principle (Hayek's famous 'pretence of knowledge') or for pragmatic reasons (simplicity and clarity of the concept of competition) not tend to identify this group of market participants as consumers who are suffering from a particular deficit and give consideration to them when creating and interpreting competition regulations. Conversely, consumer protection is at least in part based on the assumption of deficits in rational consumer behavior which competition law seems at least to dismiss. The reason for tensions between these two areas of law thus lies in divergent opinions as to which rationality assumptions apply to the normative model of the consumer. These assumptions not only shape consumer law, the direct objective of which is the optimization of consumer decisions, but also influence competition law, which does not directly serve consumer

[11] Pursuant to Art 7(1) of the Consumer Sales Dir 1999/44/EC, the consumer is not free to waive his or her rights resulting from the Directive before the lack of conformity of the contract goods is brought to the seller's attention.

[12] Pursuant to Art 25 of the Consumer Rights Dir 2011/83/EU, the right of withdrawal granted under Art 9 of the Directive has a mandatory character.

protection but, as we shall see, cannot manage without such assumptions in order to be able to judge which types of behavior are detrimental for competition and which are not.

For this reason the route to a harmonious coexistence of competition and consumer protection requires an open debate on the question as to which rationality assumptions should be the basis of *both* areas of law. The following remarks do not seek to answer this question, but rather to outline the apparent alternatives.

21.2.2 Possible Starting Points for an Over-Arching Consumer Model

21.2.2.1 The Ideal of Consumer Sovereignty: Consumers as Rational Utility Maximizers

What is closest to most competition lawyers is probably the ideal of consumer sovereignty according to which consumers are—like any other market participant—persons whose choices (in the absence of deception or coercion) we must accept for our legal system and may not call them into question. From the perspective of an ordoliberal or *Hayekian* approach geared towards freedom of competition, every determinist conception of an individual's actions as a normative starting point is out of the question, as indeed is the idea that the law can judge (and attach legal consequences to) whether a consumer who chooses 'X' instead of 'Y' in actual fact would rather have had 'Y'. This is essentially no different to a competition policy committed to neoclassical welfare economics. The neoclassical approach to law & economics is based on prognoses as to the efficiency of outcomes produced by the conduct of market participants, but at the same time accepts the actually observed behavior of market participants as being an expression of rational choice which is indicative of well-ordered but otherwise unquestioned preferences of the individual ('revealed preferences').[13] To put it differently, the consumer appears—just as every other market participant—to be a rational utility maximizer or *homo oeconomicus*, i.e. as a person who possesses well-ordered preferences and who can best decide himself how these should be realized.

Because this concept is often the cause of misunderstanding, a few clarifications are necessary. Firstly, the concept of *homo oeconomicus* must not be mistaken for a deformed idea of humanity. This does not happen if it serves solely as an instrument for the analysis of market conduct and if it is not used to comprehensively explain human behavior.[14] Secondly, this idea does not assume that the individual will not make any mistakes in his or her decision-making. Nobody would deny that time

[13] See HR Varian, *Intermediate Microeconomics: A Modern Approach*, 9th ed (New York, Norton, 2009) 121, describing 'revealed preferences' as the following assumption: 'If a bundle X is chosen over a bundle Y, then X must be preferred to Y'.

[14] This argument is further developed in T Ackermann, *Der Schutz des negativen Interesses* (Tübingen, Mohr Siebeck, 2007) 114 ff.

and again market participants (whether consumers or businesses) make decisions which, based on their own preferences and considering the information available at the time the decision was made, are suboptimal. As long as such deviations from the rationality assumption are not systematic they take away from the rational model neither its empirical usefulness[15] nor its value as a normative benchmark.[16] Thirdly, the assumption of rational consumer behavior does not justify the conclusion that no consumer protection law is required. Even the 'sovereign' consumer, acting in full possession of his or her rational powers, is subjected to the pitfalls known as market failure in neoclassical economics: constellations in which even in the case of exemplary rationality markets fail to yield any efficient results. From this standpoint consumer protection can and should be implemented to prevent market failure in particular insofar as it concerns the prevention of the detrimental consequences of information asymmetries between suppliers and consumers.[17]

21.2.2.2 Systematic Deviations from the Rationality Assumption: The Idea of Bounded Rationality

In contrast to coincidental deviations, systematic deviations from the rationality assumption are a significant challenge for the idea of consumer sovereignty: If consumers—or indeed any market participants—make decisions which following a recurring pattern deviate from that which would be expected of a rational individual with well-ordered preferences, it is (literally) not possible to count on an unlimited rationality assumption and instead an attempt must be made to accommodate these deviations. This is the starting point of the concept of bounded rationality. Whereas the fundamental idea has been known for a long time,[18] the elaboration of the (legal-) economic potential of this concept in the field of behavioral law & economics is much more recent than neoclassical economics and the subsequent law & economics movement in the tradition of the Chicago School.[19] Characteristic of this academic trend is that it pursues rationality deficits (in particular 'biases') and their

[15] See on the inclusion of non-systematic errors in economic models based on the assumption of rationality, P Belleflamme and M Peitz, *Industrial Organization: Markets and Strategies* (Cambridge, Cambridge University Press, 2010) 21.

[16] This point is further developed in Ackermann, *Der Schutz des negativen Interesses*.

[17] An information asymmetry between buyers and sellers in respect of the product quality may lead to adverse selection (also known as the 'lemons' problem), resulting in an inefficient market equilibrium. See the seminal contribution by GA Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488.

[18] The idea dates back to HA Simon, *Models of Man* (New York, John Wiley & Sons, 1957).

[19] Path-breaking contributions to behavioral economics are D Kahneman and A Tversky, 'Prospect Theory: An Analysis of Decision under Risk' (1979) 47 *Econometrica* 263; D Kahneman and A Tversky, 'Judgment under Uncertainty: Heuristics and Biases' in D Kahneman, P Slovik and A Tversky (eds), *Judgment under Uncertainty: Heuristics and biases* (Cambridge, Cambridge University Press 1982) 3; see for the legal reception C Jolls, C Sunstein and R Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 *Stanford Law Review* 1471; C Sunstein (ed), *Behavioral Law and Economics* (Cambridge, Cambridge University Press, 2000).

cognitive and motivational bases by drawing on psychological findings and with a clear emphasis on experimental and empirical methods.

If we integrate these findings into the normative consumer model the policy recommendations based on it clearly tend towards a (as compared with consumer sovereignty) stronger interventionist legal policy. This is evident for consumer law: Instead of only protecting against market failure resulting from information asymmetries, it must accordingly also be a matter for consumer law to protect the consumer from himself or herself, i.e. from a cognitive or motivational deficit and help his or her real preferences to come through. The measures required to do this may well be classical interventions by the state which prevent self-harming behavior caused by individual malfunction ('hard paternalism'), or they take on the form of a 'soft paternalism' which allows the individual to decide but sets up the external conditions such that there is a shift in incentives from self-harming choices to better alternatives.[20]

21.2.3 Potential Implications for an Economically Sound Competition Policy

Leaving measures 'hard' and 'soft' paternalism in the sphere of consumer law aside, which have been discussed widely in recent years, let us now briefly turn to the question how competition policy may be affected by incorporating systematic rationality deficits into the consumer model. Naturally the emergence of 'behavioral economics' has not escaped the attention of competition law scholars who always have a keen interest in new developments in the field of economics. Already for some time, a possible orientation of competition law towards behavioral positions has been controversially discussed.[21] Apart from the general question of whether

[20] An instructive introduction to this form of paternalism is given in the widely acclaimed book by C Sunstein and R Thaler, *Nudge: Improving Decisions about Health, Wealth and Happiness* (New Haven, Yale University Press, 2008), which seeks to justify a libertarian paternalism.

[21] See in support of such an approach, A Aviram and A Tor, 'Overcoming Impediments to Information Sharing' (2004) 55 *Alabama Law Review* 231; M Bennett et al, 'What Does Behavioral Economics Mean for Competition Policy?' (2010) 6 *Competition Policy International* 111; A Fuchs, 'Introducing more features of real life into the economists' world of theoretical models—comments on Justus Haucap, Bart Wilson and Christoph Engel' in J Drexl et al (eds), *Competition Policy and the Economic Approach* (Cheltenham, Edward Elgar Publishing, 2011) 270; D Ginsburg and D Moore, 'The Future of Behavioral Economics in Antitrust Jurisprudence' (2010) 6 *Competition Policy lnternational* 89; J Haucap, 'Bounded rationality and competition policy' in J Drexl et al (eds), *Competition Policy and the Economic Approach* (Cheltenham, Edward Elgar Publishing, 2011) 217; AP Reeves and ME Stucke, 'Behavioral Antitrust' (2011) 86 *Indiana Law Journal* 1527; ME Stucke, 'Behavioral Economics at the Gate: Antitrust in the Twenty-First Century' (2007) 38 *Loyola University of Chicago Law Journal* 513; A Tor, 'A Behavioural Approach to Antitrust Law and Economics' (2004) 14 *Consumer Policy Review* 18; against such an approach G Werden, L Froeb and M Shor, 'Behavioral Antitrust and Merger Control' (2011) 167 *Journal of Institutional and Theoretical Economics* 126; J Wright, 'The Antitrust/Consumer Protection Paradox' (2012) 121 *Yale Law Journal* 2216.

such an orientation should be supported, there are still just a few studies based on sound experimental or empirical research leading to conclusions that allow for specific recommendations for a competition policy that is informed by behavioral law & economics.[22] On the whole it is apparent that a consideration of bounded rationality (especially when it is applied not only to consumers but also to decision-makers in companies as well as in competition authorities and courts)[23] leads to less clear-cut rules, but also to a more interventionist approach as compared to a competition policy guided by neoclassical models.

This contribution is not the place to discuss the pros and cons of a behavioral orientation of competition policy and to spell out their consequences. However, even without adopting a position in this respect, it is possible to draw one important conclusion: a legal system is not consistent if its consumer law is based on the assumption of rationality deficits while its competition law adheres to the idea of consumer sovereignty. From the point of view of consumer sovereignty, it would not be reasonable for consumer law to prevent consumers from enjoying the benefits of choice that have been granted to them by the market process protected by the competition rules. From the perspective of a behaviorist policy, it would, on the other hand, be pointless and possibly even harmful if the competition rules fostered the ideal of a market which ultimately only helps a *homo oeconomicus* to an optimal satisfaction of his preferences, but not real consumers with limitations diagnosed by behavioral economics. Such tensions can only be overcome by taking uniform rationality assumptions as a basis for the consumer model.

U.S. law is a good example for potential conflicts divergent policies in the spheres of consumer and competition laws may cause. On the one hand, for several decades, U.S. antitrust law has been dominated by the Chicago School and is still immune to any doubts as to the rationality of market participants, whether they be consumers or businesses. On the other hand, with the establishing of the Consumer Financial Protection Bureau (CFPB) by way of the Dodd-Frank Wall Street Reform Act 2010, an orientation towards a behaviorist consumer policy in financial markets takes shape. In a recently published article[24], Joshua Wright pointedly highlighted impending distortions between the new authority's agenda and traditional tenets of U.S. antitrust law. Whilst U.S. antitrust law firmly endorses product innovation and diversity, low prices (above the threshold of predatory pricing, which is barely relevant due to the restrictive case law), as well as cost-efficient product bundling, (because rational consumers are generally assumed to benefit from these choices), a behaviorist consumer policy seeks to reduce the complexity caused by product diversity through optional, simply structured ('plain vanilla') financial products, to prevent short-term low price strategies ('teaser rates'), and to prohibit product bun-

[22] One example is offered by C Landeo, 'Exclusionary Vertical Restraints and Antitrust: Experimental Law and Economics Contributions' in K Zeiler and J Teitelbaum (eds), *The Research Handbook on Behavioral Law and Economics* (Cheltenham, Edward Elgar Publishing, forthcoming).

[23] See on the implications of bounded rationality of authorities and courts, Haucap, 'Bounded rationality and competition policy', 219 ff.

[24] Wright, 'The Antitrust/Consumer Protection Paradox'.

dles with components that consumers systematically misvalue.[25] We do not have to share Wright's critical view of behavioral consumer policy in order to agree with his analysis that this orientation of consumer protection does not go well with an antitrust law which assumes that consumers possess unlimited rationality. Inconsistencies can only be avoided if either the antitrust rules start to take account of bounded rationality or consumer law returns to the paradigm of consumer sovereignty.

21.3 The Substantive Dimension Under EU Law: Harmony Between Competition and Consumer Law?

Is it possible to diagnose a similar conflict for our legal system as Wright anticipates for U.S. law? This question will be considered below, though due to limitations of space, I will limit myself to EU law and not deal with specific issues in the national laws of EU Member States.

21.3.1 Interpretation and Application of EU Competition Law: Assumptions of Bounded Consumer Rationality as an Implicit Premise

If we take a look at EU competition law it becomes clear that here, in contrast to U.S. antitrust law and irrespective of the Commission's orientation towards a welfare-based 'more economic approach', there have always been rigidities in the application of Arts 101 and 102 TFEU which cannot be justified on basis of neoclassical welfare economics and are therefore often the subject of criticism. A classic example of this is the *per se* prohibition of vertical restraints leading to absolute territorial protection, which can only be explained by the specific European goal of market integration.[26] Whereas in this situation, however, competition law is provided with an additional objective going beyond the (micro-) economic function of competition, things are different when it comes to consumer protection. Here the issue is not whether a further item should be added to the list of established goals of competition law, or whether the protection of competition should be replaced by the protection of consumers as a primary goal. What is needed is rather a more precise answer to the question what idea of competition informs EU competition policy. Is the idea of competition that EU law protects a market process in which consumers—following the ideal of consumer sovereignty—are considered to be rational market actors who can only be judged according to their revealed preferences? Or is

[25] See for an in-depth analysis, ibid, 2242 ff.

[26] See e.g., T Ackermann, *Art. 85 Abs. 1 EGV und die rule of reason* (Cologne, Heymanns, 1997) 97 ff.

the basis of EU competition law—contrary to that of U.S. antitrust law—a concept of competition that accounts for bounded rationality of consumers?

The following examples will demonstrate that the latter is in fact the case. In a series of cases it becomes clear that EU competition law does not adhere to the concept of consumer sovereignty, but instead implicitly accepts a model of consumers with limited rationality, as is characteristic of paternalistic consumer protection. However, in order to avoid any misunderstanding, let me first of all strike a cautious note on two matters. On the one hand, my observation that EU competition law, as interpreted by the ECJ, takes account of rationality deficits of consumers is not connected with a normative statement on the question as to whether this approach should be preferred over consumer sovereignty. On the other hand, the following remarks will have to leave open whether the assumptions of bounded rationality that can be derived from European practice have a sound basis in behavioral economics.

21.3.1.1 Example 1: Selective Distribution

Since the ECJ's *Metro* decision of 1977, the principle applies that 'selective distribution systems constitute together with others an aspect of competition which accords with Article 85 (1) [now Article 101 (1)] provided that resellers are chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises and that such conditions are laid down uniformly for all resellers and are not applied in a discriminatory fashion'.[27] Such a choice is not open to manufacturers, however, so that they can pursue any concept of quality. As the Court made clear in *Pierre Fabre,* '[t]he aim of maintaining a prestigious image of those products is not a legitimate aim for restricting competition and cannot therefore justify a finding that a contractual clause pursuing such an aim does not fall within Article 101(1) TFEU'.[28]

Considered from the perspective of consumer sovereignty, this restrictive view fails to convince. Firstly, those who refuse to evaluate consumer preferences must also accept a preference for products with a prestigious image, which grants to the buyer a certain social distinction. If manufacturers try to satisfy demand by way of a corresponding choice of resellers, a competition law which respects consumer sovereignty should not act against this. Secondly, even if rational consumers fail to value the prestigious image for what it is, it can serve as a mechanism for signaling a high product quality and thus prevent a market failure caused by information asymmetry (adverse selection) which can occur when the information as to the quality is not disclosed to the consumer at the time of acquisition.[29]

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[27] Case 26/76 *Metro v Commission* [1977] ECR 1875, para 20.

[28] Case C-439/09 *Pierre Fabre Dermo-Cosmétique v Président de la Autorité de la concurrence* [2011] ECR I-9419, para 46.

[29] See JU Franck, 'Zum Schutz des Produktimages im selektiven Vertrieb' (2010) *Wirtschaft und Wettbewerb* 772, 781 ff.

For lack of a suitable explanation based on the recognition of consumer sovereignty, there would appear to be only two motives which serve as a reason for the Court's refusal to accept the protection of prestige as a legitimate goal of a producer's marketing strategy. Either the Court wishes to express its moral disapproval of a consumer preference for prestige or it fears that deficits of consumer rationality will be taken advantage of if marketing is aimed at maintaining a prestige image. The first alternative is almost certainly out of the question due to the moralization of competition law connected with it. Therefore, only the second approach remains as an explanation: the prestige image of a product may mislead consumers because they do not rationally deal with the signaling function of the product image. When making a decision to purchase, consumers may, for example, follow patterns of herd behavior and purchase a prestigious item simply because other (presumably solvent) people do, although on further reflection, they would not have been prepared to pay this price simply for the quality features of the product. If this were the case (which would obviously require a behavioral economic foundation which is not feasible here) the Court's position would be justified, but only, and this must be emphasized, if it is based on the assumption of limited consumer rationality.

21.3.1.2 Example 2: Vertical Resale Price Maintenance

A further example of the implicit rejection of the rationality assumption of consumer sovereignty is the prohibition of vertical minimum resale price maintenance the Commission has categorically stuck to by including it in the list of 'black clauses' of the Vertical Block Exemption Regulation.[30] Proceeding on the premise of consumer sovereignty, the *per se* prohibition is hard to maintain. Very briefly and accepting a certain oversimplification of an extensive academic debate, it can be said that from this perspective, resale price maintenance is a simple instrument to solve the problem of free-riding at the distributor level and to stimulate quality and service competition between distributors.[31] Rational consumers can be considered capable of deciding whether it is worth paying the required price for the quality or service features offered by distributors or whether they would be prefer a lower standard for a lower price. Rational producers will react and only fix minimum retail prices where it maximizes their profits because there is sufficient consumer demand for the quality or service level promoted in this way. The fact that, under certain conditions in the 'first best' world of rational market participants, competitive harms can be connected with vertical resale price maintenance (for example a higher risk of horizontal collusion) cannot be denied; however, these potential harms are not sufficient for a *per se* prohibition. In this respect, if we share the premise of consumer sovereignty, we must concur with the U.S. Supreme Court's decision in *Leegin*.[32]

[30] Art 4(a) of the Vertical Block Exemption Reg (EU) 330/2010.

[31] See for a more detailed discussion, M Motta, *Competition Policy: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 302 ff.

[32] *Leegin Creative Leather Products, Inc. v PSKS, Inc.,* 551 U.S. 877 (2007).

In contrast, there are considerably better prospects for a justification of the prohibition of minimum resale price maintenance if we lower our expectations as to the rationality of consumers and take deficits into account.[33] Anecdotal evidence suggests that, at least occasionally, the service offered by a distributor which consumers eventually finance by paying the resale price fixed by the producer may just consist of a bundle of measures (for example with regard to selecting and training sales staff) intended to seduce consumers into making purchase decisions by exploiting their rationality deficits (for example in the course of a manipulative sales conversation)[34]. In such a context, it would be downright cynical to talk about a 'service' that consumers honor as satisfying their preferences by paying a resale price that includes a premium for the distributor's efforts. This ambivalence of service competition on the distributor level might explain why EU competition law refuses to accept a complete elimination of intra-brand price competition. This contribution will not explore whether and to what extent non-price competition between distributors has negative rather than beneficial consequences for consumers from a behavioral perspective. However, for our purposes suffice it to conclude that probably the best chance of defending the prohibition of minimum resale price maintenance against the phalanx of criticism based on neoclassical economic thinking is the rejection of the neoclassical premise of consumer sovereignty in favor of the assumption of limited rationality.

21.3.1.3 Example 3: Secondary Markets

The determination of market power in secondary markets is another suitable illustration for the thesis that EU competition law better harmonizes with the idea of bounded rationality of consumers than with the assumption of consumer sovereignty. To answer the question whether and under what conditions a manufacturer of primary products (e.g. cars) is dominant (and behaves abusively) on a secondary market (e.g. the market for spare parts), the EU Commission stated in its notice on the definition of the relevant market that the delimitation of the market had to 'be undertaken with care'; according to the Commission, a narrow definition of the secondary market may result from '[p]roblems of finding compatible secondary products together with the existence of high prices and a long lifetime of the primary products', whereas the Commission assumes the opposite where 'significant substitution between secondary products is possible or if the characteristics of the primary products make quick and direct consumer responses to relative price increases of the secondary products feasible'.[35]

[33] A similar argument is made by Fuchs, 'Introducing more features of real life', 273.

[34] The argument that the margin guaranteed to distributors under a resale price maintenance scheme is an incentive for distributors to mislead customers in order to maximize profits has also been made by WS Grimes, 'Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited' (1992) 80 *California Law Review* 815, 834 ff.

[35] Commission, Notice on definition of relevant market for the purposes of Community competition law, [1997] OJ C 372/5 para 56.

If we assume that consumers behave rationally the so-called systems theory developed by the Chicago School appears persuasive. The systems theory assumes that consumers react to supra-competitive prices on the secondary market by not buying the corresponding primary product, or, in the event that they have already purchased it, by switching to another primary product. Provided that there is competition in the primary market, acquiring monopoly profits on the secondary market is thus regarded as impossible.[36] This approach renders a distinction between primary and secondary markets meaningless as there is only one systems market that includes combinations of primary and secondary products. Of course, even fully rational consumers may neither on their own nor with the help of intermediaries be able to obtain the necessary information on the life-cycle costs of the primary products without unprofitable expenses so that also in the world of consumer sovereignty, it cannot be ruled out that monopoly profits can be earned in secondary markets.[37] However, it is hardly possible to say that such a suboptimal result is likely when the conditions stated by the Commission are met (expensive, long-lasting primary products and compatible secondary products that are hard to find). From the perspective of a concept of competition based on a model of fully rational consumers, the Commission therefore tends towards 'false positives' when evaluating the abuse of dominant position in secondary markets.

If rationality deficits are included in the assessment, a different picture emerges. In this respect, academic writers have referred to 'underestimation biases' which lead consumers to underestimate both their own need for secondary products as well as the prices of these products.[38] An obvious reaction by manufacturers to such a deficit consists in offering the primary product at an inefficiently low price in order to maximize profits by subsequently demanding higher prices (in comparison with transactions with rational consumers) on the secondary market. Considering this scenario, the likelihood of abuse behavior on the secondary market increases because, contrary to the consequences following from the assumption of full rationality, the possibility of extracting monopoly rents is not dependent on prohibitively high costs for consumers to obtain information on the life-cycle costs of the primary products. Again, it is not maintained that this observation is confirmed by empirical observations or experiments. It also cannot be denied that the Commission (as indeed EU competition practice in general) has not consulted the findings of behavioral economics when determining its position on the abuse of market dominance in secondary markets.[39] It is, however, likely that the direction taken by the Commission better suits a behavioral concept of competition, which takes account of defects of rational behavior, than a concept based on full rationality.

[36] See e.g., the dissenting opinion of Justice Scalia in *Eastman Kodak Co. v Image Technological Services, Inc.*, 504 U.S. 451 (1992).

[37] S Bechtold, *Die Kontrolle von Sekundärmärkten* (Baden-Baden, Nomos, 2007) 15 ff.

[38] ibid, 30 ff.

[39] As has been observed by Bechtold, ibid, 51.

21.3.1.4 Example 4: Tying

Our final example to demonstrate the influence of a consumer model incorporating bounded rationality on EU competition law is taken from the assessment of tying in the *Microsoft* case. In this regard, I would like to call attention to one element of the reasoning with which Microsoft was reproached for tying in the Windows Media Player with the Windows operating system. The Commission and the General Court (then the Court of First Instance) based their verdict amongst other things on the fact that the pre-installation of the Windows Media Player gave Microsoft a competitive advantage over other providers of media players as it was clear that '[u]sers who find [Windows Media player] pre-installed … on their client PCs are indeed in general less likely to use alternative media players as they already have an application which delivers media streaming and playback functionality'.[40]

If we assume rational behavior on the part of the users this assertion appears to be anything but clear. The small amount of effort needed for many PC users (with the exception of particularly inexperienced groups)[41] to search for and install competing media players (which are generally easy to find and can be downloaded free of charge) would not 'generally' prevent rational consumers from acquiring a competitor's product which is better suited to his needs than the Windows Media Player. Rational consumers would only abstain from switching to competing products if their advantage over the Media Player is so small that even the minimal effort to find and install these products is not worthwhile. The Commission and the General Court did not, however, engage in an analysis of the benefits of other media players available on the market, but instead resorted to a general assumption that from the consumers' point of view one program is ultimately (almost) as good as another.

It is more plausible to interpret the general tendency of users to be content with the pre-installed software assumed by the Court and by the Commission as an expression of an intuitive assumption of typical rationality deficits. The endowment effect is one of the best-known biases which have been proven in behavioral experiments. This effect is characterized by the fact that individuals estimate the value of a good they own to be higher than that of the same good in the possession of others, with the effect that their reservation prices for purchase and sale of the same item differ.[42] The endowment affect is *prima facie* likely to give pre-installed software an initial advantage. Quite plausibly, pre-installed software simply benefits from the fact that the user can call it his own. This particular advantage does not depend on a comparison of the utility of the pre-installed product with other competing software. A user will therefore only acquire competing software if the additional

[40] Case T-201/04 *Microsoft v Commission* [2007] ECR ll-3601 para 1041, citing Commission, COMP/C-3/37.792– *Microsoft* para 845.

[41] However, in para 846 of its decision, ibid, the Commission referred to a promotion letter by Microsoft stating that the pre-installation was attractive 'for home users who know little about computers'. But this fact alone does not justify the Commission's and the Court's claim that users *in general* tended to stick to a pre-installed media player.

[42] cf D Kahneman, B Knetsch and R Thaler, 'Experimental Tests of the Endowment Effect and the Coase Theorem' in Sunstein (ed), *Behavioral Law and Economics*, 211.

benefits are not only greater than the costs involved in searching for and installing it, but also exceed the irrational 'endowment bonus' he or she has given to the pre-installed software. What makes this consideration attractive as a justification of the position taken by the Commission and by the Court is the fact that this effect is not only apparent in those users whose costs for searching and installing are particularly high due to their lack of computer literacy, but in all users, i.e. even those who are technically adept. Subject to confirmation from experimental or empirical research, this could provide the Court's and the Commission's assumption of a 'general' tendency not to use other software than that which is pre-installed with a sound basis.

21.3.2 EU Consumer Law as a Complementary Area of Law: Questions of Internal and External Consistency

As EU competition law is not a *rocher de bronze* of consumer sovereignty, but implicitly follows a concept of competition that takes account of rationality deficits of consumers, in contrast to U.S. antitrust law it does not find itself in a fundamental conflict with a paternalistic consumer protection law. The question as to a harmonious coexistence of EU competition and EU consumer law can nevertheless not unreservedly be answered with yes, for two reasons:

On the one hand, the internal consistency of European consumer law is far from clear. A number of instruments, most prominently the directives on consumer contract law[43] and on unfair B2C commercial practices (UCP),[44] intervene sometimes more (through mandatory contract or product regulations), sometimes less (through information requirements) in market conduct concerning the relationship between businesses and consumers. Connections to our leading theme of limited (consumer) rationality can naturally be found easily. However, in part, these instruments are in fact tailored to the model of consumer sovereignty and appear to neglect rationality deficits, for example when attempts are made to prevent an informational market failure (that can occur despite full rationality of all market participants)[45] by requiring a large amount of compulsory information. Such a regulatory technique is more likely to harm than benefit a consumer of limited rationality due to the much deplored problem of 'information overload'.[46] The purposes of EU consumer law become even more ambivalent if we consider doubts as to whether some of the existing instruments really contribute towards the best possible satisfaction of consumer preferences (irrespective of the underlying assumptions of rationality) or whether they simply result in an (inefficient) redistribution between the 'strong' and

[43] See e.g., the Consumer Sales Dir and the Consumer Rights Dir.

[44] Dir 2005/29/EC concerning unfair business-to-consumer commercial practices, [2005] OJ L 149/22.

[45] See Akerlof, 'The Market for "Lemons"'.

[46] See for a further discussion, T Ackermann, 'Das Informationsmodell im Recht der Dienstleistungen' (2009) *Zeitschrift für Europäisches Privatrecht* 230, 240.

the 'weak'.[47] As the purposes of EU consumer protection law are thus somewhat diffuse and heterogenic, it is difficult to establish an overarching harmony with competition law.

On the other hand, even if we generally attest that both areas of law give consideration to certain rationality deficits of consumers, this is just the beginning. What is decisive for a harmonious coexistence of competition and consumer law is the interaction of individual rules. Against this background, the above-mentioned examples would have to be examined on whether the assessment as to rationality deficits (as a cause for deficient consumer choices in examples 1 to 4) correspond to the premises of EU consumer law. As far as examples 1 and 2 are concerned, it may be possible that competition law imposes limits on distribution systems in order to discourage conduct by suppliers that would infringe the prohibition of misleading statements under the UCP directive.[48] In example 3, the intervention of competition law could be seen as a supporting measure for consumer protection rules preventing an incorrect assessment of the price to be paid.[49] Example 4 may ultimately be a form of 'undue influence' by companies with a dominant market position (by exploiting consumer biases), which is generally dealt with in the prohibition of aggressive commercial practices.[50] While these aspects cannot be explored in more detail in this contribution, they indicate a possible direction for further research.

21.4 The Institutional Dimension: A 'One-Stop' Model for Competition and Consumer Protection?

21.4.1 Private vs. Regulatory Enforcement

Besides a substantive dimension, the convergence between competition law and consumer law also has an institutional dimension which should at least be mentioned briefly. The advance of private enforcement of competition law has created a certain proximity to private law instruments used to combat unfair trade practices in Member States such as Germany.[51] Probably currently the most intensively discussed topic in the field of private enforcement is the introduction of collective damages actions, in particularly in the form of opt-out claims similar to the American class action. Generally, this is a 'horizontal' problem cutting across different areas of law. Where consumers only suffer minimal damage they have little incen-

[47] See on this point (with reference to the Commission's proposal of a Common European Sales Law), T Ackermann, 'Public Supply of Optional Standardized Consumer Contracts: A Rationale for the Common European Sales Law?' (2013) 50 *Common Market Law Review, Special Issue No 1*, 11, 16.

[48] Art 6 and 7 UCP Dir.

[49] Art. 7(4)(c) UCP Dir.

[50] Art. 8 UCP Dir.

[51] See for a comprehensive survey, C Alexander, *Schadensersatz und Abschöpfung im Lauterkeits- und Kartellrecht* (Tübingen, Mohr Siebeck, 2010).

tive to claim compensation. This problem of rational apathy applies not only to individual consumers who—possibly due to passing on via several market levels—only suffer a very small part of a significantly greater loss caused by a cartel, but also to other situations where business conduct inflicts small individual losses to a great number of consumers, for example the frequent use of invalid general terms and conditions. For such a horizontal problem there should, in principle, be a horizontal solution. Of course, one has to bear in mind that in the sphere of competition law, a strong culture of public enforcement exists whose success is largely owed to leniency regulations that reward whistleblowers. However, this does not seem to be an insurmountable obstacle.[52]

21.4.2 Advantages and Disadvantages of a Single Authority for Competition and Consumer Protection

Ultimately, as a means for avoiding tensions between competition and consumer protection, the model of a single authority dealing with both areas comes to mind, like the British Office of Fair Trading or the U.S. Federal Trade Commission. However, the capability of such an authority to avoid contradictions between competition and consumer protection is largely dependent on the extent of its competencies to itself determine policies and to implement them in regulations and decisions. This is where we find ourselves in a dilemma: The greater the discretion of such an authority, the more effectively it will be able to provide for a homogenous concept of competition and consumer protection. At the same time the more problematic its democratic legitimacy becomes. Moreover, the internal structure of such an authority is a sensitive point. If competition and consumer lawyers work separately there is a risk that the intended coordination will fail. If they are put together in joint departments, for example in a structure that is divided according to economic sectors, there is a danger of a 'hostile takeover' of one group by the other (similar to the situation with the merger of competition and regulatory authorities in network industries, where it is feared that a regulatory mindset will prevail). In the light of these considerations, we probably should not expect too much from an authority with a dual function, and in in any case not the resolution of tensions found in the substantive law.

21.5 Conclusion

This contribution has attempted to show that competition and consumer protection require a common consumer model and that divergent perceptions of the rationality of consumers within a legal system are unsustainable. However, unlike U.S.

[52] See, however, the rather hesitant approach taken by the Commission in its package of 11/6/2013, http://ec.europa.eu/competition/antitrust/actionsdamages/documents.html.

antitrust law, EU competition law as interpreted by the European courts and by the Commission, implicitly recognizes rationality deficits on the part of consumers. It thus essentially shares the premises of paternalistic consumer protection. This observation may be surprising, even objectionable for a considerable number of competition lawyers, but it provides us with a suitable explanation of some features of EU competition law which, from the perspective of neoclassical welfare economics building on the concept of consumer sovereignty, would barely be comprehensible. It remains to be seen whether this position will ultimately prevail or whether it will be replaced by a consistent orientation towards the ideal of consumer sovereignty.

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Chapter 22
Collective Management of Copyrights and the EU Principle of Free Movement of Services after the *OSA* Judgment—In Favour of a More Balance Approach

Josef Drexl

Abstract On 20 February 2014, the Council of the European Union adopted the new Directive on Collective Rights Management. In its Proposal for this Directive, the Commission argued that cross-border collective rights management services are liberalised pursuant to Article 16 of the Services Directive of 2006. Yet, only one week after the adoption of the new Directive, the Commission's view was rejected by the Court of Justice of the EU in the *OSA* judgment. This chapter analyses the relationship between the principle of free movement of services and national sector-specific regulation of CMOs in more detail in order to explore to which extent the principle of free movement of services and the need for specific rules for collective management of copyrights could be better coordinated in the future.

22.1 Introduction

In the European Union, the system of collective rights management is in transition. In June 2012, the Commission published its Proposal for a Directive on Collective Rights Management.[1] On 20 February 2014, after intensive discussions in the European Parliament and the Council,[2] the Directive was finally adopted.[3]

[1] Proposal for a Dir on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online uses in the internal market, COM(2012) 372 final.

[2] This revised text implementing the compromise was not yet publicly available at the writing of this contribution in November 2013. Indeed, both the Council and the European Parliament had proposed changes to the initial Commission Proposal. On the position of the European Parliament in particular see M Gallo, 'Draft Report', Committee on Legal Affairs, European Parliament, 30 April 2013, Doc. 2012/0180(COD), http://www.europarl.europa.eu/RegistreWeb/search/simple.htm?reference=2012/0180%28COD%29&currentPage=2.

[3] Dir 2014/26/EU of the European Parliament and of the Council of 26 February 2014 on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online use in the internal market, [2014] OJ L 84/72.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_22,

Only one week later, the Court of Justice of the European Union (CJEU) handed down its *OSA* judgment.[4] In this judgment, the CJEU rejects the Commission's view according to which Article 16 of the Services[5] Directive applies to the activities of collective management organisations (CMOs)[6] in the internal market. The Court reached this result by interpreting Article 17(11) of the Services Directive, which provides for an exception concerning 'copyright' and 'neighbouring rights'. Although this provision does not mention collective rights management, the Court held that, since only services can be excluded from the application of Article 16, Article 17(11) must be read to refer to the services provided by CMOs.[7]

Indeed, in the legislative process for the adoption of the new Directive on Collective Rights Management, application of the Services Directive was a major issue. Ever since the adoption of the Services Directive, the Commission had argued that cross-border provision of services by CMOs is covered by Article 16 of the Services Directive.[8] In June 2012, the Commission affirmed its position explicitly in the preamble of its Proposal for the Directive on Collective Rights Management. Recital 3 of the Commission Proposal was formulated as follows:

> When established in the Union, collecting societies—as service providers—must comply with the national requirements pursuant to Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market which seeks to create a legal framework for ensuring the freedom of establishment and the free movement of services between the Member States. This implies that collecting societies should be free to provide their services across borders, to present rightholders resident or

[4] Case C-351/12 *Ochranný svaz autorský pro práva k dílům hudebním o.s. (OSA),* not yet reported.

[5] Dir 2006/123/EC on services in the internal market, [2006] OJ L 376/36.

[6] Note that the Commission's Proposal uses the term 'collecting societies' instead of the internationally more accepted and also more appropriate term 'collective management organisations'. However, according to later debate in the legislative process, it is very likely that the final version of the directive will use the latter term. This is why this contribution also uses this term. This is also the term used by the new directive, whereas the Commission Proposal used the term 'collecting societies'.

[7] See also R Heine, *Wahrnehmung von Online-Musikrechten durch Verwertungsgesellschaften im Binnenmarkt* (Berlin, de Gruyter, 2008) 252; T Riis, 'Collecting societies, competition and the Services Directive' (2011) 6 *Journal of Intellectual Property Law & Practice* 482, 490 (arguing against a justification of the sector-specific regulation of CMOs under these rules). Case 351/12 *OSA,* para 65.

[8] See especially European Commission, Handbook on the implementation of the Services Directive (Brussels, 2007) 41. In legal writing, there have been many voices arguing that collective rights management should be considered exempted from the application of Art 16 as a matter of Art 17(11). See, for instance, S Alich, 'Neue Entwicklungen auf dem Gebiet der Lizenzierung von Musikrechten durch Verwertungsgesellschaften in Europa' (2008) *Gewerblicher Rechtsschutz und Urheberrecht—Internationaler Teil* 996, 1004; J Heyde, *Die grenzüberschreitende Lizenzierung von Online-Musikrechten in Europa* (Baden-Baden, Nomos, 2011) 376; against Heine, *Wahrnehmung von Online-Musikrechten,* 252 ff (pointing out that an exception for collective rights management was considered, but ultimately rejected, in the process of adopting the Services Directive). Cf also Riis, 'Collecting societies', 490 ff (hinting at the legal uncertainty that the text of the Services Directive and its history create).

> established in other Member States or grant licences to users resident or established in other Member States.[9]

The effect of Article 16 of the Services Directive would indeed have been far-reaching, but, against the background of the concept of the Services Directive, not at all exceptional. Under Article 16, for the provision of its services to other Member States, a CMO would only be obliged to respect the regulatory requirements in the Member State in which this CMO is established. In its Impact Assessment accompanying the 2012 Proposal, the Commission considers this an 'improvement'.[10] In particular, the Commission explicitly states that, under Article 16 of the Service Directive, a Member State would not be allowed 'to impose an authorisation, let alone an establishment requirement, on collective rights managers legally established in other [Member States] and wanting to provide services in its territory'. In contrast, many copyright scholars find this problematic in the light of the territorial character of copyright as an intellectual property right and, therefore, argue that collective rights management services should rather be considered exempted from the application of Article 16.[11] Some commentators have argued that the new directive should clarify that the Services Directive does not apply to collective rights management.[12] Such views have now been confirmed by the CJEU in *OSA*.

The critical discussion of the Commission Proposal had at least the positive effect that the Commission's view on the applicability of the Services Directive has not entered the final text of the Directive on Collective Rights Management. Recital 4 of the Directive only highlights the principle of free movement of services by the following more general statement:

> When established in the Union, collective management organisations should be able to enjoy the freedoms provided by the Treaties when representing rightholders who are resident or established in other Member States or granting licences to users who are resident or established in other Member States.

This statement avoids any conflict between the Court's view according to which cross-border collective management services are only protected by the provisions on the free movement of services of the TFEU. In contrast to Article 16 of the Services Directive, application of the principle on free movement of services of

[9] Recital 3 Commission Proposal (footnote omitted). See also the Commission Proposal, Explanatory Memorandum, 1.4.

[10] Commission Staff Working Paper, Impact Assessment, 11 July 2012, SWD(2012) 204 final, 11 n 43.

[11] See, for instance, J Drexl, S. Nérisson, F Trumpke and RM Hilty, 'Comments of the Max Planck Institute for Intellectual Property and Competition Law on the Proposal for a Directive of the European Parliament and of the Council on Collective Management of Copyright and Related Rights and Multi-Territorial Licensing of Rights in Musical Works for Online Uses in the Internal Market' (2013) 44 *International Review of Intellectual Property and Competition Law* 322, paras 20 and 22.

[12] GRUR (Verein für Gewerblichen Rechtsschutz und Urheberrecht), 'Stellungnahme zum Vorschlag einer Richtlinie des Europäischen Parlaments und des Rates über die kollektive Rechtewahrnehmung von Urheber- und verwandten Schutzrechten und die Vergabe von Mehrgebietslizenzen für die Online-Nutzung von Rechten an Musikwerken im Binnenmarkt' (2013) *Gewerblicher Rechtsschutz und Urheberrecht* 155, 156.'

Article 56 TFEU allows Member States to control the provision of collective rights management services to their territories for the purpose of effective protection of intellectual property.[13]

Yet the question remains whether there is a better way to coordinate the principle of free movement of services, on the one hand, and the need to protect intellectual property and to provide for effective control of the activities of CMOs, on the other hand. Indeed, the *OSA* judgment may well convince the European Commission to come up with another proposal for reform.

As guidance for such reform, this Chapter argues that the Commission should not simply 'repeal *OSA*' by making Article 16 of the Services Directive applicable to cross-border provision of collective rights management services with the intention of pushing through its previous policy. Rather, the Commission should propose a revision that much better coordinates the Services Directive and the Directive on Collective Rights Management by implementing more tailor-made rules that both give broadest scope to the principle of free movement of services and provide effective control of the activities of CMOs by allocating most appropriately the power of control between the Member States where a CMO is established and the Member States for which rights are managed. The following analysis has not the purpose of presenting and discussing the many important aspects of the new directive.[14]

Also, this research strives to contribute more generally to the scholarship of European law. The protection of the fundamental freedoms is the cornerstone of the establishment of the internal market. Hence, in principle, the Commission is right in promoting the principle of free movement of services with the objective, among others, of enhancing competition among the CMOs of different Member States. Yet EU law also has to recognise, and indeed recognises, substantive policy goals. European law scholarship plays an important role in helping the EU legislature and the courts to find the right balance between the fundamental freedoms and the conflicting policy goals.

A scholar who has given particular consideration to the need for finding a balance between the autonomy of economic actors and state regulation is Hans Micklitz. It is my pleasure to dedicate this Chapter to him and I hope that it will find his interest.

In the following, Subchap. 2 will explain the economic role of CMOs and the services they provide. This analysis will lead to a double distinction: the first is between services provided to rightholders and those provided to users, and the second is between the kinds of rights managed by CMOs, namely, rights for which rightholders freely decide that they should be exercised by CMOs, on the one hand, and rights, including statutory remuneration rights, for which collective rights management is mandatory, on the other hand. Subchap. 3 will then assess the potential for cross-border services provided both to rightholders and to

[13] In *OSA*, the Court held that effective protection of copyrights can even justify the grant of a legal monopoly to a national CMO at least with regard to uses that require supervision from within the national territory. See Case 351/12 *OSA,* paras 71–79.

[14] For such a discussion of the Commission Proposal see Drexl et al, 'Comments'.

users against the backdrop of the current legal situation within the EU. Finally, Subchap. 4 will test to what extent the new directive should contain rules that prevail over Article 16 of the Services Directive.

22.2 Services Provided by CMOs and the Economics of Collective Rights Management

22.2.1 CMOs as a Market Solution to a Transaction Cost Problem

CMOs are intermediaries for the licensing of copyright and related rights between rightholders and users. From an economic perspective, CMOs solve a transaction cost problem with regard to the mass use of such rights. Without CMOs, users would encounter insurmountable obstacles for the clearing of rights. For instance, the operator of a radio station would hardly be able to play the music she wants to play in a most flexible way if she had to find out who the rightholders are and negotiate a licence with these rightholders individually prior to use. Conversely, without CMOs, rightholders would not be able to monitor the market, to detect potential infringers and to request them to pay for the use of their rights. Hence, CMOs serve the interest of both rightholders and users. Workable markets for the licensing of mass uses of copyright can only emerge with the help of CMOs. This explains why, in most countries, CMOs developed as private organisations of rightholders and were accepted by the users without much state intervention.

22.2.2 CMOs as Providers of Services to Rightholders and Users

As intermediaries between rightholders and users, CMOs provide services to both rightholders and users.

As regards the rightholders, these services consist in (1) granting blanket licences on behalf of all rightholders the CMOs represent, (2) collecting the royalty fees from users and distributing this income to the rightholders and (3) monitoring the market and taking legal actions against infringers. Similarly, collecting societies manage statutory remuneration rights by (1) negotiating tariffs for such rights, (2) collecting and distributing the fees and (3) acting against those who try to escape their obligation to pay under the legal schemes of statutory remuneration rights. CMOs differ from other licensing intermediaries by acting as trustees of the rightholders.[15]

[15] The latter feature is not sufficiently expressed in the definition of 'collecting societies' in Article 3(a) of the Commission Proposal, above n 1. In this regard, see also the critique expressed by Drexl

With regard to users, CMOs grant licences for the use of copyright and related rights. In other words, CMOs help users to clear rights and to operate legally under the laws protecting copyright and related rights.

22.2.3 CMOs as Natural Monopolies

In the EU Member States, markets for collective rights management are characterised by monopolistic structures. Some Member States, such as Italy, Austria or the Czech Republic, even provide for legal monopolies.[16] In Italy, the Copyright Act provides for the legal monopoly of the Società Italiana degli Autori ed Editori (SIAE).[17] In Austria and the Czech Republic, the law provides that the competent supervisory body can only grant the authority to manage the rights for a particular category of works to one society.[18] Yet, even in Member States that do not provide for a legal monopoly, CMOs have emerged as *de facto* monopolies. For instance, under German law, CMOs are only required to get an authorisation to operate, which, however, is granted to any domestic or foreign applicant that fulfils the statutory guarantees of economic and professional reliability. Still, in Germany, several monopolistic CMOs have emerged that manage the rights for different categories of works or related rights. The monopolistic character of CMOs is explained by the economies of scale that characterise collective rights management. CMOs incur large fixed costs caused by the machinery of collecting and distributing income and the need to build up monitoring systems, while the marginal costs of managing the rights of an additional rightholder are relatively low. Hence, this cost structure results in a larger ratio of administrative costs for smaller CMOs and, hence, less income for rightholders who decide to join such a CMO. Therefore, in a market with several CMOs, it can be expected that rightholders will gradually migrate to the larger CMOs until the smaller competitors will have to leave the market. Due

et al. 'Comments', para 28. Fortunately, the final text of the Directive has reacted to this critique. Article 3(a) of the Directive now stipulates that a CMO needs to manage rights 'on behalf of more than one rightholder'.

[16] The *OSA* judgment of the CJEU now justifies the existence of such legal monopolies to a large extent. See above n 13.

[17] This legal monopoly has existed since the fascist era; it was instated in 1941. In 2012, a similar legal monopoly for related rights was abolished after scandals concerning the mismanagement of the revenues by this CMO had become public. See G Scorza, 'Diritti d'autore: da oggi gli artisti liberi di scegliere' (2012) ilfattoquotidiano.it (20/12/2012), www.ilfattoquotidiano.it/2012/12/20/diritti-dautore-da-oggi-artisti-liberi-di-scegliere.

[18] See s 3(2) of the Austrian Collecting Societies Act (Verwertungsgesellschaftsgesetz) of 2006; Art 98(6)(c) Czech Copyright Act. In Austria, there was an intensive debate on whether the legal monopoly is in compliance with the EU principle of free movement of services. See, eg, M Scholz, 'Dienstleistungsrichtlinie und Verwertungsgesellschaften. Kann die Dienstleistungsrichtlinie das nationale Monopol aushebeln?' (2011) *Medien und Recht* 73, 75 ff (justifying the monopoly by the legislature's consideration according to which the monopoly should prevent fragmentation of the repertoire and enable a one-stop shop for users).

to this tendency toward natural monopolies, markets with competing CMOs are extremely rare.[19]

In the EU context, however, more competition could be conceived if CMOs from different countries competed for the same rightholders and the same users by providing their services across borders. Yet such competition could also force the CMOs of smaller countries to leave the market after some time.

22.3 The Potential of Cross-Border Services Provided by CMOs

Against the backdrop of the preceding analysis, for the application of the Services Directive, there is a need to distinguish between services provided to rightholders and services provided to users. In the following, the analysis will clarify the potential for such cross-border provision of services in the current legal and economic context within the EU.

22.3.1 Cross-Border Services Provided to Rightholders

CMOs provide cross-border services to the extent that they represent the rights of rightholders from other Member States. This requires an authorisation of the CMOs to act on behalf of the individual rightholders and to represent their rights. Such authorisation can take two forms. Mostly, CMOs rely on reciprocal representation agreements that they conclude bilaterally with the CMOs of other countries. However, CMOs may also represent rights based on a direct authorisation given by the individual foreign rightholder. This requires a direct contractual relationship between the foreign rightholder and the CMO. From an internal market perspective, the second form of direct authorisation has particular advantages. CMOs from different Member States will compete for the same rightholders, if they are willing to accept foreign rightholders in principle.

In the past, however, CMOs were very reluctant to contract directly with rightholders from other Member States. Many of the reciprocal representation agreements even included provisions that obliged CMOs to refrain from accepting the management of rights of nationals or residents of other countries. Such clauses were held by the Commission to be illegal under ex-Article 85 EEC Treaty (now Article 101 TFEU) in the early *GEMA I* decision of 1971.[20] This was confirmed in substance by the ECJ and extended to the unilateral refusal to manage the rights of nationals of

[19] A competitive market exists in the US, where three CMOs compete for owners of copyrights in musical works. There, the two larger CMOs, ASCAP and BMI, have comparatively large market shares.

[20] Decision 71/224/EEC, Case IV/26.760 *GEMA* [1971] OJ 134/15.

other Member States in the *GVL* judgment of 1983.[21] Surprisingly, the Commission still found such restrictions in reciprocal representation agreements among CMOs more than 30 years after *GEMA I* in its *CISAC* decision of 2008.[22] These cases show both the reluctance of the CMOs to provide services to other Member States and the importance attributed by EU institutions to cross-border collective rights management services as a means to enhance competition in the internal market.

Yet the majority of rightholders may still prefer to join their national CMOs for valid reasons. Especially individual authors may simply prefer to communicate in their mother tongue with the CMO representing their rights. Also, for cultural or linguistic reasons, the major market for the works concerned will often be the country of the residence or settlement of the rightholder. Joining the CMO of the major market is economically reasonable, since the alternative of collecting royalties through reciprocal representation agreements would lead to higher administrative costs and, hence, additional deductions on the revenue of the rightholders.

Conversely, there can also be good reasons why rightholders prefer to contract directly with CMOs of other Member States. Foreign CMOs may simply provide much better service and, due to higher effectiveness, deduct less from the revenue distributed to the rightholders for their service they provide. Large institutional rightholders that are particularly interested in international exploitation, such as the major music publishing companies (so-called 'majors') are more likely to choose among different national CMOs than individual authors of works of music. Authors of mainstream popular music are more likely to join a foreign CMO than the author of literary works especially of languages that are only spoken in one or very few countries.[23] Yet, even in the field of literature, if the language is spoken across several countries, authors may feel an incentive to join the CMO of the larger of these countries if this is also the major national market.

In sum, promoting cross-border provision of services to rightholders both as a matter of EU competition law and the principle of free movement of services makes perfect sense in view of enhancing the efficiency of CMOs and, thereby, the quality of their services provided to rightholders. Cross-border provision of collective rights management services to rightholders has the potential of levelling the playing field among CMOs in the internal market.

[21] Case 7/82 *GVL v Commission* [1983] ECR 483.

[22] Commission Decision, Case COMP/C-2/38.698 CISAC [2008] OJ C 323/12 (summary decisions); full prohibition decision: http://ec.europa.eu/competition/antitrust/cases/dec_docs/38698/38698_4567_1.pdf.

[23] For instance, authors of Latin American music often prefer to join the CMOs of the US and Spain instead of national CMOs in Latin America. The US CMOs for music, such as BMI, traditionally try to attract authors of Latin music. On the BMI policy in this regard see http://www.bmi.com/genres/entry/history_bmi_and_latin_music.

22.3.2 Cross-Border Services Provided to Rightholders

The situation is more complex when it comes to the cross-border provision of services to users. First, more precision is needed in defining the scope of protection of the principle of free movement of services. Second, the question remains whether and under which conditions CMOs are indeed willing to provide cross-border services to users.

22.3.2.1 Application of the Free Movement Principle to Services Provided to Users and its Impact on Competition

There are two possible criteria for defining the cross-border character of the provision of services by CMOs to users, namely, (1) the grant of licences to users in another Member State and (2) the grant of licences for the use of copyright under the law of another Member State (so-called cross-border licences).[24] Both criteria will be fulfilled if, for instance, the German CMO for music grants a public performance licence to the French operator of a radio station for terrestrial broadcasts in France with regard to the repertoire held by the German CMO. In this case, the CMO and the radio station are established in different Member States and the CMO grants a licence for the use of copyrights under the law of another Member State.

However, Article 56(1) TFEU only requires that the service provider and the recipient be established in different Member States. Hence, the following case would also be covered: a telecommunication provider in France wants to extend its services to Germany, and as part of its services, this provider plans to offer the use of ringtones for mobile phones to German customers. For this purpose, the French telecommunication provider requests the German CMO to grant a licence for Germany. This scenario would be protected by the principle of free movement of services since, according to Article 56(1) TFEU, it suffices that the recipient is established in another Member State than the service provider.

Let us imagine, however, that this same French telecommunication provider seeks a licence from the French CMO for offering ringtones to German customers. In such a scenario, the literal requirements of Article 56(1) TFEU are not fulfilled since both the CMO as the provider of the licensing service and the telecommunication provider as the recipient of the licensing service are established in the same Member State. Yet the licence is granted for the use of rights under German law and for the German territory. The question is whether the mere fact that the licence was granted for another Member State suffices to bring the case into the scope of the principle of free movement of services. This question is to be answered in the affirmative in the light of EU case-law. In the 'tourist guide' judgment against Greece, the former ECJ held that even a tourist guide travelling with tourists from his own

[24] In *OSA*, the CJEU has now confirmed that also the grant of licences by a CMO to a user has to be considered as a service falling within the scope of Article 56 TFEU. See Case C-351/12 *OSA,* para 60.

country can rely on the principle of free movement of services against the application of restrictive rules in the host country.[25] The Court explicitly held:

> Although Article 59 of the Treaty [now Article 56 TFEU] expressly contemplates only the situation of a person providing services who is established in a Member State other than that in which the recipient of the service is established, the purpose of that Article is nevertheless to abolish restrictions on the freedom to provide services by persons who are not established in the State in which the service is to be provided. It is only when all the relevant elements of the activity in question are confined within a single Member State that the provisions of the Treaty on freedom to provide services cannot apply.[26]

The Court consequently held that the principle of free movement of services 'must apply in all cases where a person providing services offers those services in a Member State other than that in which he is established, wherever the recipients of those services may be established.'[27]

Accordingly, Article 56 TFEU has an extremely broad scope of application. The situation is not different under the Services Directive. Article 16(1)(1) TFEU protects the right of providing services in other Member States than that in which the service provider is established. This provision does not require that the service be provided to a recipient established in another Member State.

This means that for cross-border services of CMOs to users two general scenarios can to be distinguished: (1) the grant of licences by a CMO for the territory of another Member State (cross-border licences), wherever the licensee is established; and (2) the grant of licences for the territory of the Member State where the CMO is established to licensees established in other Member States.

With regard to the need to regulate the licensing practices, application of Article 16 of the Services Directive is only critical in the first case. It is in this case that the country for which the licence is granted may have a particular interest in controlling which societies are allowed to grant licences and in controlling the royalty rates charged to users in particular. Several Member States have indeed developed institutional arrangements and procedures of sector-specific regulation that address the problem of excessive pricing as part of copyright law. In the UK, a Copyright Tribunal has the power to control the appropriateness of royalties to be paid under British copyright law.[28] In Germany, a special arbitral board (*Schiedsstelle*), established under the Act on Collective Rights Management of 1965, has the power to make recommendations on the appropriateness of royalty fees if the users do not agree with the tariffs set by CMOs.[29] If the parties do not accept this recommendation, the user can still start regular court procedures to get a final decision on the appropriateness of the fees.[30]

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[25] Case C-198/89 *Commission v Greece* [1991] ECR I-727.

[26] Ibid, para 9 (citations omitted).

[27] Ibid, para 10.

[28] See s 149 Patents, Copyright and Designs Act 1988.

[29] See ss 14 through 15 Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz).

[30] See s 16 Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz).

Member States that have such schemes of control want to apply these schemes without discrimination to all CMOs that grant licences in the national territory, whether these CMOs are established in these Member States or in others. Such uniform application also seems mandatory in order to level the playing field between foreign and domestic CMOs. Yet such schemes seem to violate the principle of free movement of services established in Article 16(1)(3)(b) of the Services Directive, which does not allow for a justification of restrictions of the exercise of service activities by copyright law or the protection of consumers against excessive pricing. In this context, it has to be noted that such sector-specific control mechanisms are complementary to the application of Article 102(a) TFEU, the prohibition of excessive pricing of EU competition law, to the royalty schemes of CMOs in the Member States through the European courts.[31] With regard to the control of royalty rates, Article 16(1)(3)(b) of the Services Directive could therefore seriously impair the national policies designed to address excessive pricing, which are in line with EU law, and distort competition between CMOs from different Member States.[32]

By stipulating certain principles on the licencing practice, including the principle according to which the tariffs set by CMOs have to reflect the economic value of the rights, Article 15 of the 2012 Commission Proposal recognises the problem of excessive pricing. Yet the Proposal fails to implement procedural standards of control and ignores that such national procedures could be set aside under Article 16 of the Services Directive.

22.3.2.2 Practical Relevance of Cross-Border Licences and Exercise of Other Rights

However, the question is also whether cross-border licensing is of any practical relevance. Traditionally, CMOs have refrained from granting licences for other jurisdictions and have preferred to organise the management of the rights of their members and affiliated rightholders by concluding reciprocal representation agreements with the CMOs of other countries. From a policy perspective, the question is whether CMOs have a valid business reason for abstaining from granting licences for foreign territories. Indeed, reciprocal representation agreements may well be potentially restrictive of competition by excluding competition between the CMOs from different Member States. Beyond applying competition law to such agreements, the argument could be made that by applying the Services Directive, the law would enhance the willingness of CMOs to engage in direct cross-border licensing by excluding control of the licensing practices in the Member States for which the

[31] See Case 395/87 *Tournier* [1989] ECR 2521; Joined Cases 110/88, 241/88 and 242/88 *Lucazeau* [1989] ECR 2811; Case C-52/07 *Kanal 5 v STIM* [2008] ECR I-9275. Also the *OSA* decision adds to this case-law. See Case C-351/12 *OSA,* paras 87–89 (holding that national law to which excessive pricing by a monopolistic CMO could be attributed would violate Article 102 TFEU and Article 106(1) TFEU).

[32] See also Heine, *Wahrnehmung von Online-Musikrechten,* 254 (highlighting the negative impact of the Services Directive on competition among CMOs).

licence would be granted. In any case, these questions demand a better understanding of the economic incentives of CMOs to abstain from or engage in cross-border licensing.

The Traditional System of Reciprocal Representation Agreements

While rightholders may have reasons to enter into direct contractual relationships with foreign CMOs, they will usually prefer to entrust only one national CMO with the management of their rights under all different jurisdictions in order to avoid the transaction costs of having to deal with a multitude of different national CMOs. Hence, CMOs are usually able to grant licences for their own repertoire, or large parts of it, for the territory of other countries as well as their own. However, CMOs also have to monitor the market and act against the infringement of the rights they represent. While CMOs have built up very cost-intensive monitoring systems in their national territories, establishing similar systems in all other countries is clearly prohibitive and would only duplicate the already existing monitoring systems of the local CMOs. Hence, the most efficient system of managing rights across borders builds on cooperation through reciprocal representation agreements that allow each CMO to grant territorially limited licences for the 'world repertoire', consisting of the individual repertoires of all the CMOs represented under such agreements. This system also has considerable advantages for those users who only seek territorially limited licences. A radio station in Germany can get a blanket licence from the German CMO that allows the station to choose music from the repertoires of both this German CMO and all other affiliated foreign CMOs for broadcasting music in Germany. At the same time, the foreign CMOs have good reasons to refrain from direct licensing to such a German radio station, since it would not be possible for them to monitor the use of their rights in Germany.

Multi-Territorial Licensing of Online Rights for Music

However, the situation is very different for digital use of works on the Internet. The reasons for this are twofold: first, Internet use is not territorially limited. Users are not only in need of a licence for the country where the user is established, but for all countries from where the works can be accessed and where the works meet considerable public interest (so-called country-of-destination principle).[33] Second,

[33] The question of which national law applies to Internet use is not one of choice of law but substantive law. With regard to intellectual property, practically all jurisdictions apply the country-of-protection principle. Accordingly, the applicable law to IP infringement is the law of the country for which protection is sought. In the EU, this rule is fixed by Art 8(1) of Reg (EC) No 864/2007 on the law applicable to non-contractual obligations (Rome II), [2007] OJ L 199/40. If the plaintiff claims protection under the law of a specific country, because she is the owner of the respective rights in this country, the court then has to decide whether, according to the territoriality principle, there has been use of the right in this country under the substantive provision of the IP law of this country. This was recently confirmed by the CJEU in the *Football Dataco* judgment, where the

monitoring the use of works on the Internet does not seem to be in need of local control systems. Digital monitoring systems on the Internet can be operated from anywhere in the world. Therefore, it is in view of the online use of works in particular that cross-border licensing appears as a realistic option.

This was recognised both by CMOs and by the European Commission as a competition agency more than 10 years ago. It was first in the field of phonogram producers' rights that the CMOs developed a scheme for multi-territorial licences based on a new type of reciprocal representation agreements. Under the new model of the IFPI Simulcasting Agreement, the CMOs for related rights agreed to authorise each other to grant multi-territorial licences for all repertoires of the participating CMOs. Thereby, the CMOs enabled users to enjoy the so-called one-stop shop: with the grant of a single licence users were given access to all repertoires and were allowed to use the rights on the Internet with effect in all different countries. But the IFPI Simulcasting model also restricted price competition quite considerably by providing for a special mode of calculating the fees, namely, by relying on the tariffs of the different CMOs in relation to the volume of use regarding the individual countries. The CMOs therefore applied for an individual exemption from ex-Article 81(1) EC (now Article 101(1) TFEU), which was in fact granted by the European Commission in 2002.[34] The Commission granted the exemption after recognising that many of the CMOs would otherwise not join the system of the one-stop shop, and it stressed that IFPI Simulcasting would at least allow some price competition between CMOs to the extent that users could choose the national CMO that would grant the licence. This CMO was able to price-compete with other CMOs to some extent, especially with regard to the royalty rates it would charge for the use in its own territory.

The authors' rights organisations initially intended to apply the same approach in the framework of the Santiago and the Barcelona Agreements, covering the public performance right and the 'mechanical' reproduction right for the online use of works of music, as a model for a new generation of reciprocal representation agreements. Yet the Santiago and Barcelona Agreements differed in a most important point from the IFPI Simulcasting Agreement. They did not allow the users to choose the CMO that would grant the licence by only authorising the CMO established in the country of the user's residence to grant the licence. When the European Commission opposed Santiago and Barcelona, the authors' rights CMOs refused to give in and simply decided that the agreements would expire at the end of 2004. This decision prevented the one-stop shop for licences for online use of works in music.

Court was requested to decide under which conditions someone uses a sui generis database right on the Internet in interpreting the provisions of Dir 96/9/EC on the legal protection of databases, [1996] OJ L 77/20. See judgment of 18 October 2012, Case C-173/11 *Football Dataco,* not yet reported. According to the CJEU, mere accessibility on the Internet does not suffice. Rather, the Court requires that the act of the user 'discloses an intention (…) to target persons' in the specific territory. Ibid, para 40.

[34] Commission Decision 2003/300/EC IFPI 'Simulcasting' [2003] OJ L 107/58. See also Riis, 'Collecting societies', 487 ff.

Rather, users were forced again to collect territorially limited licences according to the traditional model of reciprocal representation agreements.

The European Commission took two actions in order to improve the situation that had emerged with the expiry of the Santiago and Barcelona Agreements. The first action was initiated by the Directorate General for the Internal Market and led to the adoption of the 2005 Recommendation on the management of online rights for musical works.[35] With this Recommendation the Commission departed from the IFPI Simulcasting model and recommended that the rightholders withdraw their rights and negotiate new schemes for the direct grant of multi-territorial licences without the use of any reciprocal representation agreements. Hence, the idea was that the rightholders should now use competition between different CMOs for the grant of multi-territorial licences. Yet the obvious disadvantage consisted in the fact that this approach would prevent the one-stop shop for users. Rather, users would only be offered multi-territorial licences limited to the repertoires of individual CMOs or even of individual rightholders. Later, only the major publishing companies showed their willingness to follow the Recommendation of the Commission and to build up platforms for multi-territorial licensing of their repertoires. The most prominent example is CELAS, a joint venture between GEMA, the German CMO for works in music, and PRS for Music, GEMA's British counterpart. CELAS promises to grant multi-territorial licences for online use of the Anglo-American repertoire of EMI.[36] Indeed, the deal followed the decision of EMI to withdraw its reproduction rights for online use from the European system of CMOs and negotiate this new scheme of multi-territorial licensing with GEMA.[37] Such new schemes may produce benefits for the rightholders. In contrast, the withdrawal of the rights by some rightholders destroyed the one-stop shop even for territorially limited licences against the interests of users. Despite obvious deficiencies and considerable criticism not only from legal scholars[38] but even the European Parliament,[39] in its Proposal for a Directive on Collective Rights Management, the Commission refrains from giving up its past

[35] Commission Recommendation on collective cross-border management of copyright and related rights for legitimate online music services, [2005] OJ L 276/54. See also Corrigendum, [2005] OJ L 284/10 (correcting the date of the adoption of the Recommendation from May to October).

[36] See the website of CELAS at http://www.celas.eu. On the kind of licences granted by CELAS see Alich, 'Neue Entwicklungen', 1001 ff.

[37] On the reasons for the limitation to the Anglo-American repertoire see the very thorough legal analysis by Heyde, *Die grenzüberschreitende Lizenzierung von Online-Musikrechten in Europa,* 167–212.

[38] See, for instance, the summarised criticism by CB Graber, 'Collective Rights Management, Competition Policy and Cultural Diversity: EU Lawmaking at a Crossroads' (2012) *I-call working paper* No 2012/04, 9, www.unilu.ch/files/i-call_Working_Paper_2012_04_CBG_CRM_Competition_Policy.pdf. For an early critique on the Recommendation see J Drexl, 'Auf dem Weg zu einer neuen europäischen Marktordnung der kollektiven Wahrnehmung von Online-Rechten der Musik? Kritische Würdigung der Kommissionsempfehlung vom 18. Oktober 2005' in K Riesenhuber (ed), *Wahrnehmungsrecht in Polen, Deutschland und Europa* (Berlin, de Gruyter, 2006) 193.

[39] See, in particular, European Parliament resolution on the Commission Recommendation of 18 October 2005 on collective cross-border management of copyright and related rights for legitimate online music series (2005/737/EC), P6_TA(2007)0064, [2007] OJ C 301 E/64.

policy regarding multi-territorial licensing. Rather, it even includes a whole Title III on multi-territorial licensing that builds on the approach of the 2005 Recommendation and only proposes some additional rules that enhance access of the less attractive repertoires of smaller CMOs to the service of those CMOs that develop schemes of multi-territorial licensing.[40]

The second reaction by the Commission came from the Directorate General for Competition. After the expiry of the Santiago and Barcelona Agreements, in its *CISAC* decision, the Commission decided to attack the application of the traditional bilateral agreements which lead to a territorial delimitation of the licensing practice. There, the Commission argued that the refusal to grant multi-territorial licences for online use of music as well as satellite and cable transmission amounted to a concerted practice of the CMOs that manage the rights in works of music.[41] The Commission relied on the argument that, for these three fields of exploitation, there was no valid business justification for not granting licences to users established abroad since the CMOs would be able to monitor the use of works for music across borders as well as within them. Yet, on appeal, the General Court (GC) annulled the Commission Decision in this regard. According to the Court, the Commission was required 'to render implausible the explanations of the collecting societies' parallel conduct … other than the existence of concertation.'[42] While the Commission had sufficiently argued that CMOs can monitor and enforce rights with regard to authorised use, the Court stressed that the Commission had failed to consider how a CMO would monitor markets abroad in view of guaranteeing that users will request a licence and how they can enforce their rights against unauthorised use abroad without relying on cooperation of the local CMOs.[43]

This past EU development demonstrates the difficulties that the Commission has encountered, and still encounters, in convincing CMOs to offer cross-border licences to users. Yet the fact that some CMOs had already initiated new forms of cooperation in order to offer multi-territorial licences more than 10 years ago, and later started to cooperate with large rightholders for this purpose, demonstrate that the attitude of CMOs is changing.

Cross-Border Grant of Territorially Limited Licences

Moreover, cross-border licensing can even be expected with regard to territorially limited licensing. An example of a CMO that tries to manage rights directly for the territory of other countries without cooperation with the local CMO is the German VG Media. This CMO, which represents the copyrights and related rights of television and radio broadcasters, recently brought a complaint to the Directorate General for the Internal Market of the European Commission alleging that Spanish courts did not recognise its legal standing in contravention of the EU Services Directive.

[40] For a critique on Title III see Drexl et al. 'Comments', paras 46–65.

[41] Case COMP/C-2/38.698 *CISAC*.

[42] Judgment of 22 April 2013, case T-442/08 *CISAC v Commission,* not yet reported, para 133.

[43] Ibid, paras 140–169.

In a letter responding to the complaint, the Commission restated its view that 'collective rights management services fall within the scope of the said directive'. According to the Commission, the fact that VG Media was only denied standing by a Spanish court in the context of a national litigation for the sole reason that VG Media lacked the authorisation granted by the Ministry of Culture to CMOs established in Spain raises 'serious doubts of compatibility with the Internal Market principle of freedom to provide services if it was confirmed that the only reason why [VG Media was] denied such legitimation is the fact that [VG Media was] established in another Member State and exercising [its] freedom to provide services across borders'.[44] This letter also alludes to the fact that VG Media was representing clients for which it was providing services in Spain. Although VG Media only made this letter by the Commission available on its website without any further information on the underlying case, it arises from the Commission's letter that VG Media was obviously trying to manage rights under Spanish law. Although it is not known which rights VG Media represented and tried to enforce in Spain, direct management of the cable retransmission rights would seem an obvious candidate. This is explained by the large German population living in Spain that makes the Spanish market lucrative. Also, monitoring of such rights would not seem too difficult given the relatively limited number of cable operators in Spain.

Cross-Border Exercise of Rights for which Collective Rights Management is Mandatory

The case of cable retransmission is interesting for another reason. The cable retransmission right is an exclusive right that, under secondary EU law, can only be exercised through a CMO.[45] In many other instances, European copyright directives also provide for statutory remuneration rights in the framework of certain exceptions and limitations. From an economic perspective, the private copying levy is among the most important of those rights. In this regard, the Information Society Directive provides that Member States that have opted for a private-use copying exemption are obliged to introduce a right to fair compensation of the rightholder.[46] This rule does not oblige the Member States to guarantee that such rights be exercised through CMOs.[47] Yet it is also clear that collective rights management will

[44] M Martín-Prat, Head of Unit, Letter on behalf of the European Commission, Directorate General Internal Market and Services, 30/11/2012, www.vg-media.de/images/stories/downloads/121130_european-commission_vgm.pdf.

[45] Art 9(1) of Dir 93/83/EEC concerning copyright and rights related to copyright applicable to satellite broadcasting and cable retransmission, [1993] OJ L 248/15.

[46] Art 5(2)(b) of Dir 2001/29/EC on copyright and related rights in the information society, [2001] OJ L 167/10.

[47] In other instances, copyright directives explicitly allow Member States to entrust the exercise of such remuneration rights to CMOs and to regulate the collective management of such rights in more detail. See, for instance, Art 5 of Dir 2006/115/EC on rental right and lending right and on certain rights related to copyright in the field of intellectual property, [2006] OJ L 376/28 (regarding the non-waivable right of authors and performers to equitable remuneration for the rental).

provide the most effective tool for the exercise of such rights. What is also clear is that Member States are under a general obligation to guarantee effective enforcement of such statutory rights even where EU law does not provide for mandatory collective rights management. But from this general obligation, it also arises that Member States have to provide for a functional system of CMOs whenever they decide to make collective rights management mandatory for the exercise of such rights. Hence, in the field of exclusive rights that can only be exercised by CMOs as a matter of EU law and, in particular, with regard to statutory remuneration rights that are provided by EU law, an obvious tension exists between the EU interest in effective control of national CMOs and the principle of free movement of services as enshrined in the Services Directive.

The question remains whether cross-border exercise of such rights is very realistic. Indeed, Member States usually enjoy considerable flexibility in implementing statutory remuneration rights under EU law. Hence, a CMO from other Member States would have to develop considerable expertise regarding substantive copyright law in the country where the rights are claimed. Yet this is not an absolute barrier to entry. The abovementioned example of VG Media demonstrates that rights for which collective rights management is mandatory may already today be exercised by CMOs from other Member States. Also, cross-border management of statutory remuneration rights could become more frequent between Member States that share the same language. For instance, French CMOs could try to expand their business to Belgium and Luxembourg, German CMOs to Austria. As a consequence, cross-border management could also become more common in the field of literature and writings. An Austrian author may anyhow find her major market in Germany and, therefore, prefer the German CMO to the Austrian one. The CMOs of larger Member States obviously have a competitive advantage when they compete for rightholders; the decision to extend the exercise of statutory rights to other countries may then only be the next logical step.

In sum, the analysis demonstrates that there is a growing potential for cross-border services provided to users, including the grant of licences for the territory of other Member States and even the exercise of statutory remuneration rights under the law of other Member States.

22.4 The Potential Impact of the Services Directive on Cross-Border Services Provided to Rightholders and Users

After this assessment of the potential for cross-border services provided by CMOs, the question now needs to be answered of how the application of the Services Directive would impact collective rights management and its regulation in the Member States. This will require an understanding of how sector-specific regulation deals with the protection of both rightholders and users. Both groups of persons are in need of protection given the monopoly position of national CMOs. Special consideration will have to be given to the treatment of rights for which collective rights management is mandatory.

22.4.1 The Impact on the Protection of Rightholders

The need to protect rightholders against the monopoly position of CMOs is not only a matter of national regulation. This concern is also deeply enshrined in the practice of EU competition law regarding collective rights management. EU competition law has developed important principles that need to be respected by CMOs wherever they are established in the EU and to whichever countries they provide services. Whereas Article 16 of the Services Directive would only limit the application of the national law in the country in which the service is provided, EU competition law remains fully applicable.

The most important principle of EU competition law in this regard is certainly that market-dominant CMOs are under a duty to accept rightholders who are nationals or residents of other Member States, a rule that was first stated by the Commission in the *GEMA I* decision[48] and later confirmed by the ECJ in the *GVL* judgment.[49] In *GVL*, the Court rejected the argument brought by GVL, the German CMO for the related rights of phonogram producers and performing artists, that under German law existing at that time CMOs were only under a statutory obligation to contract with rightholders of German nationality or who were resident or established in Germany. Rather, the Court argued that GVL was generally dominant with regard to the exploitation of the rights in Germany[50] and that the provision of German law on which GVL relied did not oblige German CMOs to refuse collective rights management services to foreign rightholders.[51] Following the *Phil Collins* judgment, which clarified that EU Member States are not allowed to discriminate against the owners of copyright who are nationals of other Member States as a matter of the general non-discrimination provision (now Article 18(1) TFEU) of EU law,[52] Germany extended the obligation to manage the rights of all rightholders to all nationals of the Member States of the EU and the European Economic Area.[53]

In *BRT v SABAM*, for the first time, the ECJ controlled restrictions of the freedom of rightholders to withdraw their rights from a CMO. According to the Court, a CMO can only impose restrictions on rightholders that are 'absolutely necessary' for the enjoyment of a position required for the CMO to carry out its activity.[54] The scope of rights transferred to CMOs and restrictions on withdrawing certain rights

[48] Case IV/26.760 GEMA.

[49] Case 7/82 GVL.

[50] Ibid, paras 44 ff. Indeed, participation in the German revenues via bilateral reciprocal representation agreements was not an option. The case arose prior to the harmonisation of the related rights of performing artists in the EU. At that time, several of the Member States had not yet provided for rights of performing artists regarding secondary use of their performances and only a few bilateral representation agreements existed between the CMOs of the different Member States. See the preceding Decision of the Commission, Case IV/29.839 GVL [1981] OJ L 370/49, paras 7 and 11 (relying on these facts to argue an abuse of market dominance).

[51] Ibid, para 53.

[52] Joined Cases C-92/92 and C-326/92 *Phil Collins and Patricia In- und Export* [1993] ECR I-5145.

[53] See s 6(1) Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz).

[54] Case 127/73 *BRT v SABAM* [1974] ECR 313, para 11.

have been addressed by the Commission on several occasions.[55] In the more recent decision in the so-called *Daft Punk* case,[56] the Commission reacted to the new Internet environment. The Commission had to decide on the refusal of the French SACEM to accept the musicians of the Daft Punk group as its members. The musicians wanted to retain certain rights, especially for online use, in order to license them directly to users. According to SACEM's rules, members were only allowed to retain such rights if they entrust these rights to another CMO. In the 1970s, the Commission still had accepted SACEM's membership rules through a comfort letter, justifying them by the need to protect rightholders against powerful users and the goal of excluding cherry-picking by rightholders. By 2002, the Commission had changed its view; now it argued that the rightholders should be allowed to retain rights for licensing directly to users over the Internet.[57] This decision indicates the Commission's willingness to reconsider its former practice and to broaden the freedom of rightholders to manage their rights themselves against the backdrop of declining transaction costs on the Internet.

Sector-specific regulation in the Member States can address the same or similar concerns with regard to the interest of rightholders. Some laws of EU Member States prescribe a certain, membership-driven corporate structure of CMOs[58] or that CMOs need to be run as non-profit organisations.[59] Some Member States provide that CMOs are required to hold an authorisation. Under the German system, such an authorisation is only refused (1) if the charter of the CMO is not in conformity with the legal requirements under the Act on Collective Rights Management, (2) if the persons representing the CMO do not demonstrate the required professional reliability for running a CMO or (3) if the entity does not have the financial resources for operating a CMO.[60] Finally, supervisory bodies may have the power to control the accountings of CMOs and the rules guaranteeing equitable distribution of the revenue to the rightholders.[61]

These rules of sector-specific regulation are not undermined by Article 16 of the Services Directive. Member States are free to apply such rules to the CMOs established in their own national territory. Hence, theses states act as the country

[55] This started with Case IV/26.760 *GEMA*.

[56] Case COMP/C2/37.219 *Banghalter & Homem Christo v SACEM,* http://europa.eu.int/comm/competition/antitrust/cases/dec_docs/37219/37219_11_3.pdf (only available in French).

[57] Ibid, 11.

[58] CMOs must be private law associations of rightholders in Bulgaria, Croatia, Hungary and Poland.

[59] CMOs must be non-profit organisations in Austria, Bulgaria, Estonia, Lithuania, Slovakia and Spain.

[60] See s 3(1) Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz).

[61] See, for instance, ss. 7 through 9 of the German Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz). s. 7 of this Act provides that CMOs have to adopt a distribution plan that must not be arbitrary. This provision is most important with regard to the distribution of revenue among different categories of rightholders. In Germany, as in many other Member States, authors and publishers are traditionally members of the same CMO.

of exportation of services, while Article 16 only limits the power of the country of importation of the service.

In contrast, Member States do not impose any restrictions on foreign CMOs that provide direct services to their national rightholders. In particular, authorisation requirements apply to foreign CMOs when they grant licences under national law, but not to foreign CMOs that export collective rights management services to rightholders.

Hence, European competition law and national regulation in the country of the settlement of the CMO provide for sufficient protection of domestic and foreign rightholders. Under the non-discrimination principle of EU law, Member States are even prevented from protecting the nationals of other Member States less effectively than their own rightholders.

The only concern is that some Member States may provide less protection for rightholders than others, for instance, in those countries that do not require CMOs to apply and receive a particular authorisation before they start their business. However, this is a concern which should be addressed by means of European harmonisation. Hence, it would be for the Directive on Collective Rights Management to fix minimum standards of control of the business of CMOs. Yet already the Commission Proposal failed in particular to provide for a mandatory authorisation system. To the extent that such rules are not harmonised, it is for the rightholder to be aware of lower standards of protection in other countries.

In sum, the application of Article 16 of the Services Directive would not raise any need for opposition with regard to services provided to rightholders. Indeed, Member States where the rightholders are based typically do not restrict such services. The interests of the rightholders are sufficiently protected as a matter of EU competition law and sector-specific regulation in the Member States where the CMOs are established. It is however regrettable that the new Directive on Collective Rights Management does not establish sufficient minimum standards for sector-specific protection of the interests of rightholders.

22.4.2 The Impact on the Protection of Users

Yet Article 16 of the Services Directive has a more important impact on the protection of users. And it is in this regard that the judgment in *OSA*, confirming the non-applicability of Article 16, deserves to be welcomed in particular.

The most important aspect of protection of users relates to the control of the royalty rates that CMOs impose on users. Those rules can differ considerably among Member States. Also, EU competition law contributes, as already explained above, to the control of royalty rates under Article 102(a) TFEU.[62] Yet competition law only provides for a mechanism of *ex post* control that relies on individual complaints brought by users and often requires lengthy proceedings before the com-

[62] See the case-law cited above n 31.

petition authorities and courts.[63] In particular, competition agencies may hesitate to engage in price control based on competition law in the field of copyright law.[64] In contrast, sector-specific regulation is a better basis for an *ex ante* authorisation system for the royalty rates of CMOs and may offer more flexible, process-oriented systems of arbitration between CMOs and users than competition law based on the prohibition of excessive pricing.

Additional elements of protection of users are the provision of an authorisation system and of a duty to grant licences to all users. None of these rules can be justified under Article 16(1)(b) of the Services Directive.

This effect can be illustrated by the law in Germany. According to Section 1(1) of the Act on Collective Rights Management, whoever represents rights under the German Copyright Act on the account of several rightholders is in need of an authorisation. Hence, the German Act follows the territoriality approach of intellectual property law even with regard to collective rights management. Foreign entities can nevertheless acquire such an authorisation in Germany at non-discriminatory terms. In particular, German law does not require that a CMO be established within Germany.[65] A CMO that does not have the authorisation under German law has no legal standing before German Courts according to Section 1(3) of the Act on Collective Rights Management. Such a requirement of authorisation would no longer be possible under Article 16 of the Services Directive.

The Commission seems to be of the opinion that such effect is the very purpose of the Services Directive and that CMOs do not present a case that is different from other kinds of service providers. Indeed, as in other service sectors where Member States provide for authorisation requirements, the major concern regarding the effect of Article 16 of the Services Directive relates to the risk that service providers may engage in forum shopping by moving to Member States that do not provide for similar requirements. However, such a risk is not very convincing with regard to authorisation systems like that in Germany, which do not create a very high market entry barrier. In contrast, Article 16 of the Services Directive would have a much more significant impact on the situation in Member States, such as Italy, Austria and the Czech Republic, that still today provide for a legal monopoly of CMOs. Regarding the authorisation requirement, what needs to be criticised more than the

[63] There are however exceptions. In Ireland, until a change of competition law in 2002, CMOs had to notify their agreements to the competition authority and apply for an exemption. This led to an ex ante review system and considerable case-law on the appropriateness of royalty rates under Irish competition law. See J Drexl, Copyright, Competition and Development, Report of the Max Planck Institute for Intellectual Property and Competition Law for WIPO (2013) 251 ff.

[64] In copyright cases, the application of the traditional price-cost analysis for identifying a case of excessive pricing usually does not work. The costs of producing a copyrighted work are largely unrelated to how much the exploitation of the work should cost. Competition law enforcers therefore rely on a comparison with the royalty rates of CMOs in other countries where the level of economic development is comparable. See especially the two judgments in Tournier Lucazeau and *OSA*.

[65] The situation is very different in Austria. There, in addition to the fact that an authorisation can only be granted to one CMO for the management of the rights with regard to a particular field of activity, according to s 2(2) of the Collecting Societies Act, the supervisory body even has the power to close down CMOs that do not hold an authorisation.

application of Article 16 of the Services Directive to national authorisation requirements is the failure of the new Directive on Collective Rights Management to make authorisation systems mandatory in the Member States and to fix minimum standards for such an authorisation.

More critical would be the effect of the Services Directive on sector-specific regulation of the royalty rates fixed by CMOs. This can be discussed in the light of the VG Media case which was reported above. Let us imagine that Article 16 of the Services Directive is applied to the licensing of cable retransmission rights for German television programs held by the German VG Media to Spanish cable operators. Under Article 16(1)(3) of the Directive, Spain would not be allowed to control the royalty rates according to the rules and procedures applicable under Spanish law. Indeed, Article 16 is based on the assumption that service providers should not be confronted with double control by two countries when they provide cross-border services. However, in the case of the control of royalty rates, the rules of the country of establishment of the CMO would not apply in the first place. In particular, the German rules and procedures under the Act on Collective Rights Management on the control of royalty rates only apply when licences are granted for the use of rights under the German Copyright Act. Indeed, Germany has no interest in telling Spain what prices can be charged for the use of rights in Spain. Therefore, application of Article 16 would result in a 'regulatory vacuum'.[66] Although there is a need to control prices, the principle of free movement of services would make such control impossible. It is obvious that it should be for the country for which the licences are granted to provide and apply its rules and procedures to control whether royalty rates are equitable. Only the regulatory bodies and courts in the country for which the licences are granted have the necessary expertise and knowledge of the domestic market to adjudicate such cases appropriately. At the same time, only the institutions and procedures in the country for which the licences are granted can create a level playing field for domestic and foreign CMOs that grant such licences.

As indicated above, another means to protect users against dominant CMOs is the provision of a statutory duty to grant licences to all users who request a licence. There are only very few jurisdictions that provide for such a duty. In the EU, the major example is Germany.[67] If Article 16 of the Services Directive applied against the application of the German duty to license, this application would create a competitive advantage of foreign CMOs in relation to CMOs established in Germany. The duty to license has a major impact on the bargaining power of CMOs when they negotiate royalty rates. A German CMO cannot threaten to refuse the licence if the user and users' associations do not want to pay the royalty rates that the CMO intends to charge. Also, a duty to license in the country for which the licence is to be

[66] Cf also Heine, *Wahrnehmung von Online-Musikrechten,* 254 (hinting at a regulatory gap regarding the duty to grant licences to all users); U Himmelmann, 'Die Aufsicht über die GEMA' in R Kreile, J Becker and K Riesenhuber (eds), *Recht und Praxis der GEMA,* 2nd ed (Berlin, de Gruyter, 2009) ch 18 para 215 (alluding in general to the unfortunate interplay of the country-of-origin principle under the Services Directive and the territoriality principle of copyright law).

[67] See s. 11 of the Act on Collective Rights Management (Urheberrechtswahrnehmungsgesetz).

granted does not create a specific barrier to entry. Just as in the case of the control of royalty rates, this rule does not lead to a doubling of legal requirements for the CMO that grants licences across borders. Yet, instead of providing for an exception to Article 16 of the Services Directive, the problem could better be solved by providing for a duty on the part of CMOs to license to all rightholders under the new Directive on Colletive Rights Management. But this Directive refrains from following the German model. If Article 16 of the Services Directive were applied, the German legislature would have to decide whether it would maintain the duty to license or abolish it in order to protect German CMOs against competition by foreign CMOs that would be free to refuse to grant licences to individual users.

In sum, the liberalising effect of Article 16 of the Services Directive can in principle also be accepted for the case of cross-border licensing. However, in the framework of the Directive on Collective Rights Management, it would be wise to consider making an authorisation requirement mandatory for all Member States and introducing a duty on the part of CMOs to license to all users who request a licence. In contrast to the authorisation requirement, application of Article 16 of the Services Directive to the national systems on the control of the royalty rates would be highly inappropriate, since Article 16 would lead to a regulatory vacuum in which neither the country of origin has an interest, nor would the country for which the licences are granted be allowed to control royalty rates. The duty to license to all users belongs to national systems of price control in a broader sense. Hence, it is welcomed that the *OSA* judgment guarantees that Member States can continue to apply their national systems for the control of royalty rates. This authority should also be preserved if, in the framework of a future reform, more scope were given to the principle of free movement of services.

22.4.3 The Special Case of Rights for Which Collective Rights Management is Mandatory

Rights for which collective rights management is mandatory, and statutory remuneration rights in particular, present a very special case in the framework of applying Article 16 of the Services Directive. The reasons for this are threefold:

First, statutory remuneration rights may differ considerably among the Member States. In cases in which a Member State makes collective rights management mandatory for such rights, the Member State is using CMOs as private entities for achieving a particular legislative goal. This does not necessarily require that collective rights management by foreign CMOs be excluded. Yet one has to acknowledge that Member States have a strong interest in controlling which entities manage such rights. This argues in favour of allowing the Member States to provide at least for a national authorisation requirement for the exercise of statutory remuneration rights that would prevail over the application of Article 16 of the Services Directive.

Second, the arguments supporting this recommendation are even stronger where statutory remuneration rights are mandated by secondary EU law. In such cases, the Member States are even under an obligation to provide for effective exercise of

such rights. If they entrust such exercise to private CMOs, they also have to guarantee that such rights are managed appropriately and effectively.

Third, statutory remuneration rights that are exercised by CMOs are in special need of systems of price regulation. One option would consist in fixing the rates by law. Under the territoriality principle of intellectual property law, which seems to find a confirmation in Article 17(11) of the Services Directive, royalty rates fixed by law would also apply to CMOs established in other Member States. Yet Member States could also choose to entrust the determination of the amount to be paid to collective bargaining between the CMOs and users or users' organisations and, at the same time, apply special mechanisms of control and arbitration in such instances. In this latter case as well, application of Article 16 of the Services Directive seems inappropriate not only because of the arguments advanced in general with regard to the control of royalty rates, but also because Article 16 would unnecessarily restrict the flexibilities enjoyed by Member States and would even oblige them to opt for the more interventionist approach, namely, statutory royalty rates. This supports the view of the CJEU in *OSA* to extend the exclusion of Article 16 of the Services Directive under Article 17(11) of this Directive beyond substantive copyright law to the collective rights management services provided by CMOs.

In sum, the following is to be recommended: for all exclusive rights and statutory remuneration rights for which collective rights management is mandatory, application of Section 16 of the Services Directive would be inappropriate. Also in the future, the European legislature should safeguard the power of Member States to provide for a national authorisation system and to control the operation of the exercise of such rights. Similarly, Member States should be allowed to introduce special rules and procedures for the control of the tariffs that are imposed or negotiated by CMOs for such rights.

22.4.4 Scope of the Copyright Exception in Article 17(11) of the Services Directive

After the *OSA* judgment of the CJEU, it is now clear that Article 17(11) of the Services Directive needs to be given a broad interpretation that excludes the provision of cross-border collective rights management services from the application of Article 16 of the Directive. Yet this interpretation does not exclude an also literal understanding in the sense that substantive copyright law will always prevail over the principle of free movement of services.

A recent German case can be reported as an illustration of this prevailing character of substantive copyright law. In the so-called *MyVideo* case, the Munich District Court[68] and, on appeal, the Munich Court of Appeals[69] were requested to decide on

[68] LG Munich I, 25/6/2009, (2009) *Zeitschrift für Urheber- und Medienrecht* 788.

[69] OLG Munich, 29/4/2010, (2010) *Zeitschrift für Urheber und Medienrecht* 709. The case was further appealed to the German Federal Supreme Court (Bundesgerichtshof), but finally settled by

a declaratory action of MyVideo, the operator of an Internet platform that is established in Romania, but addresses the German audience.[70] MyVideo allows users to upload and share videos of any kind, including movies and TV programs. The action was brought against CELAS, the joint venture of GEMA, the German CMO for works of music, and the British PRS for Music, for the multi-territorial licensing of the Anglo-American Repertoire of EMI.[71] CELAS had challenged MyVideo for copyright infringement in Germany. With its action, MyVideo succeeded in getting a declaration from both Munich courts that CELAS could not assert any rights with regard to the reproduction rights of the EMI repertoire. The decision was based on the rule of German copyright law according to which the rightholder is empowered to license the use of the work in specific regards.[72] Traditionally, this rule is read as one that also limits the capacity of the rightholder to fragment the rights. Accordingly, rightholders can only grant licences that are economically viable. In the *MyVideo* case, the Munich courts criticised the decision of EMI to only withdraw the reproduction rights for online use of music, while the public performance rights which are also needed for online uses remained with the CMOs.[73] CELAS was then only empowered by EMI to grant a licence on its behalf for the reproduction right, while CELAS acted as an agent for GEMA and PRS for Music with regard to the public performance right. The reasons why EMI withdrew only the reproduction rights are to be found in the Anglo-American tradition of collective rights management, in particular the practice in the US, the UK and Ireland. There, CMOs are established only as 'public performance societies'. Accordingly, these CMOs only request authors to transfer their public performance rights in their existing future works when authors join the CMOs, while the reproduction rights remain with the authors. Usually, it is only later that the authors enter into contracts with the music publishers, who then only acquire the reproduction right.[74] With its rule against fragmentation, German copyright law protects users against the grant of licences they would not be able to make use of. Also, this rule protects alleged

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the parties. Hence, there is no final decision on the case from the highest German court. See also the English translation at (2014) 45 International Journal of Intellectual Property and Comeptition Law 97.

[70] See http://www.myvideo.de.

[71] See text above at n 36.

[72] See s. 31(1), 1st sentence, German Copyright Act (Urheberrechtsgesetz) of 1965. The provision reads: 'The author may grant a right to another to use the work in a particular manner or in any manner (exploitation right).' English translation of the Act available at: http://www.gesetze-im-internet.de/englisch_urhg/englisch_urhg.html.

[73] See also RM Hilty, 'Kollektive Rechtewahrnehmung und Vertügungsregelungen: Harmonisierungsbedarf und möglichkeiten' in M Leistner (ed), *Europäische Perspektiven des Geistigen Eigentums* (Tübingen, Mohr Siebeck, 2011) 123, 157 ff (agreeing with the Courts in this regard, but maybe not necessarily with the final result of rejecting the infringement claim).

[74] See also the very thorough analysis of the different traditions in the Anglo-American system and the Continental system by Heyde, *Die grenzüberschreitende Lizenzierung von Online-Musikrechten in Europa,* 153–212.

infringers, such as MyVideo, against being sued by several rightholders for the same infringement.

Indeed, the facts of the German *MyVideo* case do not fall within the scope of Article 16 of the Services Directive, since the case is about application of the law in Germany, which is also the Member State where CELAS as the provider of multi-territorial licences is established. However, the situation would change immediately if German law were applied to a licensing platform provider in another Member State that offered similar multi-territorial licences for Germany.[75] In such a case Article 16 of the Services Directive would have been applicable in principle according to the Commission's view prior to *OSA*. But this provision cannot prevail over rules of substantive copyright law, at least according to Article 17(11) of the Services Directive.

This example demonstrates that more cross-border licensing through collective rights management is still in need of more harmonisation of substantive copyright law. It also highlights the fact that national traditions of collective rights management still need to be overcome. Indeed, the Anglo-American tradition of licensing the public performance right and the reproduction right separately made sense in the pre-Internet era, but should no longer be continued. Rather, adoption of rules against fragmentation of licences under substantive EU copyright law could help to bring more cohesion and legal certainty to cross-border licensing in the EU. Of course, adoption of a German anti-fragmentation rules would make such business models as CELAS. Yet CELAS deserves to be criticised as a symbol of the flawed policy of the Commission under the 2005 Recommendation, which served the interest of large rightholders but not the interest of individual authors.[76]

22.5 Conclusion

Free movement of services constitutes a fundamental principle of the internal market of the European Union. The European legislature promoted this principle considerably by adopting the Services Directive in 2006.

The Commission has constantly argued that this Directive also fully applies with regard to the services provided by CMOs. Yet, in the framework of its 2012 Proposal for a Directive on Collective Rights Management, the Commission has not given sufficient consideration to the consequences of applying the Services Directive. Application of this directive may be appropriate in some instances, but not in others.

After the *OSA* judgment of the CJEU, which rejected the view of the Commission and held against the application of Article 16 of the Services Directive, it is already time to review the brand-new Directive on Collective Rights Management

[75] An example would be D.E.A.L., which constitutes a similar joint venture of Universal as a music publisher with SACEM, the French CMO for works of music. See Heyde, *Die grenzüberschreitende Lizenzierung von Online-Musikrechten in Europa,* 140 ff.

[76] For the same critique see Graber, 'Collective Rights Management', 13 fn 35.

and to redefine its relationship with the principle of free movement of services by more tailor-made rules.

With regard to the services provided to rightholders, applicaton of the regime of the Services Directive would seem appropriate. Already today, there are incentives for rightholders to join a CMO in another Member State, at least in certain situations. With regard to rightholders, the Services Directive quite rightly concentrates control in the Member States where the CMO is established. Yet, in the framework of a future reform, the Directive on Collective Rights Management should enhance the trust of rightholders in the reliability of foreign CMOs by guaranteeing a mandatory authorisation requirement and minimum standards for the control of CMOs by national authorities.

More problematic is the impact of the Services Directive on the protection of users when CMOs grant cross-border licences. In this regard, Article 16 of the Services Directive would undermine effective control of royalty rates through sector-specific regulation. The practice of EU competition law highlights the need for control. Yet EU competition law is in need of being complemented by a more effective system of *ex ante* control as part of sector-specific regulation. Member States apply their rules and procedures for the control of the tariffs and royalty rates of CMOs only with regard to licences that are granted under their domestic copyright law. Hence, Article 16 of the Services Directive would fail to concentrate control in the Member State where the CMO is established. Rather, application of this provision would lead to a regulatory vacuum. From a competition-oriented perspective, control of the royalty rates should take place in the Member States for which the licences are granted. The institutions there are most familiar with the local market conditions, which are crucial for assessing the economic value of the licence. In addition, only the institutions in the Member State for which the licences are granted will be able to create a level playing field among all economic actors that use copyright licences in the local market. The *OSA* judgment of the CJEU preserves this system for the time being. Accordingly, also in the framework of any future reform, there is a need to concentrate price control in the country for which licences are granted against the application of the principle of free movement of services. The same should apply to national rules that provide for a statutory duty to grant licences to all users.

Particular consideration needs to be given to exclusive rights and remuneration rights, for which collective right management is mandatory. So far, cross-border exercise of such rights has remained limited, but may grow considerably in the future. Quite often when a Member State makes collective rights management mandatory, it pursues the protection of certain individual interests, such as that of the authors vis-à-vis the publishers and producers. Also, such rights are often mandated by secondary EU law. Also in this regard, the *OSA* judgment preserves control under the law of those countries that recognize such exclusive rights and statutory remuneration rights for which collective rights management is mandatory. This system should also be maintained in the framework of any future reform and should not be made subject to the application of Article 16 of the Services Directive.

In the light of this analysis, any extension of the application of the principle of free movement of services to collective rights management services would be in need of being accompanied by tailor-made rules in the new Directive on Collective Rights Management that respond appropriately to the need to calibrate the interest in effective collective rights management with the principle of free movement of services. For the moment, the *OSA* judgment is very helpful for Member States that provide for high levels of control of CMOs. Those regimes are not in need of being amended. However, during the process of implementation, the Member States should also think about how they can maintain a high level of protection of users through substantive copyright law. Also such rules can be applied according to Article 17(11) of the Services Directive to CMOs from other Member States that grant licences under domestic law.

The final conclusion is much more optimistic than it would have been before the *OSA* judgment. The CJEU prevented the Commission from undermining national control systems in many Member States, which, even there, are far from being perfect. But the *OSA* judgment will not put an end to the debate on the future of the European system of collective rights management. Apart from a series of important competition law decisions, the European policy has been meandering for many years now, taking a series of measures and making quite some policy turns that have not necessarily contributed to more coherence and have not managed to improve the internal market for collective rights management services. The disagreement of the Commission and the CJEU on whether Article 16 of the Services Directive applies to CMOs adds just another chapter to this never ending story. The new Directive on Collective Rights Management will not contribute much to a more coherent system. Also after *OSA*, the system remains very fragmented. The EU is still in need of a more harmonised and integrated system of collective rights management that allows for cross-border rights management and simultaneously guarantees rightholders and users effective control of what CMOs are doing.

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Chapter 23
Patenting Coffee—IP Protection and Its Impact on Innovation in the Coffee-Capsule Market

Reto M. Hilty and Peter R. Slowinski

Abstract Despite a hard to kill belief patents are not a booster for innovation per se but an instrument of competition and innovation policy that needs to be used in a careful manner and with a clear understanding of its functioning and consequences. In the last decades discussions about the strengths and weaknesses of the patenting system have circulated mostly around pharmaceuticals or the information technology. Some of the most important questions addressed in these discussions are the ever rising and unmanageably large number of patents, a phenomenon known as patent thickets, the overlapping of different intellectual property rights, and in consequence the limitation of necessary competition.

This article focuses on a market that so far has been widely ignored in relation to problems of overbroad patenting but which demonstrates clearly what the problems of the present patent system are and where the focus of the discussion should be. By concentrating on the relatively new and fast-growing market for capsuled coffee we demonstrate the importance of a potential market failure as the most crucial justification for intellectual property rights. We also address the danger of reverse market failure as a result of overly strong patent protection in linked markets.

23.1 The Nespresso IP-Litigation Story

The market for capsuled coffee became an area of interest for patent professionals and academics with the numerous disputes surrounding Swiss Manufacturer *Nestlé* and its booming business idea called *Nespresso*.[1] The disputes in which *Nespresso*

[1] In the various court proceedings sometimes *Nestlé S. A.* is the plaintiff and sometimes its subsidiaries are involved. For the purpose of this article we slightly simplify the situation by referring to the plaintiffs collectively as either *Nestlé* or *Nespresso*.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_23,

is involved raise questions of patent-thickets, functional aspects of trademarks, and overlap of intellectual property rights. Courts in at least Switzerland, the UK, and Germany are presently occupied with law suits and competitors are lining up and fighting for a share of the market for capsuled coffee. The law suits surrounding the *Nespresso*-system can be divided into two groups: patents and trademarks. The following paragraphs give a short overview of the disputed questions and the rulings so far.

23.1.1 Trademark

For more than a decade *Nestlé* has been marketing its products and protecting the growing revenues with a wide range of intellectual property rights. It was in 2010 when Swiss retailer *Denner* attempted to get a foot into the market and began to advertise coffee capsules compatible with the *Nespresso*-System. *Nestlé* responded immediately asking a Swiss court for a preliminary ex parte injunction based on its three-dimensional trademark of the coffee-capsule.[2]

On first instance in January 2011 the St. Gallen Commercial Court (*Handelsgericht*) granted the preliminary injunction ex parte, but reversed its decision after having heard both parties in oral proceedings.[3] After the Swiss Federal Court *(Bundesgericht)* decided that a judge required the opinion of an expert to decide the question of technical requirement in trademark law, the case went back to St. Gallen.[4] Based on a detailed expert analysis the St. Gallen Commercial Court finally decided in 2013 that the *Denner* capsules did not infringe *Nestlé's* three-dimensional trademark.[5] In the process of assessing the infringement the court compared the *Nespresso* capsules and the *Denner* capsules and came to the conclusion that the *Denner* capsules were sufficiently different from *Nestlé's* registered trademark and the *Nespresso* capsules. The main differences were that the *Denner* capsules were made out of plastic instead of aluminum, that they had an additional wrapping as a substitute to the aluminum protecting the coffee, and that the bottom of the capsules was pre-punctured to allow interaction with the coffee-machines.

While this decision allowed *Denner* to continue with the sale of its capsules, it still leaves numerous questions unanswered but also highlights some additional problems of the present IP system. By first granting an *ex parte* injunction, reversing the decision without sufficient expertise, and only reaching a final decision after

[2] See the decision of the St. Gallen Commercial Court, 10/1/2011, HG.2011.10-HGP, http://www.gerichte.sg.ch/home/dienstleistungen/rechtsprechung/kantonsgericht/entscheid_2011/hg_2011_10/_jcr_content/Par/downloadlist/DownloadListPar/download.ocFile/Entscheid%20Handelsgericht%20vom%2010.%20Januar%202011.pdf.

[3] St. Gallen Commercial Court, 4/3/2011, HG.2011.10-HGP, http://www.gerichte.sg.ch/home/dienstleistungen/rechtsprechung/kantonsgericht/entscheid_2011/0/_jcr_content/Par/downloadlist/DownloadListPar/download.ocFile/Entscheid_HG_2011_10-HGP_2_.pdf.

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[5] St. Gallen Commercial Court, 21/5/2013, HG.2011.199 http://www.gerichte.sg.ch/home/dienstleistungen/rechtsprechung/kantonsgericht/entscheide-2013/hg-2011-199/_jcr_content/Par/downloadlist/DownloadListPar/download.ocFile/HG_2011_199.pdf

appeal, the courts have demonstrated weaknesses of the enforcement system. Probably the most problematic weakness is the apparent willingness of courts to grant *ex parte* injunctions even in cases where a protective letter has been submitted to the court. As can be seen in the present case, the questions that needed to be answered were far too complicated for a rushed decision while the consequence was that the defendant for some time lost a business opportunity and consumers lost an alternative and beneficial product. This demonstrates the danger of an IP enforcement that is primarily orientated on the interests of the right holders and does not sufficiently take into account the interests and needs of other stakeholders.

The other striking point in the *Nespresso* decisions is that according to the final decision by the St. Gallen court the form of the registered three-dimensional trademark is not *technically required*, since it is possible to construct capsules with alternative forms from different material, i. e. from plastics instead of aluminum.[6] This reasoning is insofar questionable as the choice of material is not purely one of design and appearance but also one of technical functionality, and technical solutions are the domain of patent law.

23.1.2 Patents

While the litigation in Switzerland still focuses mainly on trademarks, the courts in Germany and the UK have been occupied with questions regarding patents.[7] There are two types of patents that need to be distinguished. First, there is—or rather was—patent protection for the coffee capsule as such. This patent protected the aluminum-wrapped capsule until 2011 when the patent expired.[8] The present patent suits are therefore based on the patents protecting the coffee-machines and their respective extraction and brewing system.[9] To prevent the distribution of compatible capsules, *Nespresso* claims that the capsules are an essential part of the overall patented brewing system and therefore protected by the patents.[10]

Courts in Germany as well as in England and Wales have ruled that the distribution of compatible capsules does not constitute infringement of the system patents. In Germany, the decisions came from the *Landgericht* Düsseldorf and the appellate court, the *Oberlandesgericht* Düsseldorf.[11] In the German cases *Nestlé* did not base its claims on patents for the capsules since those have already expired, but on a patent protecting the brewing system within the coffee machines. From *Nestlé's*

[6] Ibid, 25 f.

[7] It seems that so far there has been only one – unpublished – court decision regarding the infringement of *Nespresso*-patents in Switzerland. In a preliminary *ex parte* decision the Commercial Court Zurich dismissed the allegations of infringement based on two European Patents. See Commercial Court Zurich, 21/1/2011, HE110003-O.

[8] European Patent No 0 512 148– Enclosed cartridge for making a beverage.

[9] In the proceedings before the High Court in England the suit was based on the European Patent (UK) No 2 103 236– Capsule extraction devise.

[10] See the arguments presented by *Nespresso* as summarized in the court decisions.

[11] LG Dusseldorf, 16/8/2012, 4b O 82/12; OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185.

point of view the patents on the brewing system cover not only the parts within the machine, but also the capsules that are inserted into the machine to brew the coffee. So based on this conception *Nestlé* claims that the consumers using the capsule with the machine are 'constructing' the patented invention—the brewing mechanism—every time they make a cup of coffee. Therefore, the use of capsules that have not been produced or licensed by *Nestlé* would amount to patent infringement while the production and supply of such unauthorized capsules would amount to secondary patent infringement. Secondary infringement is regulated in Sec. 10 para. 1 of the German Patents Act (*Patentgesetz*) and requires inter alia that the secondary infringer provides another person (the primary infringer) with means relating to an essential element of the protected invention if the other person is not entitled to exploit the invention.

So, since secondary liability can only be established if primary liability exists, the courts focused on the question whether the consumers were entitled to use capsules that were not provided by *Nestlé*. The courts decided that consumers have the right to use compatible capsules from alternative sources.[12] The crucial argument for the courts was that the patent on the brewing system that is incorporated in the machines was exhausted when the machines and the original capsules were placed on the market by *Nestlé* or with *Nestlé's* consent.[13] In the view of the courts it was an exhaustion of the patent protection for the overall machine-plus-capsule-entity to put the machine and the capsules on the market.[14] While the courts acknowledged that the capsule is necessary to brew the coffee, they also pointed out that the technological advantage of the patent on the extraction-and-brewing-system is not the capsule but the parts of the system that are built into the machine. Exchanging the capsule therefore does not amount to (re-)construction of the protected invention but is merely ordinary use that might be compared with the exchange of non-essential spare parts.[15] Balancing the involved interests, the courts in Germany pointed out that while the patent owner had the rightful interest to claim the commercial value of the invention the consumer had the rightful interest to use the invention that has been placed in the channels of commerce.[16] Both the first instance and had appellate court also highlighted that it is the justification of the patent system to reward the inventor for the protected invention and not to provide him with means to protect his general business idea.[17] The invention as disclosed in the patent is reason for but also the limit of the protection granted by the law.[18]

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[12] Ibid.

[13] In most cases *Nestlé* does not place the coffee machines on the market but instead licenses the technology to established manufacturers of coffee machines and allows them to sell those machines through various channels of commerce. Only with respect to the capsules *Nestlé* has the exclusive right to sell those.

[14] LG Dusseldorf, 16/8/2012, 4b O 82/12; OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185.

[15] LG Dusseldorf, 16/8/2012, 4b O 82/12; OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185.

[16] Ibid.

[17] Ibid.

[18] Ibid.

The judgment by Justice Arnold in the High Court of England and Wales (Chancery Division) is interesting in two respects.[19] First, in contrast to the German courts, Justice Arnold did not limit the judgment to one question, but addresses all of the possible problems including questions of validity that could not be addressed by the German courts on grounds of the German bifurcation.[20] Second, the High Court came to the same conclusion relying partially on the same precedents as the German courts by ultimately using a slightly different reasoning.

The High Court addressed the question of patent validity based on interesting circumstances. The patent in question was claiming priority from an earlier European patent application.[21] However, *Nestlé* did not merely submit the same application for a second time but instead changed some of the claims in the process.[22] The question was now whether the later patent could claim priority from the earlier patent despite those changes. The court decided that it could not. The changes went beyond the disclosure of the first patent and therefore amounted to a new invention according to Art. 87 of the European Patent Convention (EPC). And since *Nestlé* presented the coffee machines to the public between those two applications, the court decided that the later machines lacked novelty. The attempt of *Nestlé* to extend the scope of protection while claiming priority from an earlier application demonstrates that certain patent right holders attempt to extend the scope of protection beyond the goals of the patent system. As judge Arnold pointed out, the main difference between the two patent applications was that *Nestlé* tried to make the capsule a part of the invention in the later application, thus trying to extend the protection for the capsule.[23]

Regarding the infringement Justice Arnold also came to the conclusion that the consumers were entitled to use the coffee machines with compatible capsules based on an implied license.[24] He also pointed out that the same result could be reached based on the doctrine of exhaustion.[25] Therefore, consumers are entitled to use the coffee machines with any compatible capsules. Based on Sec. 60 subs. 2 of the Patents Act 1977 Justice Arnold focused on the question whether the capsules "are suitable for putting, and are intended to put, the invention into effect".[26] Similar

[19] *Nestec S. A. et al v Dualit Ltd. et al* [2013] EWHC 923 (Pat).

[20] The principle of bifurcation in German patent law gives jurisdiction regarding the validity of patents exclusively to the Federal Patents Court (*Bundespatentgericht*) while leaving the infringement proceedings with the Regional (Civil) Courts. The Regional Courts cannot rule on the validity of a patent but can only in clear-cut cases stay their own decision until the Federal Patents Court has decided on the validity. For an in-depth explanation of the bifurcation see A Schwarz, 'Nullity Proceedings' in C Milbradt (ed) *Patent Litigation in Germany* (Stuttgart, German Law Publishers, 2012) 227; AR Klett, M Sonntag and S Wilske, *Intellectual Property Law in Germany* (Munich, CH Beck, 2008) 24 f.

[21] The priority document was the European Patent No 1 495 702 A1 filed on 7/10/2003 regarding a device for extraction of a capsule as well as the machine incorporating said device.

[22] See for a comparison of the differences the judgment by Justice Arnold in *Nestlé v Dualit* [2013] EWHC 923 (Pat) para 51–68.

[23] *Nestlé v Dualit* [2013] EWHC 923 (Pat) para 203.

[24] Ibid, para 166.

[25] Ibid, para 167.

[26] Ibid, para 183.

to the German decisions the core question was whether the consumer 'makes' the protected system by replacing a capsule. The High Court decided that he does not. First, the capsules have to be regarded as being "an entirely subsidiary part of the system". Second, capsules and machines "have an independent commercial existence". Third, since the capsules are consumables the purchaser of the machine can assume that he is entitled to replace them as he pleases. Forth, the replacement of the capsule is even less than repairing it. Finally, and probably most important, "the capsule does not embody the inventive concept of the Patent".[27]

Clearly, *Nestlé* was attempting to perpetuate the protection for the capsules that is the main basis for its locked-in system that eliminates choice for the consumers on the coffee market. It is ironic that *Nestlé* even tried to argue before the German courts that consumers knowingly and willingly entered this locked-in system and expected to have no choice in respect to the capsules and the coffee.[28] Obviously, the real economic value for *Nestlé* is the long-term supply of the capsules and not the one-time sale of the machines.[29] The Düsseldorf Higher District Court rejected the argument of the willingly limited consumer and ruled that the consumer expected to be able to replace the originally provided capsules with any compatible capsules.[30] The court got at the heart of the issue when it pointed out that the locked-in system is significantly based on the patent and therefore *Nestlé* cannot rely on it as an argument beyond the scope of the patent.[31] So while *Nestlé* was of the opinion that its whole business concept is one system and market that required protection, the courts rejected this notion and limited the protection strictly to the invention presented in the patent. Unfortunately, the courts did not use the opportunity to take a closer look at the relevant markets and the justification for patent protection.

23.2 Justification for Protection and Problems of Overprotection in Relation to Capsuled Coffee

23.2.1 The Conceptual Justification for Patent Protection

To fully understand the implications of the *Nespresso* litigation for the patent system it is important to bear in mind the function of the patent system. In contrast to a widespread belief a patent incentivizes not innovation per se, but competition. To

[27] Ibid, para 200.

[28] OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185.

[29] Although the machines can cost several 100 € it is important to realize that this prize is paid once for a machine that will last for a longer period of time. The price for the capsules, however, is approximately 50 ct. but will be paid for each cup of coffee for as long as the machine lasts. This will in many cases lead to substantial spending throughout a year.

[30] OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185, para 141.

[31] ibid.

achieve sufficient revenue, players in the market will try to gain an advantage over their competitors by investing in new products or by improving existing products thus creating innovation. If the innovation is sufficiently beneficial to customers and is accepted by the market it will provide the innovator with a return on the investment and profits. These profits will last until competitors either are able to imitate the invention and provide it to customers at lower costs or until the innovation is outdated by a new and better solution. The time between the first innovation and the moment when competitors are able to catch up and diminish the advantage provided by the innovation is called lead time. However, this rule is only valid under optimal circumstances. If the marginal costs of time and resources to imitate are relatively low competitors will be able to enter the market before the first mover is able to get a sufficient return on the investment in innovation. Under such circumstances the first mover will be deprived of the advantage and will lose the incentive to innovate which in turn will lead to losses for the overall economy and society.[32] When the market does not provide sufficient incentives by itself the result can be market failure. At this point patent protection steps in as a corrective to overcome the market failure and to provide incentives to innovate by creating an artificial additional lead time.[33] If the requirements of patent protection are met, the law will grant the inventor a monopoly limited in scope and time and thus giving him the economic security to innovate. Under perfect circumstances this protection in scope and time will be designed in a way that will be optimal in relation to the necessary protection to overcome the described market failure. Protection that goes beyond this optimum is *overprotection* while protection that does not reach the required optimum is *underprotection*. The goal of the system must be to avoid both.

So the conceptual justification for patent protection in a nutshell is the need for a working market for innovations. Therefore, the question whether a market does or does not need protection by patents requires primarily identification and analysis of the relevant market. In the case of *Nespresso* there is not only one market, but in fact there are three different albeit linked markets. Firstly, and probably most obvious, there is the market for coffee machines. Secondly, and in the case of *Nespresso* more exclusive but also most disputed, there is the market for coffee capsules. Finally, and perhaps easily overlooked, there is the market for the coffee as such, since strictly speaking the coffee and the capsule are two distinct products and the question is in what way the connection between the two markets plays a role in the justification of intellectual property protection in general and patent protection in particular.

From this basic point, we will now turn to a more detailed analysis of the three markets and demonstrate how the requirement of market failure as a justification for patent protection applies to the *Nespresso* case.

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[32] WM Landes and RA Posner, *The Economic Structure of Intellectual Property Law* (Harvard University Press, Cambridge, 2003) 294; RM Hilty, 'Märkte und Schutzrechte' in J Beckert et al (eds), *Märkte als soziale Strukturen* (Campus Verlag, Frankfurt, 2007) 235, 236.

[33] RM Hilty, 'Economic, legal and social impacts of counterfeiting' in C Geiger (ed), *Criminal Enforcement of Intellectual Property* (Cheltenham, Elgar, 2012) 9, 14.

23.2.2 The Necessity of IP Protection for Innovation in the Market(s) for Capsuled Coffee

The important question whether patent protection regarding the three markets for capsuled coffee is in fact required to incentivize innovation needs to be answered based on a two-step-analysis. First, it is necessary to justify the protection for each market separately. In a second step it is crucial to verify if there is a link between the markets and if so how such a link can have an effect on this justification.

23.2.2.1 The Market for the Coffee As Such

Since it might be the most straightforward market when it comes to the question of patent protection but since it is the market that can be overlooked quite easily we first want to turn to the market for the coffee as such. Competition on the coffee market is achieved by price and quality of the product. Protection by intellectual property rights is primarily required to support the consumer in his or her search for the desired product, that is, to reduce the search costs in the market.[34] In addition, protection might be desired that creates incentives for producers to provide coffee of a higher quality. Those specifics of the coffee market—apart from possible plant varieties protection—point into the direction of intellectual property rights that allow to link a product to expected or actual origin and/or quality and therefore into the direction of trademarks or the protection of geographic origin.[35] Technical intellectual property rights such as patents, however, do not play a role in this particular market.

23.2.2.2 The Market for the Coffee Machines

On the other end of the spectrum is the market for coffee machines. Making good coffee, that is, making the most out of the product, is an art and a science. The challenges for each designer of a coffee machine are to allow for the best possible result, with the least possible difficulty, for the lowest possible price. Innovation in this market happens in a technical field and requires sufficient resources and time. Since the innovation regarding the coffee machines occurs in a technical field it is open to patent protection as long as a solution is new and includes an inventive step.[36] Since it is likely that imitation of the technology in a coffee machine will happen faster and at lower costs than the initial development of a new technology, this can lead to

[34] DZ Johnsson, 'Using Intellectual Property Rights to Create Value in the Coffee Industry' (2012) 16 *Marqette Intellectual Property Law Review* 283 points out that in the past two decades consumers began to increasingly value coffee that can be differentiated by origin, quality or cultivation process and describes the importance of trademarks, geographic origins and certified sustainability as the most important assets in the coffee market.

[35] Ibid.

[36] See Arts 52, 54, 63 of the European Patent Convention.

market failure based on insufficient incentives for innovators to undertake to be the first movers. Such forms of market failure may be overcome by patents.

However, regarding patent protection we have to bear in mind that a functioning market does not only require sufficient incentives for the first innovator but as far as possible also sufficient space for competitors to work around the patents and to provide alternatives to consumers. Only a balance of sufficient incentives on both sides, that of the patent owner and that of his competitors, will prevent market failure. At first sight, it might seem that the latter are missing, if the *Nespresso* model creates a locked-in system on the market for coffee machines for pre-portioned coffee.[37] However, contrary to some beliefs, while *Nespresso* is the largest player in many countries there are alternatives to its solution.[38] Some other producers use coffee-pads as an alternative while others rely on capsules and machines using a different technical solution to brew coffee than the system provided by *Nespresso*. So from the point of view of competition the *Nestlé* patents may have the effect of stimulating a new—possibly better—solution to make coffee. Therefore, a theoretical justification for patent protection in this market may be assumed. Nevertheless, as we will see in a moment, there is still the danger of overprotection based on patents.

23.2.2.3 The Market for Capsuled Coffee or Coffee Capsules

This leaves us with the third market, which is in fact at the center of the litigation described at the beginning: the market for capsuled coffee, or the capsules themselves.

But what is the real market? Is it a market for capsuled coffee, for capsules containing coffee, or do we need to separate the content from the capsule? As described above, there is a market for the coffee itself since consumers value the differences in coffee and choose in respect to their own taste, the origin, and the price. We further can assume that this coffee market is separate for coffee that is pre-portioned in the various kinds of capsules or pads and, for example, grounded or ungrounded coffee. The consumer chooses the preferred coffee primarily based on taste and maybe additionally based on questions of convenience. Convenience is the main reason to choose pre-portioned coffee. Since pre-portioned coffee is more expensive than loose coffee and available at the same quality, the reason to choose pre-portioned coffee is, that one neither needs to wash equipment nor to be a qualified barista to make a decent espresso. So from the perspective of the consumer the capsules or pads add convenience to the overall process. Thus, *a priori* the consumer has no reason to link the technical solution of the capsule to its content and the quality of the content as long as he has sufficient choice. Therefore, it should be possible to achieve competition on both—separate—markets. Coffee and capsules from different providers could be mixed based on consumers' demand.

[37] While the coffee machines can be obtained from different sources and are distributed through different companies, the capsules can only be obtained from *Nestlé*.

[38] In his judgment Judge Arnold mentions some of those alternative systems. See *Nestec v Dualit*, [2013] EWHC 923 (Pat) para 75–79.

As we have seen in the case of *Nespresso*, *Nestlé* tries to rely on three different approaches to protect its capsules from unwanted competition. First of all, *Nestlé* has protected the capsules with patents.[39] Second, *Nestlé* attempts to argue that the capsules are an essential part of the brewing system incorporated in the machines and that they are therefore protected by the patents on this brewing system.[40] The third approach to protect the capsules is the protection by three-dimensional trademarks on the form of the capsules.[41] However, the main question from the point of view of IP is whether this market *requires* IP protection and if so *what kind* of IP protection is required and to what extent.

There is no doubt that the capsules have technical characteristics. They are designed in a way that allows them to interact with the machine and they protect the coffee from premature exposure to oxygen and other influences. So they are at least suitable for patent protection. But the real question is not whether they can be protected by patent law but instead we have to ask first whether they *should* be protected by patent law. The same question needs to be asked in respect to the three-dimensional trademark for the capsule. Does this capsule require such protection to prevent market failure? This is, at the very least, very doubtful. The reason why such protection for the capsules is not required is the link between the market for the capsules and the market for the coffee.

23.2.2.4 Connection of the Markets

While we have demonstrated that there are three different products and markets, we need to take the strong link between the market for capsules and the market for coffee into account to assess the probability of market failure and thus the necessity for patent protection. Though the capsule and the coffee can exist on two different markets, they are always being sold together. One cannot buy a capsule and the coffee separately and combine them as one wishes. But which of the two components is the decisive one? Since the main purpose of the whole process is to make coffee, the decisive factor is the coffee itself and not the cartridge that contains it. So the consumer will primarily pay attention to the coffee and accept the capsule as a means to achieve the desired result. So the real market where competition should happen is the market for coffee and as we have seen previously this market will not benefit from patent protection.

However, because of the link between the two markets, if protection for the capsule is granted competition on the market for the (capsuled) coffee becomes impossible with regard to the related capsule; market failure due to overprotection becomes likely. The absence of IP protection for the capsule, in contrast, will not cause market failure through underprotection, since quality of the coffee, brand

[39] European Patent No 0 512 148– Enclosed cartridge for making a beverage.

[40] This is the litigation in England and Wales as well as in Germany based at least on EP 2 103 236.

[41] In Switzerland the cases were based on the Swiss trademark Reg No P-486 889 registered for ‘coffee, coffee extracts and preparation on the basis of coffee’.

recognition, and good service will allow the coffee companies to compete for customers and thus to remain on the market for capsuled coffee. In other words, patent protection for the capsules is not justifiable from an economic point of view; the danger is not a lack of protection, but that patent protection may cause—and has already caused—unjustified limitation to the coffee market and thus market failure: sort of a reverse form of market failure.

23.2.3 Problems of Overprotection

The case of capsuled coffee does not merely exemplify the consequences of unjustified protection. In addition, it provides a good example of an existing overprotection by intellectual property rights.[42] Overprotection in general can be caused by various factors, including the duration of protection and the lack of sufficient limitations. The effect of overprotection is that the right holder receives more protection than required to overcome market failure. This, in turn, can lead to less competition since especially patents will allow the patent holder to exclude competitors from the related market or markets. And the lack of competition will lead to less choice for consumers and will therefore cause market failure. Thus, overprotection causes the effect that intellectual property rights are supposed to prevent. In the case at hand, overprotection can be particularly seen in overlapping rights and patent thickets.

23.2.3.1 Overlapping of Patents and Three-Dimensional Trademarks

The term overlapping rights describes a situation in which the same product is being protected by multiple intellectual property rights. Such overlap is not necessarily unjustified.[43] In fact, there might be good reasons to grant protection through different protection regimes for the same product but based on different protectable subject matter. Thus, while patents protect technical innovation, trademarks allow for identification of the producer. The latter reduces search costs while the former provides incentives for innovation deriving from competition. Furthermore, it is possible that one product includes more than one technical innovation and therefore deserves multiple patents. However, overlapping rights can cause dysfunctional effects.

Such an effect can occur when limitations in IP protection are being circumvented by the use of another, additional, protection regime.[44] Those limitations can refer to the scope or the duration of protection. The best example for this is the difference in protection between patents and trademarks.

[42] An additional layer of protection is also possible based on design rights. However, as this has not played a role in the *Nespresso* litigation, we omit it for the purpose of this paper.

[43] M-R McGuire, 'Kumulation und Doppelschutz' (2011) *Gewerblicher Rechtsschutz und Urheberrecht* 767, 768.

[44] Ibid.

Patents foster innovation by providing additional lead time while the main rationale behind trademarks is quick recognition of a product's source. However, trademarks are not designed to protect the innovative technology imbedded in a product. These differences in the rationale are also the justification for the fact that patent protection is limited in time for a maximum of 20 years while trademark protection—provided the mark is being and the protection period extended—is without temporal restrictions.[45]

A problem arises when a company uses the shape of a product as a registered three-dimensional trademark to provide perpetual protection for the technical features of the product. In theory, trademark law prevents protection of attributes that are primarily a of technical nature.[46] However, the main question is where to draw the line. In this respect, the *Nespresso* coffee capsules are an object lesson. As the St. Gallen Commercial Court pointed out the fact that the capsules sold by *Denner* have holes on the bottom and are made of plastic is sufficient to distinguish them from the *Nespresso* capsules made of aluminum and having a bottom side *"shaped like a volcano"*.[47] The volcano-like shape of the bottom side seems to be a feature linked solely to the outer appearance. But what about the distinction between aluminum and plastic or the pre-existing holes that allow for extraction of the coffee even if aluminum is not used? Those are characteristics that can be linked to the outer appearance as well as to the technical features. Aluminum combines the ability to protect the coffee from premature exposure to water or oxygen while allowing perforation of the capsule during the brewing process. At the same time an aluminum capsules looks distinctively different than a plastic capsule.

While the abstract decision whether a feature is technical in nature might be difficult, the presence of a patent might provide valuable help in the distinction. As a rule it could be established that if a right holder did apply for patent protection with respect to a particular feature, for example a particular material or its appearance, this feature should be banned from trademark protection.[48] At least in the case of the capsules protection through three dimensional trademarks is not necessary. A capsule is never sold as an individual piece or unpackaged. Therefore, the customer does not require the shape of the capsule to recognize the source and to reduce the search costs. The customer distinguishes the capsules in the market by reference to a brand name or the distinct packaging—and both are open to trademark protection. Again, the rationale for the protection is an important guide when it is necessary to decide whether protection should be granted or not.

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[45] See Art 63 of the European Patent Convention and Arts 46, 47 of Reg (EC) No 207/2009 on the Community Trade Mark.

[46] See Art 7(1)(e)(ii) of Reg (EC) No 207/2009 on the Community trade mark as well as Art 3(1)(e)(ii) of Dir 2008/95/EC relating to trade marks.

[47] See the decision by the St. Gallen Commercial Court, 31/5/2013, HG.2010.199.

[48] See in the respect the decision of the European Court of Justice C-48/09—*Lego Juris A/S v OHIM* [2010] I-08403.

23.2.3.2 Patent Thickets

The concept behind patent protection is to disclose new innovation while granting the inventor protection for a limited period of time. As described above, this protection helps to prevent market failure. But as the Düsseldorf Higher District Court rightly pointed out, the (written) patent also creates the boundaries for this protection thus allowing competitors to innovate around the scope of the patent.[49] It is this possibility for additional innovation that sparks competition and that provides customers with alternative products.

However, if the same product is protected by a multitude of patents and those patents have overlapping scopes this can lead to the creation of patent thickets.[50] Patent thickets constitute a danger to the market and to innovation since they make it extremely difficult for competitors to establish the exact boundaries of protection. The inability to establish those boundaries subjects the competitors to the risk of infringing. Secondary innovation outside the scope of protection becomes difficult if not impossible. The threat of being sued for alleged infringement based on previously unidentified intellectual property rights creates a detriment—or negative incentive—to innovation.

In the case of *Nespresso* this danger is quite obvious since according to various sources the combined product made up of the machine plus the capsuled coffee is, or was, protected by up to 1,700 different patents.[51] As the litigation before the High Court for England and Wales demonstrates, some of those patents are a clear attempt to include sequential innovation into the scope of patent protection by claiming priority from earlier application while adding new, formerly not disclosed features. Such additional patents that partially overlap with prior patents are unlawful under Art. 76 para. 1 EPC. However, they fuel the complexity of patent thickets and discourage competitors. In the case at hand, the European Patent Office finally declared the patent invalid and the decision of the High Court was able to take the invalidity into account.[52] However, one has to wonder how many other questionable patents are still out there as an unjustified threat to competition.

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[49] OLG Dusseldorf, 21/2/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht – Rechtsprechungsreport* 185.

[50] On patent thickets in general see C Shapiro, 'Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting' in AB Jaffe et al (eds), *Innovation Policy and the Economy* (MIT Press, Cambridge, 2001) 119.

[51] See for example the claim by Nestlé itself: *Nestlé tops the food industry patent filing*, claiming that 'Nespresso is protected by over 1,700 patents, both on the capsule and how the capsule interacts with the machine', www.nestle.com/media/newsandfeatures/nestle-tops-food-industry-patent-filings.

[52] While the judgment regarding the invalidity by the EPC has not been published yet, the declaration of invalidity is included in the minutes of the oral hearing. See the minutes of the oral proceeding EPO T 1674/12-3.2.04, 8, https://register.epo.org/application?documentId=EVDUCV7M4281795&number=EP09007962&lng=en&npl=false.

23.2.4 Summary

The case of capsuled coffee demonstrates various weaknesses and dangers of the present patent and trademark system or at least the inherent risk of abuse by right holders. The most important problems involve the protection of subject matters in markets that do not require protection. Such overprotection leads to dysfunctional effects of the IP system, which even worsen when patent thickets and unduly overlapping rights come into play. However, the analysis has also demonstrated that a clear focus on the related markets and a strict observence of the rationales behind the protection of patents and other intellectual property rights may help to reduce such problems.

23.3 Conclusions for the IP and Patent System

From the analysis of the intellectual property disputes surrounding the various markets connected to coffee capsules we have been able to demonstrate some of the present problems in IP protection in general and patent protection in particular.

First of all, we have shown that the starting point for IP protection must always be a sufficiently exact description of the related market. In the case at hand, the general discussion as well as the arguments put forward by the right holder seem to be linked to one integrated market—or business idea—while, in fact, three linked markets are concerned. Based on the identification of the markets an analysis of the function of intellectual property rights in those markets is necessary. As we have described, the various intellectual property rights fulfill very distinct functions and their requirements as well as their scope are—or at least should be—carefully drafted based on those functions. In the view of that, IP protection in a specific market should (only) be granted if the functions of that particular intellectual property right are apt to address specific failures potentially occuring in that market.

With respect to patent protection in particular there are two conclusions that need to be pointed out. While patents are important to prevent market failure based on insufficient lead time and therefore possible underinvestment in innovation by potential inventors, their boundaries need to be described very carefully. The example of the coffee machines and the coffee capsules raises the concern that the problem of patent thickets also exists outside the commonly cited area of information and communication technology. The large number of partially overlapping patents makes it difficult for competitors to innovate around, to enhance competition, and ultimately to provide alternatives to customers. In addition, since patent protection is required to extent insufficient lead time in a specific market, the justification for patent protection is to be found within the rationale for free competition. At the same time free competition determines the limits for patent protection, as extensive patent protection can cause reverse market failure and market failure is what intellectual property protection is designed to avoid in the first place.

The patent decision by the High Court and the Düsseldorf courts came to the right conclusions by paying attention to the rationale behind patent protection and especially by primarily taking the perspective of the consumer into account and not only by paying attention to the goals and wishes of the right holders. Particularly in a political environment where the necessary balance of interests sometimes seems to get lost, it is important to remember that the reason to grant IP protection is to prevent market failure—in whatever form—and that the ultimate effect is to foster innovation based on sufficient competition. Therefore, if it is not absolutely clear that legal protection is required beyond the naturally existing lead time, IP protection—or its enforcement—should be denied in order to prevent reverse market failure.

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Chapter 24
Restitution of 'Degenerate' Art

Franz Jürgen Säcker

Abstract Only recently, around 1,500 long lost paintings were found in an appartment in Munich. This raises, again, the question as to who the owner of those paintings is, many of which appear to have been stolen from Jewish collectors, or confiscated by the nazis. This essay discusses the legal status of so-called 'degenerate' art under German and international property law, taking into consideration the constitutional law dimension of the problem.

24.1 Applicable Property Law

On 31st May 1938, the 'Law on the Confiscation of Degenerate Art' came into force. According to Section 1 of this act, pieces of 'degenerate' art which were to be found in museums or public collections before this act came into force could be confiscated without compensation for the benefit of the Reich as long as they were part of the property of citizens of the Reich or of domestic legal entities at the time of confiscation.[1] If it did not destroy the confiscated pieces of art, the German Reich usually commissioned art dealers with the realization of the confiscated pieces of art abroad. The 'discovery of paintings'[2] in Munich again raises the questions if the previous owners of the paintings lost their property through the confiscation and realisation or if they can claim restitution of the paintings.[3]

[1] Imperial Gazette (Reichsgesetzblatt; RGBl.) 1938 I, 612.

[2] Cf A Zielcke, 'Raubkunstfragen' (2013) *Süddeutsche Zeitung* No 259 of 9 to 10/11/2013, 14.

[3] The following thoughts constitute an up-to-date version of FJ Säcker, 'Eigentumsverlust durch staatliche Einziehung und Veräußerung "entarteter Kunst"' in B Dauner-Lieb et al (eds), *Festschrift für Horst Konzen zum siebzigsten Geburtstag* (Tübingen, Mohr Siebeck, 2007) 847.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_24,

To answer this question, it is relevant if the owners of the paintings or their heirs have lost their property through the confiscation or through one or more subsequent purchase activities. In the event of a purchase abroad, the question is to be addressed which national property law is to be applied. The application of the substantive law is mainly determined by the principle of 'lex rei sitae' which has been codified by Art. 43 para. 1 of the Introductory Act to the Civil Code ('EGBGB') and which governs all modern conflict-of-law rules. According to this principle, the acquisition of a good is to be assessed on the basis of the law of a state in whose territory the good was located at the time of the purchase activity. The 'securing', 'confiscation', 'purchase' by the German Reich are to be assessed according to German law (Situs-Principle)[4], whereas the ownership in the event of purchase and the transfer abroad are determined by foreign law.

24.2 Property Loss Through State's Acts Between 1933–1945?

24.2.1 Property Loss Through Securing and Consfiscation?

The *securing* of paintings of 'degenerate' art by the National-Socialist State did not lead to a change of ownership of the confiscated paintings from an objective point of view. It only transferred the paintings into immediate possession of the German Reich. The Reich had the intention to subsequently decide upon their retention and to delegitimise them before as being artistically valueless following the objectives of the national-socialist 'culture politics' in the Munich exhibition 'Degenerate Art' and to present them as 'daunting' examples of art in travelling exhibitions to 'educate' German people[5]. However, it is questionable whether the ownership of the paintings was transferred to the German Reich by subsequent *confiscation*. This requires differentiating between the seizure and the subsequent Law on Confiscation with the state's acts of confiscation based on this. Only the latter could have led to a loss of ownership.

24.2.1.1 Legal Expropriation Through the Law on Confiscation?

It is conceivable that the coming into force of the Law on Confiscation caused a change of ownership of the relevant paintings without requiring an additional state's

[4] B von Hoffmann, *Internationales Privatrecht*, 8th ed (Munich, CH Beck, 2005) 513 ff; BGH, 20/3/1963, 39 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 173, 174; BGH, 4/7/1969, 52 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 239, 240; BGH, 9/3/1979, 73 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 391, 395; BGH, 8/4/1987, 100 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 321, 324; BGH, 28/9/1994, (1995) *Neue Juristische Wochenschrift* 58, 59; BGH, 25/9/1996, (1997) *Neue Juristische Wochenschrift* 461, 462; BGH, 25/9/1997, (1998) *Neue Juristische Wochenschrift* 1321.

[5] Cf for more details HH Kunze, *Restitution "entarteter Kunst"* (Berlin, de Gruyter, 2000) 42.

act of confiscation. The wording of the law, 'pieces of degenerate art which were seized could be confiscated without compensation for the benefit of the Reich', indicates discretion to be exercised on case-by-case basis, thus, the necessity of an additional state's act of confiscation. Furthermore, Section 2 para. 1 of the Law on Confiscation stipulates: 'The confiscation is commanded by the Führer or the Chancellor of the Reich.'

In the literature on constitutional law, the significant Hilleke's commentary assumed that an internal administrative act of confiscation will necessary[6]. However, the practice during the Third Reich does not show any examples which indicate that this power has been exercised and that there was a concretising administrative act of confiscation regarding single pieces of art[7]. The seized paintings were regarded forfeited for the benefit of the Reich with enacting of the Law on Confiscation. The concept of the "internal administrative act" is regarded to be paradox according the Weimarian and the modern legal tradition[8]. On this basis it can be assumed that Section 2 did not mean a legal administrative act but an internal administrative order by the Führer or by a commissioned representative. It is therefore more convincing to interpret the Law on Confiscation in way that it requires an immediate expropriation of the paintings by law. The question on the change of ownership is therefore determined by the legality of the Law on Confiscation.

24.2.1.2 Nullity of the Law on Confiscation?

1) The question if the Law on Confiscation is void or not has been discussed very controversially[9]. The fate of this law after 1945 (effect under the German Constitution according to Art. 153 of the Basic Law (Grundgesetz, GG) and repealing by the laws of the Allied) did not have any direct influence on the assessment of the ownership. The question is only be determined by the fact if the Law on Confiscation was established law at the time of the confiscation and if it had legal effects at that time. The legal effect of the Law on Confiscation is therefore to be examined on according to the law at that time[10].

[6] H Pfundtner and R Neubert, *Das neue deutsche Reichsrecht* (Berlin, Späth & Linde, 1941) EinziehG, para 6.

[7] Kunze, *Restitution*, 85.

[8] Cf O Mayer, *Deutsches Verwaltungsrecht*, vol I, 3rd ed (Leipzig, Duncker & Humblot, 1924) 94; P Laband, *Deutsches Reichsstaatsrecht* (Tübingen, Mohr, 1907) 118; HJ Wolff, O Bachof, R Stober and W Kluth, *Verwaltungsrecht*, vol I, 12th ed (Munich, CH Beck 2007) § 45 para 78; P Stelkens, HJ Bonk and M Sachs, *Verwaltungsverfahrensgesetz*, 7th ed (Munich, CH Beck, 2008) § 35 para 146.

[9] Arguing that it is void: SA Reich and HJ Fischer, 'Wem gehören die als "entartete Kunst" verfemten, von den Nationalsozialisten beschlagnahmten Werke?' (1993) *Neue Juristische Wochenschrift* 1417, 1418; Kunze, *Restitution*, 67; BT Grell, *Entartete Kunst. Rechtsprobleme der Erfassung und des späteren Schicksals der sogenannten Entarteten Kunst* (Zurich, Diss, 1999) 56. It is not obvious that the majority of legal scholars regard the Law of Confiscation void as Zielcke, 'Raubkunstfragen', does.

[10] Regarding the relevance of the law at the time of enacting the piece of legislation, cf BGH, 8/2/1959, 5 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 76, 94.

The Law on Confiscation was enacted by the Government of the Reich in 1938. Taking into consideration that the law referred to the field of culture content-related and this field of law is covered by the legislative power of the Länder according to Art. 12 in conjunction with Art. 6 and 10 of the Weimar Constitution, the question has to be answered whether the Law on Confiscation has been in line with the rules on legislative powers set out in the Constitution. The seizure of power by the Nazis was combined with a series of new laws which were in conflict with the federal and democratic principles of state's structures provided by the Weimar Constitution. These include 'The Reichstag Fire Decree' (Reichstagsbrandverordnung) enacted in 1933 and the 'Enabling Act' (Ermächtigungsgesetz) enacted on 23 March 1933. Art. 1 and 2 of the Enabling Act[11] allowed the Government of the Reich to enact laws amending the constitution. The power to legislate the Law on Confiscation therefore derived from the Enabling Act.

This raises the question on the legal effectiveness of the Enabling Act itself. Although this has been heavily doubted[12] taking into consideration to circumstances of its coming into being and the fact that it set aside the principle of democracy and the division of powers, German courts have not regarded the Enabling Act as being void ex tunc in the interest of legal certainty in the course of the confrontation with the NS injustice. The courts only assessed the legality of the laws which were enacted on the basis of the Enabling Act on a case-by-case basis[13]. The Enabling Act therefore was part of the established law until it was repealed by the Allied Control Council Act of 20 September 1945[14] with the prevailing opinion. Aside the Enabling Act, the so-called Gleichschaltungsgesetze[15] (forcing into line laws) of

[11] RGBl. 1933 I, 141.

[12] According to G Radbruch, 'Gesetzliches Unrecht und übergesetzliches Recht' (1946) *Süddeutsche Juristen-Zeitung* 105, 106, the Enabling Act came into being against the rules set out in the Constitution. All 81 members of the Parliament from the Communist Party were hindered in voting; they lost their seats on the basis of the Reichtag Fire Decree. The rules of procedure were amended to achieve the quorum by treating all members absent without justification as being present. The procedure applied by the Reichrat did not met the requirements set out by the Constitution, either. For more details, cf J Biesemann, *Das Ermächtigungsgesetz als Grundlage der Gesetzgebung im nationalsozialistischen Staat*, 2nd ed (Münster, LIT-Verlag, 1987) 284 ff; E-W Böckenförde, *Staatsrecht und Staatsrechtslehre im Dritten Reich* (Heidelberg, Müller, 1985) 77 ff; H Schneider, *Das Ermächtigungsgesetz vom 24.3.1933*, 2nd ed (Bonn, Bundeszentrale für Heimatdienst, 1961); CH Ule, 'Vor fünfzig Jahren—30. Januar 1933' (1983) *Deutsches Verwaltungsblatt* 109; E Wadle, 'Das Ermächtigungsgesetz' (1983) *Juristische Schulung* 173; U Reifner, 'Juristen im Nationalsozialismus' (1983) *Zeitschrift für Rechtspolitik* 15.

[13] Cf BGH, 10/7/1952, (1952) *Neue Juristische Wochenschrift* 1139; BVerfG, 24/4/1953, 2 *Entscheidungen des Bundesverfassungsgerichts* 237, 249; BVerfG, 17/12/1953, 3 *Entscheidungen des Bundesverfassungsgerichts* 58, 119; BVerfG, 10/5/1957, 6 *Entscheidungen des Bundesverfassungsgerichts* 389, 414; E Schmidt-Jortzig, 'Entstehung und Wesen der Verfassung des 'Großdeutschen Reiches' in FJ Säcker (ed), *Recht und Rechtslehre im Nationalsozialismus* (Baden-Baden, Nomos, 1992) 71, 76.

[14] Official Journal of the Military Government Germany (Amtsblatt der Militärregierung Deutschland) No 1, 11; cf Kunze, *Restitution*, 50.

[15] RGBl. 1933 I, 153, 173. These acts were repealed by the so-called *Reichsstatthaltergesetz* enacted in 1935 (RGBl. 1933 I, 65). However, the latter did not repeal the legislative powers but implemented stricter rules for the control through the Reich. The so-called *Gesetz über den Neuaufbau des Reiches* of 1934 set the governments of the Länder under immediate control of the

1933 deprived the Länder of powers (including the legislative power in the field of culture) for the benefit of the Reich. Hence, the Law on Confiscation is not void for reasons of conflicting with the powers of legislation set out in the Constitution.

2) The question if the Law on Confiscation is in line with all other provisions set out in the Constitution can only be examined on the basis of the Weimar Constitution, not according to the principles of German Basic Law. The Law on Confiscation contained a legal basis for confiscating paintings which were owned by the Länder and seized in public museums for the benefit of the Reich. This was not in conflict with Art. 127 of the Weimar Constitution stipulating the principle of local self-government. This principle was not of the same significance as it has been assigned by the German Federal Constitutional Court[16] in its case-law. Firstly, Art. 127 was regarded as a simple provision on the organisation of the state without protecting a core of autonomy before the time of the National Socialism. Secondly, although the legal effectiveness of the Weimar Constitution during the Third Reich, Art. 127 had not been assigned any substantial significance[17].

Furthermore, the Law on Confiscation does not conflict with the principle of ownership in Art. 153 of the Weimar Constitution and with the principle of artistic freedom in Art. 142 of the Weimar Constitution. As far as the possible infringement of the ownership of the Länder and local communities is concerned (which means as the seizure of the painting owned by public entities is concerned), Art. 153, being a citizen's right of defense against the state, cannot be applied on these legal internal-relationships between public entities[18]. Regarding the confiscation of paintings which were owned by private persons, these cases fall in the scope of application of Art. 153 of the Weimar Constitution. However, Art. 153 allowed expropriations without compensation if these were stipulated by an act of the Reich for the benefit of the general public. The requirements of the benefit of the public were given according to purposes and the objectives of the national-socialist culture politics which is to be regarded inacceptable from the present point of view. The reason is that the question if a state's measure is for the benefit of the general public is to be answered on the basis of approach of the state given in the absence of a general theory of bonum commune[19]. If one does not follow this opinion, the Law on Confiscation does not infringe Art. 153 of the Weimar Constitution

Government of the Reich. Furthermore, the sovereign powers of the Länder including their powers to legislate were transferred to the Reich.

[16] Cf BVerfG, 23/11/1988, 79 *Entscheidungen des Bundesverfassungsgerichts* 127–'Rastede' with further references.

[17] G Anschütz, *Die Verfassung des Deutschen Reiches vom 11. August 1919*, 14th ed (Berlin, Stilke, 1933) on Art. 127; Grell, *Entartete Kunst*, 32.

[18] Cf BVerfG, 8/7/1982, 61 *Entscheidungen des Bundesverfassungsgerichts* 82–'Sasbach/Wyhl', following BVerfG, 2/5/1967, 21 *Entscheidungen des Bundesverfassungsgerichts* 362.

[19] For more details cf FJ Säcker, *Gruppenautonomie und Übermachtkontrolle im Arbeitsrecht* (Berlin, Duncker & Humblot, 1972) 275 ff; J Isensee, *Handbuch des Staatsrechts der Bundesrepublik Deutschland*, vol III (Heidelberg, Müller, 1988) 53 ff; P Häberle, *Öffentliches Interesse als juristisches Problem* (Bad Homburg, Athenäum-Verlag, 1970); M Stolleis, *Gemeinwohlformeln im nationalsozialistischen Recht* (Berlin, Schweitzer, 1974); HP Bull, *Die Staatsaufgaben nach dem Grundgesetz* (Frankfurt, Athenäum-Verlag, 1973) 105 ff, 369 ff.

since the principle of ownership was set aside by the 'The Reichstag Fire Decree' (Reichstagsbrandverordnung) of 1933.

The principle of artistic freedom was not limited by 'The Reichstag Fire Decree'. However, Art. 142 of the Weimar Constitution was subject to limitations which were justified by a legitimate interest prevailing the artistic freedom[20]. The courts in the Third Reich regarded the 'cleansing' of the German museums of the so-called 'decadent decayed art' and its elimination from every day life as such a ligitimate prevailing interest[21]. It can therefore be concluded that the Law on Confiscation did not infringe any provisions of the Constitution according to the legal approach at that time.

3) In the event of a law deviating from justice, the relevant law has also to be assessed according to suprapositive law in addition to the Constitution (cf. Art. 20 Para. 3 GG). Even if the German Courts regard the Enabling Act legally effective, they recognise that the laws based on the Enabling Act—such as the Law on Confiscation—can be legally ineffective because of infringing suprapositive law. This is the case of their content does not meet the substantial requirements of the state's rule of law[22] and contain injustive rather than justice[23]. The German Federal Constitutional Court stated in several judgments that the time of National Socialism had taught that even the legislator could enact injustice and that therefore the principle of substancial justice should, ultimately, prevail the need für legal certainty[24]. The Court thereby used Gustav Radbruch's formulation: The positive law cannot be effective if it conflicts with justice to an intolerable extend, so that the

[20] F Poetzsch-Heffter, *Handkommentar der Reichsverfassung vom 11. August 1919*, 3rd ed (Berlin, O. Liebmann, 1928) 459.

[21] Regarding the willingness of the courts to adapt the National Socialist ideology cf B Rüthers, *Die unbegrenzte Auslegung. Zum Wandel der Privatrechtsordnung im Nationalsozialismus* (Tübingen, Mohr, 1968) 91 ff.

[22] The normative model of both a formalistic and a substantial state governed by the rule-of-law is a consequence of the German Constitutional Theory which deals with the negative impacts of the revolutionary amendments to the Weimar Constitution (see K Stern, *Das Staatsrecht der Bundesrepublik Deutschland*, vol I, 2nd ed (Munich, CH Beck,1984) 145) through the Third Reich and which regards the protection of human rights as being essential in a state governed by the rule-of-law.

[23] BGH, 10/7/1952, (1952) *Neue Juristische Wochenschrift* 1139; BVerfG, 23/10/1951, 1 *Entscheidungen des Bundesverfassungsgerichts* 14, 16; BVerfG, 14/2/1973, 34 *Entscheidungen des Bundesverfassungsgerichts* 269, 286; BVerwG, 20/11/1990, 87 *Entscheidungen des Bundesverwaltungsgerichts* 133, 136; also Stern, *Das Staatsrecht der Bundesrepublik Deutschland*, 150 f; L Enneccerus and HC Nipperdey, *Allgemeiner Teil des Bürgerlichen Rechts*, vol. I/1, 15th ed (Tübingen, Mohr, 1960) §§ 21, 33 III; W Kägi, *Die Verfassung als rechtliche Grundordnung des Staates* (Zurich, Polygraph, 1945) 56 ff. The principle of a relative positive law as developed by C Schmitt has been overcome (cf C Schmitt, *Verfassungslehre* (Munich, Duncker & Humblot, 1928) 76 ff); E Tosch, *Die Bindung des verfassungsändernden Gesetzgebers an den Willen des historischen Verfassungsgebers* (Berlin, Duncker & Humblot, 1979) 82.

[24] BVerfG, 18/12/1953, 3 *Entscheidungen des Bundesverfassungsgerichts* 225, 232.

law being a 'wrong' law has to be set aside for the benefit of justice[25]. According to this principle, that National Socialist 'legal' provisions cannot be regarded as laws if they evidently conflict with the fundamental principle of justice so that the judge applying these provisions and recognising their legal effects would administer injustice rather than justice[26]. In this case the provision is ineffectice from its coming into being[27]. This case-law has been supported by the German Federal Court of Justice in its 'East German Border Guard Law Suits' on the shots at the Berlin Wall dealing with the so-called shoot-to-kill orders by the Government of the GDR.

The German Federal Court of Justice also referred to the case-law based on the principle developed by Radbruch and declared the grounds for justification set out in Section 27 of the Law on the Border (GDR) ineffective. It argued that such a ground for justification, which allows the prohibition of passing the border prevailing the human right to live, obviously and intolerably conflicts with the fundamental principle of justice and with human rights protected under international law was ineffective[28]. Additionally, the Court referred to the principle developed by Radbruch and clarified by the International Covenant on Civil and Political Rights of 1966[29].

The Law on Confiscation used as with its core concept of 'degenerate art' typical National Socialistic thinking. Although this concept referred to the whole field of modern art, it was targeted to the works of Jewish artists. This indicated similarities to the aforementioned judgments of the German Federal Constitutional Court[30]. In this judgment, the Court regarded the Eleventh Law on Citizens of the Reich as being void from ist coming into force since the expropriation combined with the expatriation of Jewish people was aimed at physically and substantially destroying parts of the the people according to racist criteria. This was not in line with law and justice and conficting with the ban on arbitrary decisions. Although the discrimination of Jewish artists through the development of the concept of 'degenerate' art linked to the Jewish descent has not yet been acompanied by immediate physical thread, it was, however, an expression of an inhuman racist ideology and requires to regard the Law on Confiscation being void ex tunc.

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[25] Cf G Radbruch, *Rechtsphilosophie*, 4th ed (Stuttgard, Köhler, 1950) 353: The conflict between justice and legal certainty can be harmonised by giving the enacted law preference even if ist content is injustice or does not contribute to a legitimite purpose unless the conflict of the positive law with the principle of injustice has reached an extend which allows justice to prevail the written law. Cf also E Kaufmann, 'Die Gleichheit vor dem Gesetz im Sinne des Art. 109 der Reichsverfassung' (1927) 3 *Veröffentlichungen der Vereinigung der Deutschen Staatsrechtslehrer* 11: I share the opinion of others that even the principle of egality can be assessed by the judge … The question to be raised is: What is justice? … This term does not only means an instrument for discussion, not only rules for discussions, as often stated, but it means a substatial order which has to be achieved by everyone dealing with law, the legislator and the judge … Only those who are pure of heart, act with justice.

[26] BVerfG, 14/2/1968, 23 *Entscheidungen des Bundesverfassungsgerichts* 98, 106.

[27] ibid.

[28] BGH, 26/7/1994, (1994) *Neue Juristische Wochenschrift* 2708, 2709; BGH, 3/11/1992, (1993) *Neue Juristische Wochenschrift* 141.

[29] BGBl. II 1973, 1534.

[30] BVerfG, 14/2/1968, 23 *Entscheidungen des Bundesverfassungsgerichts* 98.

The same also applies to artists whose works were regarded 'degenerate' not because of a Jewish artist but because of other influences stigmatised as being 'Jewish-Bolshevik' such as paintings with pacifistic motifs or abstract paintings. The racist, defaming and unfair target of the Law of Confiscation becomes obvious if the conceptualisation of the Munich exhibition of 'Degenerate Art' is considered which followed the same ideology as the Law on Confiscation. In the single rooms, the works were presented under headlines such as 'Revelation of the Jewish Racist Soul', 'Insanity as a Method', 'As ill ghosts regard the nature' and 'Madness at any costs' (Kandinsky)[31]. From the point of view of the artists affected, there is a second issue to be regarded: The confiscation finally cut the linkage between the originator and work based on the general rights of personality. The confiscation hindered them from exersing the rights of personality as their copyrights, especially their rights to access their piece of art. Althought the copyright at those times did not expressvely included the right to access the piece of art, but—as stated by the German Federal Court of Justice[32]—it is part of the originator's general right of personality. It was, therefore, part of the suprapositive human rights at that time. Hence, it cannot be doubted that the artist's general right of personality was affected and if not the physical but the mental extermination was intented by the legislation[33].

In view of the private owners affected by the confiscation, there is also an intolerable conflict with the principle of injustice. The private owners should loose their ownership—without compensation—through the withdrawel of the right to possess through state's confiscation.

The view that the Law on Confiscation does not lead to an intolerable situation as paintings are not goods which are essential to live cannot detract from the fact that the law encroaches on rights on personality and human rights for racist reasons and ignoring the rule-of-law. This alone is enough to argue that the Law on Confiscation is void—disregarding the material value of the relevant pieces of art. This is supported by the International Covenant on Civil and Political Rights, which the German Federal Court of Justice referred to in the case of the shots at the German border. It included—among others—the right to equal treatment (Art. 2), the right to honour (Art. 17) as well as the freedom of opinion (Art. 19). Although the convenant did not bind the Third Reich, the Federal Republic of Germany is obliged to give effect to these rights. Germany also recognised suprapositive, unwritten human rights prevailing the German legal order through signing and ratifying Art. 6 TEU and the European Charta on Fundamental Rights. If one legally accepted the expropriations intended by the Law on Confiscation, this would have lead to disregarding fundamental human rights[34], and the judge would have rule injustice rather than justice.

[31] Catalogue of the exhibition, 3 ff.

[32] BGH, 26/10/1951, (1952) *Gewerblicher Rechtsschutz und Urheberrecht* 257; G Schricker, '§ 25', in G Schricker (ed), *Urheberrecht*, 2nd ed (Munich, CH Beck, 1999) para 3.

[33] Jayme referred to by Kunze, *Restitution*, 77.

[34] Cf also Kunze, *Restitution*, 78.

Finally, the retroactive legalisation of the previous state's act of seizing intended by the Law on Confiscation is inevitably contrary to justice. A state which acts without having a legal basis for its actions and which later legalises these acts infringes the fundamental principle of the rule-of-law[35]. The Law on Confiscation is therefore to be regarded as void from its coming into force[36]. Hence, it could not have the effect of the loss of ownership of the paintings.

24.2.1.3 Nullity of the Administrative Acts of Expropriation

In so far as pictures were expropriated by virtue of an individual official act of confiscation it depends on how important the fact that it does not rest on any legal basis is for the validity of such an administrative act.

1) Then and now, the fact that an official act is unlawful due to e.g. a missing legal basis does not automatically render such an act void. This would furthermore require the mistake to be of a particularly grave nature (as is e.g. the case when it comes to so called lawlessness)[37] which, according to contemporary opinion, ought to have been evident at the time the administrative act was adopted. This latter condition was not yet applicable during the times of the Weimar Republic[38]. However, from a teleological point of view, it begs the question whether, if the legal basis of the official act is indeed void due to an infringement of a suprapositive law, this nullity ought furthermore to be applied to the administrative act itself. The principle developed by Radbruch would be ineffective if the nullity of an unjust law did not carry consequences for the administrative act which implements injustice.[39] As such the nullity of the Law on Confiscation consequentially renders the subsequent confiscation act ineffective.

2) However, if one is of a different opinion it is important to examine whether such deficiencies were evident at the time. A mistake in an administrative act is evident if it is apparent upon prudent and reasonable appraisal of the circumstances.[40] This formulation does not derive from the administrative law at that time but from the meaning of Section 44 of the Federal Law on Administrative Proceedings. However, this evidentiary condition sets a very high threshold, so much so that even the administrative legal practice at that time did not impose any further conditions for

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[35] Cf regarding the requirements of a state governed by the rule-of-law K Füßer, 'Geheime Führerbefehle als Rechtsquellen? Minima Juris und das Erfordernis "minimaler Rechtskultur"' (1993) *Zeitschrift für Rechtspolitik* 180.

[36] See also A Müller-Katzenburg, 'Besitz- und Eigentumssituation bei gestohlenen und sonst abhanden gekommenen Kunstwerken' (1999) *Neue Juristische Wochenschrift* 2551, 2552; Kunze, *Restitution*, 76.

[37] Cf regarding the administrative law HJ Wolff, O Bachof and R Stober, *Verwaltungsrecht*, vol II, 5th ed (Munich, CH Beck, 2004) 107.

[38] Cf Mayer, *Deutsches Verwaltungsrecht*, 95.

[39] Cf Kunze, *Restitution*, 89 referring to examples in case law.

[40] P Stelkens, HJ Bonk and M Sachs, *Verwaltungsverfahrungsgesetz*, 6th ed (Munich, CH Beck, 2001) § 44 para. 117.

the an administrative act to be rendered void.[41] The reason for this is the standard of the judicious and unbiased man, the attentive and prudent citizen as the average bystander.[42] The actual opinion at the time the measure was adopted is decisive. Even for a prudent and reasonable contemporary the unlawfulness had to be blatantly obvious. Academic opinion on the matter agrees on the fact that the Law on Confiscation was also adopted due to the sentiment after the seizing acts had been implemented without a sufficient legal basis.[43] The prohibition of any retroactive effect of the Law on Confiscation would also have been obvious to any observer at the time.

Furthermore, it had to be apparent to everyone that the confiscation also entailed the expropriation of museums and private lenders without receiving any compensation as well as the complete and final obliteration of artists in the public sphere. The prudent and attentive citizen would have recognised the futility of any form of resistance as well as the utter lack of any effective legal remedy. The so-called Führerprinzip, which means the principle of dictatorship which reached to the full dispensability of any legal basis, could not deny the requirement of evidence. As a consequence, both the Law on Confiscation and any administrative acts of confiscation based on that law were void and therefore legally ineffective.

24.3 Loss of Ownership Through Subsequent Purchases

Thus, the loss of ownership of pictures of degenerate art can only follow from subsequent derivative-translative purchases or by way of primary purchase.

24.3.1 Public Purchase of Degenerate Art

Given the fact that the state was involved in the transfer of these pictures to a third party by the German Reich and that the seizure represented a state measure it is firstly to be determined whether the purchasing regulations of private law are applicable or whether this is in fact a purchase governed by a set of public law regulations.

A parallel could be drawn to the law of foreclosure. According to the prevailing opinion[44] the public auctioning of the distrained object and the surcharge awarded

[41] Cf Mayer, *Deutsches Verwaltungsrecht*, 95, who does not mention the this requirement for a *void* administrative act.

[42] F-J Peine, *Allgemeines Verwaltungsrecht*, 10th ed (Heidelberg, Müller, 2011) 160.

[43] Kunze, *Restitution*, 62.

[44] So-called public law theory regarding the legal nature of this right; cf F Stein, *Grundfragen der Zwangsvollstreckung* (Tübingen, Mohr, 1913); H Thomas and H Putzo, *Zivilprozessordnung*, 34th ed (Munich, CH Beck, 2013) § 803 para 8; R Zöller, *Zivilprozessordnung*, 30th ed (Cologne, Otto Schmidt, 2014) § 804 para 2.

to the highest bidder constitutes an official state act which, regardless of whether the object has been lost or of bad faith, transfers onto the purchaser ownership of the object in question. This is based on an effective seizure as a consequence of a forfeit or of the security right of an execution order under private law which is similar to the state's seizure.

However, this public law theory on the security right of an execution order and the fact that it disregarded the private law principle of the acquisition of property in good faith have faced substantial criticism.[45] Even the theory under public law requires an effective security right of an execution order which means an effective act of seizure under private law.[46] As such, the emergence of the security right of an execution order can be regarded as a sufficient, however not really necessary condition for state exploitation. According to the case law of the German Federal Court of Justice enforcement measures—such as seizure under private law—are void and without any legal consequences if they exhibit fundamental and grave deficiencies.[47] This includes an enforcement measure implemented without any judgment or equivalent to a judgment.[48] In the present case this could be compared to seizure, a void measure, as it was implemented without any valid legal basis. Just as seizure without any legal judgment does not let a security right of an execution order emerge as a basis for any further legally valid exploitation by the state, in the same vein, nor does seizure, it being void any without any legal basis, constitute a basis for further exploitation, following public law regulations, by the German Reich.

At this point, it is not important if the act of seizure is void. The nullity of the act of seizure results from the nullity of the Act of Confiscation as this expressively refers to measures taken before it came into force. This means that not only the Act of Confiscation itself will be void, but also the measures taken before. This is based on the following reasons:

The legitimacy of the measure is firstly based on the *Enabling Act* which allowed the Government of the Reich to create new legal bases without following any rules of a parlamentary legislative procedure. The Enabling Act should have effect for only 4 years but it has been extented several times. Regarding acts of seizure in 1937, it therefore contained the relevant legal basis for the following order of the minister of propaganda Goebbels:

[45] FJ Säcker, 'Der Streit um die Rechtsnatur des Pfändungspfandrechts. Zugleich ein Beitrag zum Anteil der Rechtswissenschaft an der Rechtsfortbildung' (1971) *Juristenzeitung* 156.

[46] H Brox and W-D Walker, *Zwangsvollstreckungsrecht*, 10th ed (Munich, CH Beck, 2014) 224 and 234: A void seizure does not render a confiscation; security right of an execution order requires an effective seizure; cf Zöller, *Zivilprozessordnung*, § 804 para 3; Stein, *Grundfragen der Zwangsvollstreckung*, 31: The creation of this right is determined by the Civil Procedural Code. Effective seizure under private law requires a judgment or any equivalent.

[47] BGH, 10/6/1959, (1959) *Neue Juristische Wochenschrift* 1873, 1874; BGH, 6/4/1979, (1979) *Neue Juristische Wochenschrift* 2045; W Schuschke and W-D Walker*, Vollstreckung und vorläufiger Rechtsschutz*, 3rd ed (Cologne, Heymann, 2002) 802.

[48] BGH, 6/4/1979, (1979) *Neue Juristische Wochenschrift* 2045, 2046; Thomas and Putzo*, Zivilprozessordnung*, Vor § 704 para 58.

'Following an expressive authorisation through the Führer, I hereby commission the President of the Reich's Chamber of Visual Arts, Professor Ziegler, Munich to select and to seize pieces of German decayed art, both paintings and sculptures since 1910, which are possessed by the German Reich, the German Länder and the local communities, for an exhibition. I ask for supporting Professor Ziegler during the process of viewing and selection the pieces of art.

Signed: Dr. Goebbels'[49]

As mentioned before, following the case-law of the German Federal Constitutional Court and the German Federal Court of Justice, it cannot be argued that the administrative act is void referring to a nullity of the Enabling Act (which is not the case). An examination of the effectiveness of the relevant administrative act on the basis of the Enabling Act is required on a case-by-case basis. It is important if the so-called *Führerbefehl* (order of the Führer) constitutes a relevant measure adaopted on the basis of the Enabling Act. Following the theories of constitutional law at that time, the intention of the Führer did not constitute a legal source but the highest instrument of legislation. This means that the authorisation through the Führer is independant from the Enabling Act[50]. It could thus have own legal effects without requiring further formalities. The legitimation for the order of the minister of propaganda is directly based on the Führerbefehl. The effectiveness of the Führerbefehl did not require any further formalities, regardsless of its from, it could thus be enacted in the form of a decree, a regulation or an act[51]. There was a debate on the question if the Führerbefehl at least had to be published in the offical journal of the Reich which meant that secret orders of the Führer would had been void according to the legal rules at that time[52]. However, the Führer's unlimited power of legislation could abolish the requirement of publication[53]. The 'authorisation' mentioned by Goebbels has never been published. Nevertheless, it had be be regarded effective following the legal approaches at that time. The same applies considering the question of legislative powers of the Reich in the field of culture.

The Führerbefehl (as well as the Enabling Act) was also in line with the substantial law at that time. Although the seizing acts commanded by Hitler constituted a severe infringement of the principle of ownership/possession and the principle of

[49] Printed at Grell, *Entartete Kunst*, 22.

[50] Regarding the Führerbefehl as a legal source cf H Welzel, 'Gesetzmäßige Judentötungen?' (1964) *Neue Juristische Wochenschrift* 521, with references to the National Socialist Constitutional Law; J Baumann, 'Rechtmäßigkeit von Mordgeboten?' (1964) *Neue Juristische Wochenschrift* 1398, 1400; Füßer, 'Geheime Führerbefehle als Rechtsquellen?', 183; G Bemmann, 'Zu aktuellen Problemen der Rechtsbeugung' (1995) *Juristenzeitung* 123; G Werle, 'Der Holocaust als Gegenstand der bundesdeutschen Strafjustiz' (1992) *Neue Juristische Wochenschrift* 2534.

[51] Regarding the different forms of expresstion of the intention of the Führer cf Grell, *Entartete Kunst*, 28.

[52] Cf references by Welzel, 'Gesetzmäßige Judentötungen?'; Baumann, 'Rechtmäßigkeit von Mordgeboten?'.

[53] Cf Bemmann, 'Zu aktuellen Problemen der Rechtsbeugung'; Werle, 'Der Holocaust', 2534: To regard a secret Führerbefehl void only because it has not been published would ignore fact of the National-Socialist time. The Führerwille was the starting point, the essence and the core of the National Socialist legal order. Therefore the Führerbefehl was fully effective.

local self-government of the Länder, they were not covered by Art. 153 of the Weimar Constitution and did not constitute an infringement of the Consitution following the interpretation of Art. 127 of the Weimar Constitution at that time.

The same applies to the private owners. Although the right to possess affected by the seizure is covered by the principle of ownership[54]; Art. 153 of the Weimar Constitution was subject to limitations by law. At the time the order of seizure was enacted, the principle of ownership was already set aside by the Reichstag Fire Decree.

Therefore, the questions is to be addressed if the relevant provision is ineffective according to suprapositive law. Although the order of seizure does not include the confiscation of ownership of the pieces of art, all issues mentioned regarding the Law of Confiscation also refer to the act of divesting of possession which was „only" intended. This is because the Law of Confiscation further develops the injustice rendering from the acts of seizure. These and the difamation of the pieses of art as „rubbish" were influenced by the same arbitrary, discirminating and difaming ideology that inflenced the Law of Confiscation. Furthermore, it was already very obvious at the time of the seizing acts that the painting would never be given back to their owners and the artists. The Führerbefehl therefore constitutes 'legal injustice' according to suprapositve approaches of justice developed by Radbruch and is thus to be regarded void ex tunc.

Goebbel's order and the single acts of seizure therefore lacked of a legal basis which is a case of lawlessness. Regarding the question if this was obvious—as required by the majority of legal scholars—reference is made to the explainations on the acts of confiscation. The confiscation constituted a prey intended and organised by the state according the legal approaches and that time and today and were regarded inapplicable[55].

On this basis, it can be concluded that the acts of seizures were void. The purchase of the painting by the German Reich under public law was not based on a legal provision. Selling the paintings, the Reich acted as a private person according to private law. The purchasing of the painting is thus to be examined on the basis of §§ 929 et sEq. of the German Civil Code (Bürgerliches Gesetzbuch; BGB).

24.3.2 Private Purchase of Degenerate Art?

The requirements of an acquisition of ownership from the person entitled were not met since the German Reich did not own the paintings. It is therefore to be discussed if the requirements of good faith acquisition from a person not entitled according

[54] Cf Poetzsch-Heffter, *Handkommentar der Reichsverfassung*, 482.

[55] This is in line with the opinion of Paul Ortwin Raves (referred to by C Zuschlag, *„Entartete Kunst"* (Worms, Werner, 1995) 177), which was commissioned to lead the National Gallery Berlin from 1937-1945 and reports as a contemporary witness on the common sense at that time. Regarding Goebbel's order he says: 'It was terrible. A minister can seize the possession of the Reich, the Länder and the Cities on the discretion of a fully unknown painter? He could do so. He managed to receive a Führerbefehl which allowed to do everything in such a unitary state.'

to § 932 BGB were met. § 932 para. 2 states that the acquirer is not in good faith if he is aware, or as a result of gross negligence he is not aware, that the thing does not belong to the alienor[56]. A person act negligently if he fails to exercise reasonable care when assessing the ownership[57]. Although an objective view is hereby relevant, the personal circumstances of the acquirer can require more strict rules[58]. The acquirer can furthermore be obliged to investigate if there is reason to doubt the ownership of the possessor against the rule of § 1006 BGB[59].

Considering the National Socialist 'legislation' recognising secret orders of the Führer as a source of law beyond any constitutional principles and suprapositive law, the fact that the state took measures could not serve as a basis for having good faith[60]. If the ownership is furhtermore to be doubted because of the unlawful behaviour of the state itself, it cannot be argued that weaker rules for assessing the negligence can be applied[61]. Even if one is of another opinion, the requirements of a good faith acquisition from a person not entitled were not met as the paintings have been lost in any other way within the meaning of § 935 para. 1 BGB.

It has therefore to be examined if the paintings were „lost in another way" by the acts of seizure. § 935 BGB does not only cover the loss of immediate possession but also the loss of the agent's possession within the meaning of § 855 BGB. In the event of a change of possession through a state's measure, the measure replaces the intention and the instruction of the possessor. If the state's measure was void, the thing can thus the regarded as being 'lost in another way'[62]. It has already been mentioned that the acts of seizure were void. The paintings were therefore lost in another way withing the meaning of § 935 para. 1 BGB.

With the assumption of ownership, the German Reich also claimed to be entitled to own the painting. On this basis, an acquisition in analogy to § 388 para. 1 of

[56] Positive knowledge means that the acquirer knows that the thing is not owned by the alienor. In the absence of this knowledge, he does not 'know' this even if he knows all facts which hinder the acquisition of ownership by the alionor. Cf BGH, 23/4/1951, (1952) *Neue Juristische Wochenschrift* 219– 'Goebbels' letters').

[57] BGH, 13/4/1994, (1994) *Neue Juristische Wochenschrift* 2022.

[58] Especially regarding the case of art dealing cf Müller-Katzenburg, 'Besitz- und Eigentumssituation', 2556 ff.

[59] Cf LG Munich I, 8/12/1993, (1995) *Praxis des Internationalen Privatrechts* 43, on the case 'Sumpflegende' (Zitat), which states that there was good faith arguing with the special good faith situation based on the fact that the alionor was the state. The acquirer can generally invoke this fact. The view of the court can be supported to the extent that actions of the state can create good fatih which lessens the obligation to investigate. However, this can only apply in a state governed by the rule-of-law.

[60] Cf J Eckert, 'Was war die Kieler Schule?' in Säcker (ed), *Recht und Rechtslehre im Nationalsozialismus*, 37, 59.

[61] Cf BGH, 10/1/1973, (1973) *Rechtsprechung des Bundesgerichtshofs in Zivilsachen Warneyer* No 3– 'Kykladenidol', regarding the obligations to take care in the case of pieces of art of high reputation.

[62] So the majority of legal scholars; P Bassenge, '§ 935' in O Palandt (ed), *Bürgerliches Gesetzbuch*, 73th ed (Munich, CH Beck, 2014) para 6; M Henssler, '§ 935' in H-T Soergel (ed), *Bürgerliches Gesetzbuch*, 13th ed (Munich, CH Beck, 2003) § 935 para 10.

the German Commercial Code (Handelsgesetzbuch; HGB) can be examined. As stipulated by this provision, ownership can be acquired from a person on entitled if the alionor is a merchant and the acquirer knows from the lack of ownership but assumes that the alionor is entitled. However, consequently, there was not only a lack of good faith regarding the ownerwhip but also a lack of good faith regarding the entitlement of the German Reich. Both can only render from an effective confiscation which was not the case. Furthermore, § 366 HGB only extends § 932 para. 1 sentence 1 BGB but does not constiute an exemption from § 935 BGB. As the thing was 'lost in another way', the requirements of § 366 HGB were not met[63].

24.4 Limitation Period

The Regional Court of Munich regarded the Law of Confiscation of 1938 void following the aforementioned reasons in a judgment of 8 December 1993[64] in a case on a claim against the City of Munich for restitution of Paul Klee's painting 'Sumpflegende'. However, it also argued that the claim for restitution according to § 935 BGB expired after 30 years. It is therefore to be examined if invoking the principles of limitations conflicts with the principle of good faith provided for by § 242 BGB.

According to well-settled case-law it can be argued that the exercise of rights is against the principle of good faith if the debtor (possessor) hindered the creditor from refusing performance or from suspending expiry of the claim.[65] The fact that the dector fight against the claim (e.g. by arguing that the Law of Confiscation is effective), is not against the principles of good faith.[66] Only of the debtor actively hinders the creditor from filing his claims, this meets the requirements of bad faith with the consequence that the effects of limitation cannot be invoked.[67]

It an art dealer or the heirs as non-entitled possessors of 'degenerate' art hide the possessed paintings and tell that they were burned by the Nazis with the aim to sell them abroad, this is against the principle of good faith.

Furthermore, it conflicts with the obligation of the legislator to enact a law of expropriation without compensation which infringes the principle of ownership according to Art. 14 para. 1 sentence 2 GG. If an owner looses his ownership and his

[63] K Schmidt, *Handelsrecht*, 5th ed (Cologne, Heymann, 1999) 677.

[64] LG Munich I, 8/12/1993, (1995) *Praxis des Internationalen Privatrechts* 43; similar KG, 21/5/992, (1993) *Neue Juristische Wochenschrift* 1480. The BGH, 16/3/2012, (2012) *Neue Juristische Wochenschrift* 1796, did not need to decide upon the limitation period since the effects of limitation were not invoked.

[65] Cf RG, 17/12/1926, 115 *Entscheidungen des Reichsgerichts in Zivilsachen* 135, 137; RG, 27/10/1934, 145 *Entscheidungen des Reichsgerichts in Zivilsachen* 239, 244 ff; BGH, 3/2/1953, 9 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 1, 5; BGH, 18/12/1997, (1998) *Neue Juristische Wochenschrift* 1488, 1489 ff.

[66] BGH, 29/2/1996, (1996) *Neue Juristische Wochenschrift* 1895; BGH, 4/11/1997, (1998) *Neue Juristische Wochenschrift* 903.

[67] BGH, 14/9/2004, (2005) *Neue Juristische Wochenschrift—Rechtsprechungsreport* 415, 416.

right to use owned things on the basis of §§ 197, 214 BGB with the consequence that the only has a ius nudum and that the possessor not having good faith and hiding the painting is entitled to possess and to use the paintings[68], this infringes the principle of ownership in Art. 14 of the German Basis Law. (In the case *City of Gotha and Federal Republic of German v Sotheby's and Cobert Finance S.A*. at the High Court of London, the Federal Republic of Germany as the plaintiff argued that interests have to be balanced.[69] It argued that the expiry of the claim according the § 985 BGB for the benefit of the possessor in bad faith would conflict with the English principle of ordre public. The court followed this opinion: Allowing a party, who admits not to have acted in good faith, to invoke the expiry of a claim while the plaintiff did not know about the location of the painting and did not have a chance to restitute the painting infringes the principle of ordre public.)

The claim set out in § 985 BGB is an essential part of the principle of ownership. Denying this claim economically constitutes an expropriation.[70] It has therefore to be justified by another relevant and important requirement such as legal certainty which is not the case if the possessor know or grossly negligent not knows that the owners directly or indirectly lost their possession directly through unlawful measures of the National Socialist State[71] which constitute a 'loss in another way' within the meaning of § 935 BGB.

Invoking the effects of limitation with the separation of ownership and possession therefore conflicts with § 242 BGB since the possessor has contributed to the expiry of the claim in § 985 BGB against the pinciples of good faith.

24.5 Conclusion

The owners of the paintings defamed as 'degenerate' art did not loose their rights through the state's measures of injustice. The principle of ownership is to be protected from infringements through state's acts of injustice by the application of suprapositive law (Art. 20 para. 3 GG). Invoking the effects of limitation is prohibited in the event of hiding the possession of paintings despite of knowing the unlawful acts taken by the National Socialist State.

[68] Cf K Siehr, 'Verjährung der Vindikationsklage?' (2001) *Zeitschrift für Rechtspolitik* 346; O Remien, 'Vindikationsverjährung und Eigentumsschutz' (2001) 201 *Archiv für civilistische Praxis* 730; C Armbrüster, 'Verjährbarkeit der Vindikation?—Zugleich ein Beirag zu den Zwecken der Verjährung' in L Aderhold et al (eds), *Festschrift für Harm Peter Westermann zum 70. Geburtstag* (Cologne, Otto Schmidt, 2008) 53, 63 ff; G Schulze, 'Moralische Forderungen und das IPR' (2010) *Praxis des Internationalen Privatrechts* 290, 296; against B Plambeck, *Die Verjährung der Vindikation* (Frankfurt, Lang, 1996) 206 ff.

[69] High Court, 9/9/1998, www.iuscomp.org/gla/judgments/foreign/gotha1.htm.

[70] BGH, 16/3/2012, (2012) *Neue Juristische Wochenschrift* 1796.

[71] Regarding the criteria for forced sales to prevent the pieces of art from being confiscated, and the similiarites to states' acts of seizure cf FJ Säcker, *Vermögensrecht* (Munich, CH Beck, 1995) § 152 ff VermG, paras 165 ff.

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Part IV
Product Safety Law

Chapter 25
Product Safety—A Model for EU Legislation and Reform

Geraint Howells

Abstract The General Product Safety Directive has been radically amended once and is now subject to a further consultation about reform. This paper argues that the Directive has been refined over the years and an increased emphasis is now being given to enforcement. As well as tracking the principle development it is argued this has been a good model for reform and finally it is contrasted with the lack of activity in the field of product liability.

25.1 Introduction

Hans Micklitz's work has ranged far and wide across the field of consumer protection. My choice of EU product safety reform is a topical subject and one that Hans has been engaged in for many years. One of the first examples of his work that I heavily used was *Federalism and Responsibility: A Study on Product Safety Law and Practice in the European Community*.[1] This combined a theoretical approach with a firm grounding in empirical reality; both aspects have always been distinguishing features of his work. The current paper may not live up to those high standards but it should serve as a useful survey of this topic's development at the EU level and also allow us to reflect on three broader dimensions.

First, the process of law reform. The General Product Safety Directive is a good example of the stages through which EU legislative activity can evolve. Incidentally, it is an example of such law reform being undertaken well. The three stages identified involve initially *adoption* (getting political acceptance that the EU has competence and getting some law on the books), followed up by *refinement* (sorting out what works and what does not and amending accordingly), and a concern ultimately for effective *enforcement* (ensuring there are mechanisms to make the law work in practice). These stages map on well to the first Council Directive 92/59/EEC on

[1] H-W Micklitz, T Roethe and S Weatherill (eds), *Federalism and Responsibility: A Study on Product Safety Law and Practice in the European Community* (London, Graham & Trotman, 1994).

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_25,

general product safety[2] (adoption), the second Directive 2001/95/EC[3] (refinement) and the third proposed Regulation[4] (further refinements and enforcement). Future-proofing is also present in the latest Proposal as the Commission gives itself the powers to decide whether, for example, certain products need to adhere to a traceability system.

Second, the use of soft law and co-regulation. This is evident in the integration of standardisation into the process. Further examples of soft law include the use of guidelines.[5]

Third, the increasing emphasis on enforcement, which is also prominent in Commission consumer policy strategy documents.[6] This is again something close to Hans Micklitz's heart and which I have had the pleasure to work with him on in practical projects such as the Consumer Justice Enforcement Forum (COJEF)[7] and the Consumer Law Enforcement Forum (CLEF).[8]

The structure is to first set out the basic principles in the first Directive in Sect. 25.2. Section 25.3 describes the main trends in refining and developing those basic principles. Section 25.4 evaluates the attempts to enhance enforcement. An assessment of the history of the General Product Safety Directive is made in Sect. 25.5 and favourable comparisons drawn with the Product Liability Directive.[9]

25.2 Adoption

Prior to 1992 the EU had been engaged in a gradual process of developing common standards for products. Initially this had been painfully slow as products were dealt with one at a time and in great detail. The push to create the single market gave rise to a new impetus to develop harmonised technical norms. Under the new approach[10] directives dealt with categories of products (e.g. toys[11]) and set down safety expectations in broad terms backed up by annexes containing essential safety

[2] Dir 92/59/EEC on general product safety [1992] OJ L 228/24 (General Product Safety Directive 1992). For detailed discussion of the 1992 Directive see G Howells, *Consumer Product Safety* (Aldershot, Ashgate, 1998) Ch 2.

[3] Directive 2001/95/EC on general product safety [2002] OJ L 11/4 (General Product Safety Directive 2001). For consideration of the reforms see D Fairgrieve and G Howells, 'General Product Safety—a Revolution Through Reform?' (2006) 69 *MLR* 59.

[4] Proposal for a Regulation on consumer product safety, COM(2013) 78 final.

[5] See text at Sect. 25.3.2.

[6] See e.g. Commission, 'EU Consumer Policy Strategy 2007–2013: Empowering consumers, enhancing their welfare, effectively protecting them', COM(2007) 99 final, which continued the emphasis in the previous strategy to promote better enforcement and redress.

[7] For information about COJEF see http://cojef-project.eu.

[8] Project guidelines available at www.cojef-project.eu/IMG/pdf/d_CLEFfinalguidelines_76647.pdf.

[9] Dir 85/374/EEC concerning liability for defective products [1985] OJ L 210/29.

[10] Council Resolution on a new approach to technical harmonisation and standards [1985] OJ C 136/1.

[11] Dir 2009/48/EC on the safety of toys.

requirements which were in turn fleshed out by CEN standards.[12] Producers could choose to adopt the standards or alternatively find their own way to achieve the required level of safety. There is now a 'New Legislative Framework for the marketing of products'. This comprises:

1. Regulation (EC) No 764/2008[13] laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State ensures that the application of technical rules in non-harmonised areas does not unduly impede trade.
2. Regulation (EC) No 765/2008[14] sets out the requirements for accreditation and market surveillance relating to the marketing of products and in particular sets out the criteria for national accreditation bodies.
3. Decision No 768/2008/EC[15] on a common framework for the marketing of products sets out the requirements for conformity assessment and the CE mark.

However, notwithstanding the development of new approach directives there were always consumer products outside their scope and even some of those vertical directives only covered aspects of safety regulation; typically many did not have post-marketing rules on matters such as notifying the Commission of risks. Therefore in the early 1990s the General Product Safety Directive 92/59/EEC (hereafter 1992 Directive) was adopted.

The 1992 Directive covered all consumer products where no specific Community regulations existed and imposed the obligation to ensure products placed on the market were safe. Without going into detail the safety standard has always required that products under normal or reasonably foreseeable conditions of use 'do not present any or only the minimum risks compatible with the product's use'.[16] A range of factors have been specified as relevant as regards compliance with the following of certain norms being either deemed or presumed to show compliance.

Producers were of course under this general safety obligation, which also included obligations to inform consumers of risk and to keep themselves informed of the risks posed by their products. Distributors also had to act with due care within the limits of their respective duties. Enforcement was targeted at the party responsible for the first stage of distribution on the national market. Member States had to ensure there was a national authority to monitor product safety equipped with the necessary powers. This meant that there had to be some national enforcement, but in practice the level of resourcing varied markedly between states. Two separate notification routes for Member States to communicate to the Commission product safety incidents were established depending upon whether or not there was a serious and immediate risk. The Commission had the power to intervene and establish a temporary rule by decision where Member States had taken different approaches to a product safety issue.

[12] CEN is the European Committee for Standardization; these standards are then reproduced as national standards.

[13] [2008] OJ L 218/21.

[14] [2008] OJ L 218/30.

[15] [2008] OJ L 21/82.

[16] General Product Safety Directives, Art 2(b).

In 2001 the new General Product Safety Directive 2001/95/EC was adopted (hereafter 2001 Directive). This overhauled the 1992 Directive making some refinements to the original provisions as well as introducing some new elements. The latest proposals are for a Regulation on Consumer Product Safety[17] (hereafter 2013 CPS Regulation Proposal) and a Regulation on Market Surveillance of Products[18] (hereafter 2013 Market Surveillance Regulation Proposal), which suggest some further refinements. Also the enforcement is separated from the substantive rules in an attempt to align it with other enforcement functions related to the marketing of products. Some of the main points of discussion are considered in the next section.

25.3 Refinements

25.3.1 Scope—Migrating Products and Products Supplied in the Course of a Service

One early need for clarification concerned whether products intended for the commercial market but which had migrated to be used by consumers were to be covered. Examples include large fireworks intended for commercial displays or heavy duty DIY hire equipment. They were clearly brought within the scope by the 2001 Directive adding the italicised words to the definition of product which now refers to products 'intended for consumers or likely, under reasonably foreseeable conditions, to be used by consumer *even if not intended for them.*'[19]

There had also been uncertainty as to whether products used in the course of providing a service to customers were included. The 2001 Directive brought them within the scope, but only to the extent they were used by consumers. Recital 9 of that Directive made it clear that this also meant that the safety of the equipment used by service providers and the equipment on which consumers ride or travel if operated by the service provider belong to service safety and are excluded from the Directive. Thus the escalator in a department store would not be covered. My reading was also that, for example, a shampoo selected and applied by a hairdresser would also not be covered as it would not be used by the consumer herself. By contrast gym equipment used by the consumer would be covered. The 2013 CPS Regulation Proposal makes it clear that it intends to cover all products which consumers are exposed to in the context of a service provided to them.[20] Thus the shampoo applied by the hairdresser would be also covered. Recital 6 seems to narrow the scope to products consumers are 'directly' exposed to. Probably the exclusion is intended for trade equipment, such as ramps and equipment in garages that might fail or explode and cause collateral damage to consumers. It seems the proposed rules would be broad enough to cover technical equipment used on consumers e.g. a dentist's drill

[17] COM(2013) 78 final (n 4).

[18] Proposal for a Regulation on market surveillance of products, COM(2013) 75 final.

[19] General Product Safety Directives, Art 2(a).

[20] 2013 CPS Regulation Proposal, Art 2(1)(c).

or the hairdresser's dryer, as consumers are certainly directly exposed to them. The one exception that recital 6 maintains is for 'equipment on which consumers ride or travel which is operated by a service provider' so escalators would still be excluded. However, there will be a decided broadening of the scope.

25.3.2 Relationship with Vertical Harmonisation Directives

One of the most complex issues is the relationship between the 'horizontal' General Product Safety Directive and the 'vertical' specific sectoral directives. The 2001 Directive clarifies that the General Product Safety Directive should apply where there are no specific Community laws with the same objective or where there are specific Community provisions but they do not cover the specific aspects and risks or categories of risks. The 40 page *Guidance document on the Relationship Between the General Product Safety Directive and Certain Sector Directive with Provisions on General Safety*[21] underlines the difficulty in drawing a clear demarcation line and acknowledges there is scope for interpretation about what the Directive means when it refers to 'aspects and risks or categories of risks'[22] not covered by the specific rules. The 2013 CPS Regulation Proposal tries to draw a clearer distinction. It is helped by the 2013 Market Surveillance Regulation Proposal applying to all products covered by Community legislation. The general provisions in part 1 of 2013 CPS Regulation Proposal setting out the general safety requirement would apply even to products covered by other EU harmonised legislation, which are only exempted from the following chapters on implementing the general provisions. However, there would be a presumption of safety as regards risks covered by Union harmonised legislation designed to protect human health and safety if those requirements are conformed to. A presumption is less strong than compliance being deemed, but in most cases should remove the need to invoke the 2013 CPS Regulation. Interestingly, under the proposals there are presumptions of safety also for compliance with European norms or standards and also national health and safety requirements under the 2001 Directive the latter were deemed compliant rather than merely presumed to show compliance.

25.3.3 Standards in Assessing Conformity

Standardisation has always played an important role under the new approach directives and in the original 1992 Directive standards were to be taken into account when assessing safety.[23] The role of standards was enhanced in the 2001 Directive as compliance with voluntary national standards transposing relevant European

[21] Available at http://europa.eu.int/comm/consumers/cons_safe/prod_safe/gpsd/guidance_gpsd_en.pdf.

[22] General Product Safety Directive 2001, Art 1(2).

[23] General Product Safety Directive 1992, Art 4(2).

standards led to a presumption of safety.[24] It also set down a procedure for European standards to be adopted, compliance with which will provide a presumption of conformity.[25] Standardisation has become an ever more important element in product safety, with the EU placing faith in the involvement of industry to produce standards that ensure safety, whilst allowing for innovation and competitiveness. It also generates rules more cheaply and more speedily than traditional law-making allows. This favouring of co-regulation is again present in the 2013 CPS Regulation Proposal, with products complying with European standards published in the Official Journal and adopted under set procedures set out in the draft Regulation again benefiting from a presumption of safety; whereas other European standards shall be taken into account when assessing safety.[26] The procedure for adopting standards in relation to the general safety requirement found in articles 16 and 17 of the 2013 CPS Regulation Proposal fits into the general EU framework on standardisation which is now found in Regulation 1025/2012 on European Standardisation.[27] It also would also incorporate the right of Member States or the European Parliament to object to standards in a similar manner to that provided for by Decision 768/2008/EC.[28]

25.3.4 Marketing Obligations

Another evolution has been the trend to require better procedures by economic operators both to ensure products are produced safely in the first place, but then also to be able to monitor them and deal with any issues arising. The 2013 CPS Regulation Proposal increases the specificity of these obligations. Possibly the most contentious new measure is the proposed requirement for manufacturers to produce a technical document.[29] What this needs to contain depends on the nature of the products as the list of contents for such a document is prefaced by the words 'as appropriate'. Also the primary obligation is said to be subject to a test of what is 'proportionate to the possible risks.' It is unclear whether this would permit producers to dispense altogether with the need for a technical document for some low-risk products. It is the uncertainty about the scope of this obligation which businesses find disconcerting. The technical documentation will have to be kept for 10 years as will information as to economic operators to whom or from whom the product was supplied.[30]

There is also uncertainty as to how widely the Commission will seek to use its proposed new powers to require specific products to adhere to a system of

[24] General Product Safety Directive 2001, Art 3(2).

[25] General Product Safety Directive 2001, Art 4.

[26] 2013 CPS Regulation Proposal, Arts 5(b) and 6(2)(b).

[27] [2012] OJ L 316/12.

[28] Decision No 768/2008/EC on a common framework for the marketing of products [2008] OJ L 218/82.

[29] 2013 CPS Regulation Proposal, Art 8(4).

[30] 2013 CPS Regulation Proposal, Art 14.

traceability.[31] This is aimed at products that are susceptible to posing a serious risk to health and safety.

The 2013 CPS Regulation Proposal also places new specific obligations on importers,[32] who are defined as natural or legal persons within the Union who place a product from a third country on the Union market.[33] Under the 2001 Directive importers had been classed as producers but only when the manufacturer did not have a representative in the Community.[34] This provision making clear the obligations of importers is no doubt intended to reassure European consumers after a number of scares relating to products from third countries, often China. There have also been criticisms that the proposed indication of origin obligation[35] is more a desire to protect European markets from competition from countries like China than having any necessary connection with safety.

Just as the standardisation rules sought to align themselves with the Standardisation Regulation, the marketing rules fit into the framework of Decision 768/2008/EC on a common framework for the marketing of products.

25.3.5 Recall

Probably the most controversial aspect introduced by the 2001 Directive was the recall provisions. This, combined with the introduction of duties on traders to report safety concerns,[36] seemed to borrow from the US experience.[37] The 1992 Directive had simply talked about withdrawing unsafe products from the market, and whilst this encompassed goods under the control of the supplier it was not apt to impose any obligations with respect to goods in the hands of consumers. This was clearly inappropriate as that is where there is the most immediate and obvious threat to consumer safety. The 2013 CPS Regulation Proposal imposes requirements on manufacturers, importers and distributors to recall where appropriate.[38] The power of regulators to recall where economic operators have failed to do so is found in the new 2013 Market Surveillance Regulation Proposal.[39] The 2001 Directive stipulates that recalls should take place solely 'as a last resort'[40] and whilst that is not expressly stated in the new Regulations it is still likely to be the case and in practice authorities will seek to work with economic operators to resolve emergencies keeping their powers in reserve.

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[31] 2013 CPS Regulation Proposal, Art 15.

[32] 2013 CPS Regulation Proposal, Art 10.

[33] 2013 CPS Regulation Proposal, Art 3(6).

[34] General Product Safety Directive 2001, Art 2(e)(ii).

[35] 2013 CPS Regulation Proposal, Art 7.

[36] See text at Sect. 25.3.6.

[37] Fairgrieve and Howells, 'General Product Safety'.

[38] 2013 CPS Regulation Proposal, Arts 8(9), 10(7) and 11(5).

[39] 2013 Market Surveillance Regulation Proposal, Art 10.

[40] General Product Safety Directive 2001, Art 8(2).

Recall obligations are always disconcerting both for economic operators and regulators. For economic operators they interact both with product liability insurance cover (as insurers may wish to be involved in decision-making on recalls and this may affect insurance cover) and their relationship with consumers which they want to control as much as possible. Regulators also fear the traders may seek to place the responsibility for deciding whether or not to recall on them. However, economic operators cannot avoid their responsibilities in this way.

25.3.6 Duty of Producers to Notify

Possibly the most important change in the relationship between regulator and industry arose from the duty imposed by the 2001 Directive on producers and distributors to notify enforcement authorities where their products pose risks to consumers because they are incompatible with the general safety requirement.[41] This obligation is similar to the long standing reporting obligations that s 15 of the Consumer Product Safety Act[42] places on businesses in the United States. However, it is more extensive. In the US the obligation arises when a product fails to comply with a consumer product safety rule, a voluntary standard relied upon by the Consumer Product Safety Commission, contains a defect which could create a substantial product hazard or creates an unreasonable risk of serious injury or death. The 2001 Directive covers any risks caused by failure to comply with the general product safety requirement. The potential breadth of this reporting obligation could place an intolerable burden on businesses and regulators. To help prevent this, the EC has developed Guidelines on when notification is necessary and how it should be made.[43] Although the guidance cannot avoid the obligation to report every non-isolated breach of the general safety requirement it spells out what has to be considered before a product is found to have failed to meet that requirement. It considers what can be done to prevent both producers and distributors notifying and to facilitate notification only in the state in which the trader is established. Moreover it expands in great detail on what amounts to isolated circumstances under which notification is not required. This covers situations where the producer or distributor has solid evidence to conclude that the risk has been fully controlled and its cause contained and dealt with and notification would be of no interest to the authorities (for example, malfunctioning of a production line, errors in handling and/or packing).

The 2013 CPS Regulation Proposal contains the duty of manufacturers, importers and distributors to inform authorities of products that are not safe and of any corrective action.[44] Supporting obligations are found in 2013 Market Surveillance Regulation Proposal.[45] The 'isolated circumstances' exemption is replaced

[41] General Product Safety Directive 2001, Art 5(3) and Annex I.

[42] Codified at 15 USC §§ 2051–2084.

[43] Available at http://europa.eu.int/comm/consumers/cons_safe/prod_safe/gpsd/notification_dang_en.pdf.

[44] 2013 CPS Regulation Proposal, Arts 8(9), 10(7) and 11(5).

[45] 2013 Market Surveillance Regulation Proposal, Art 9(3).

by exemptions where only a limited number of well-identified products are not safe; it can be demonstrated that the risk has been fully controlled and cannot any more endanger the health and safety of persons or the cause of the risk is such that knowledge of it does not represent useful information for the authorities or public.[46] These conditions can be specified in implementing acts by the Commission, which can also by delegated act exempt products, categories or groups of products with low risk.

25.3.7 Duty of States to Notify

The 1992 and 2001 Directives had adopted a bifurcated notification procedure with less serious or localised actions taken by enforcement authorities being handled under a separate procedure to the 'Rapid Exchange of Information System' (RAPEX) procedure for serious risks.[47] Under the 2013 Market Surveillance Regulation RAPEX will become the sole notification procedure for all risks, but it will not cover situations where the effects of risk do not go beyond the Member State. This is probably a sensible move for at times there had been technical refusals to receive information under RAPEX, where there would in any event be an obligation to notify under the alternative procedure.[48] There was evidence of a disparity of notification practices between states.[49] Such technical issues are only likely to deter notifications, which risk being a low priority when officials are dealing with day-to-day incidents close to home. The various different notification procedures have already come to share a common IT platform: General Rapid Alert System (GRAS = RAPEX). Also the RAPEX-China system is used to inform the Chinese authorities as to which of their products have been subject to regulatory action.

25.3.8 Community Legislative Procedures

The 1992 and 2001 Directives provided a procedure for Community decisions where there were serious risks and Member States took different approaches. Such decisions can have effect for up to a year. This time limit has, however, proven

[46] 2013 CPS Regulation Proposal, Art 13(1).

[47] In the General Product Safety Directive 2001 see Arts 11 and 12 and Annex 2.

[48] In 2013 of the 2278 notifications 104 were deemed not to present a serious risk and hence distributed under alternative procedure, whereas 236 were distributed for information only as they did not satisfy the criteria for either distribution procedure: European Communities, *Keeping Consumers Safe: 2012 Annual Report on the operation of the Rapid Alert System for non-food dangerous products* (Luxembourg, Publications office of the European Communities, 2013) 14. The Annual Report is available at http://ec.europa.eu/consumers/safety/rapex/docs/2012_rapex_report_en.pdf.

[49] In 2012 five countries accounted for 56% of all notifications: Hungary (294 notifications, 15%); Bulgaria (271 notifications, 14%); Spain (199 notifications, 10%); Germany (167 notifications, 9%); and United Kingdom (146 notifications, 8%): *RAPEX 2012 Annual Report*, ibid, 15.

problematic.[50] The 2013 Market Surveillance Regulation Proposal would provide the means to act against products presenting a serious risk. Such measures could include measures prohibiting, suspending or restricting the marketing of such products. The risk must be one that cannot be contained satisfactorily by means of measures taken by Member States or under other procedures. There is no requirement that Member States have taken different approaches. Therein lies a potential problem for it might be that the matter could be addressed at the Member State level but in different ways that cause internal market problems. To ensure the provisions meet the internal market objectives that lie at the heart of the current Community decision-making power, it would require the concept of 'satisfactory containment' to include an internal market as well as health and safety dimension. There is no time limit for the rules adopted under this procedure save for those within the scope of REACH[51] where the laws will have a 2 year maximum duration.

25.4 Enforcement

Enforcement is currently spread across three instruments:

1. The General Product Safety Directive;
2. Regulation (EC) No 765/2008[52] setting out the requirements for accreditation and market surveillance relating to the marketing of products; and
3. Sector specific legislation (which increasingly refers to Decision No 768/2008/EC 2008 on a common framework for the marketing of products).

This tripartite system was criticised by the *Schaldemose* EU Parliament Report on the *Revision of the General Product Safety Directive and Market Surveillance*.[53] The 2013 Market Surveillance Regulation Proposal seeks to ensure that the same controls as far as possible are applied to all products whether consumer or non-consumer, harmonised or non-harmonised. Indeed article 1 of the Proposal is very broad in scope referring to 'a framework for verifying that products meet requirements which safeguard, at a high level, the health and safety of persons in general, health and safety in the workplace, consumer protection, the environment, public security and other public interests.' This wording may need to be finessed as it is understood it is not intended to apply to all consumer protection rules (i.e. it would not cover unfair commercial practices law), but the general drift is clear and to be welcomed.

[50] Commission, 'More Product Safety and better Market Surveillance in the Single Market for Product', COM(2013) 74 final.

[51] Reg 1907/2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) [2006] OJ L 396/1.

[52] [2008] OJ L 218/30.

[53] 24/2/2011, A7-0033/2011.

The 2013 Market Surveillance Regulation Proposal is aimed at public authorities, although it contains a few rules relating to economic operators, such as those requiring them to make information available to market surveillance authorities.[54] It sets out the duties of market surveillance authorities, the powers they should have to require economic operators to take action and the power they should have to act themselves. It provides the Union with the power to assess measures taken at national level with regard to harmonised legislation in order to decide whether the measure is justified and therefore should be applied throughout the Union or unjustified and in need of being withdrawn. As already noted, the Union will be able to take action against products presenting a serious risk.[55]

The RAPEX provisions will be included in this measure.[56] It also provides for maintaining an Information and Communication System for Market Surveillance (ICSMS)[57] and for exchange of confidential information with third countries and international organisations.[58] There are provisions for co-operation and mutual assistance[59] central to which is the European Market Surveillance Forum (EMSF).[60] The Commission can also assist by designating Union reference laboratories for specific products, categories or groups of products.[61] It also has powers to finance activities assisting enforcement.[62]

Effective enforcement is the Achilles' heel of European consumer policy. This Proposal seeks to provide a more effective legal framework, but also it is important that at a national level enforcement is seen as a priority and properly supported. The Proposal should be commended for seeking to be pro-active in taking steps to ensure Member States fulfil their obligations. Differential commitment of resources to market surveillance as between the Member States had been recognised as a problem.[63] In addition to the measures listed above it is noticeable that every year Member States have to report to the Commission on how they have monitored market surveillance activities and external border controls[64] and at least every 4 years Member States will need to develop a market surveillance programme.[65] This will set out the organisation of relevant authorities, an indication of their priority areas and importantly the financial resources, staff, technical and other means at their disposal. These measures will give the Commission the means to monitor the engagement of Member States.

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[54] 2013 Market Surveillance Regulation Proposal, Art 8.

[55] See text at Sect. 25.3.8.

[56] 2013 Market Surveillance Regulation Proposal, Arts 19 and 20.

[57] 2013 Market Surveillance Regulation Proposal, Art 21.

[58] 2013 Market Surveillance Regulation Proposal, Art 22.

[59] 2013 Market Surveillance Regulation Proposal, Arts 23–24.

[60] 2013 Market Surveillance Regulation Proposal, Art 25.

[61] 2013 Market Surveillance Regulation Proposal, Art 28.

[62] 2013 Market Surveillance Regulation Proposal, Art 29.

[63] Schaldemose, Revision of the General Product Safety Directive (n 53) 12.

[64] 2013 Market Surveillance Regulation Proposal, Art 4(3).

[65] 2013 Market Surveillance Regulation Proposal, Art 7.

In addition to these obligations under the Proposal, the Commission has set out a clear agenda for improved enforcement in its Communication, *20 actions for safer and compliant products for Europe: a multi-annual action plan for the surveillance of products in the EU*.[66] This has several strands. Some are aimed at making the surveillance of products more efficient: such as facilitating the portability of test results within the Union; maximising the benefits of ICSMS; developing a common approach to risk assessment; and facilitating controls for high-tech and innovative products. Others are aimed at co-ordination of cross-border surveillance activities; creating an executive Secretariat for the EU market surveillance forum; promoting joint enforcement actions; encouraging exchange of officials and providing more support for Administrative Cooperation Groups; integrating European organisation representing consumers, SMEs and businesses; and studying more about products sold online. Measures are proposed to improve product traceability and for studying the option of developing compliance schemes. Professional, non-harmonised goods that are not subject to any European rules will also be studied. There are action points to improve controls on the entry of products into the Union.

This shows a real commitment to market surveillance and product safety on the part of the Commission which has the powers to finance several of these strands. Ultimately the effectiveness will depend upon the engagement of national authorities and the willingness of their governments to properly finance market surveillance. The obligation in the 2013 Market Surveillance Regulation Proposal for Member States to draw up a general market surveillance programme is crucial. The multi-annual plan backs this up by requiring the development of key performance benchmarks of market surveillance. This is necessary if all states are to be held to account and required to show equal commitment to the safety of EU citizens. Whether it will ensure these services are probably funded, especially in the less affluent Member States, is yet to be seen. However, whereas the 1992 Directive forced states to have such an authority there is now a clear determination to make sure this authority functions at a level that assures the safety of EU citizens. The Commission will be challenged to ensure that this excellent package of rules is backed up by rigorous monitoring and enforcement action against those Member States that fail to meet their commitments. The key message behind this package is that success depends upon good laws, good enforcement structures but also crucially resources to back them up.

Finally, there are key new powers to enhance border controls against imported products that pose a risk.[67] This is a response to increase imports, including products bought over the internet. There is a high incidence of reports about Chinese products[68] with some high profile cases of potentially dangerous imports.

[66] COM(2013) 76 final.

[67] 2013 Market Surveillance Regulation Proposal, Arts 14–18.

[68] For example in 2012 58% of RAPEX notifications concerned Chinese products: See *RAPEX 2012 Annual Report* 11.

25.5 Evaluation and Comparison

Academic commentaries, like news reports, normally focus on the bad news of what is wrong with the world. By contrast on the whole the General Product Safety Directive history is a good news story. There is a broad consensus that its objectives are valuable and that Member States and the Commission need to work effectively in a co-ordinated manner to achieve its goals. There have been some issues over the years, but the Commission has shown itself willing to engage and refine its laws and practices. The current concerns with the recent Proposals focus on the lack of certainty over some of the provisions, which gives the Commission a lot of leeway as to how they interpret the obligations against economic operators. Hopefully these can be addressed as the measures move towards adoption or by use of Commission guidance. The Proposals have managed to integrate their rules it into a common framework for both standardisation and the New Legislative Framework for the marketing of products. This allows it to achieve its goals of co-regulation, in which context one should note the Commission's judicious use of guidelines in complex areas. It is showing a keen determination to ensure that laws are enforced both at the Union's borders and internally. It will be interesting to see how this is managed going forward especially with respect to those Member States with limited resources to deploy on consumer protection services.

One cannot fail to note the contrast between the on-going review and revision of the General Product Safety Directive, with the relative inertia as regards the Product Liability Directive. The explanations for this difference may be complex. One suspects the truth is that the Commission does not want to disturb product liability law for fearing of awakening concerns about a litigation crisis. By contrast product safety involves more technical reforms and many of them come to light as officials deal with them on a daily basis, whereas product liability law is now dealt with by practitioners and many cases may not even reach the courts. Nevertheless, one cannot help but feel that responsibility for the Product Liability Directive looks strangely isolated in DG Enterprise and Industry, whereas its more natural home might be in DG SANCO alongside the General Product Safety Directive or DG Justice alongside other private law consumer protection directives. Moving it to the same team that has dealt so skilfully with product safety and which has consumer protection at the heart of their mission, might at least give consumers confidence that their needs are fully taken into account. DG Enterprise and DG SANCO seem to have worked together on the current set of proposals and hopefully they can be persuaded jointly to review product liability law.[69]

Acknowledgments Thanks to Peter Cartwright for his comments on an earlier draft. Also many aspects of my knowledge on this topic have benefited from discussions with Duncan Fairgrieve.

[69] D Fairgrieve, G Howells and M Pilgerstorfer, 'The Product Liability Directive: Time to Get Soft?' (2013) 4 *Journal of European Tort Law* 1.

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Chapter 26
To the Question of What Should be and What is—Plans and Actuals

Thomas Roethe

Abstract Hans Micklitz' research has been occupied by a ghost-like entity in the form of the irritating 'brute facts' and 'faits sociaux' that creep in from the outside, from society, into reality and into the considerations of legal theory. It follows no general principle, but nevertheless still always come into the plan, when law and social reality are to be considered. This is the stage of private law, in particular consumer law, which also, if needed, easily and elegantly also puts light into public law and criminal law. I will weave the concept of the consumer as a supernumerary like-protagonist and consumer law totally wrongly a residual category until the middle of the past century, when the President of the United States of America, Kennedy declared the fundamental freedoms of the consumers that radiated out into the whole western world and appeared with cheers and rejoicing.

We have a guest of honour. It is not difficult to honour him—he has gained manifold merits. The catalogue of his publications reaches a limit of what is hardly to be managed. Students sigh under the burden of the thoughts. Colleagues try to inspiringly keep up with him. The citation index is right. So much now for the songs of praise.

But there is a completely different side to him that lays hidden behind this esteem. I am not talking of the conscientious work, of the unconditional impulse to get to the bottom of jurisprudence, to research its ramifications, its confusions and its aporias—I want to speak about the 'faits sociaux' (Durkheims intersective reality that is time and time again astonishing) or the 'brute facts' (Searle's nearly unavoidable almost 'physical facts' in social clothing), that often lie far beyond the law and his occupation with it, that only take effect between the 'law in the books'and the social reality, that from case to case make their presence felt or even assert their dominance, cause amazement, bewilderment and perplexity, without ever being recognized and thus can themselves finally be made the subject of curious legal research.

To put it differently, all of these thoughts and all of this research is subject to the activity of a third party, a ghost-like entity and I mean the irritating 'brute facts' and 'faits sociaux' that creep in from the outside, from society, into reality and into

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*, Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_26,

the considerations of legal theory, follow no general principle, but nevertheless still always come into the plan, when law and social reality are to be considered.

Which stage do we have before us? The stage of private law, in particular consumer law, which also, if needed, easily and elegantly also puts light into public law and criminal law. The consumer as a supernumerary like-protagonist and consumer law totally wrongly a residual category until the middle of the past century, when the President of the United States of America, Kennedy declared the fundamental freedoms of the consumers that radiated out into the whole western world and appeared with cheers and rejoicing.

Already before that, for example through Vance Packard's *The Hidden Persuaders*[1] had become known that wanted to take possession of a subject that was only constituted for the legal reality at this time.

Was that without prerequisites?

No, even earlier in the nineteenth century housewife organizations and consumer cooperative societies had formed that stood by the troubled manual workers and white-collar employees, when it was necessary to be able to expend their lives halfway cost-efficiently.

It was therefore about poverty and the possibility of somehow making ends meet within the capitalistic manner of production. It was still about the question of the classes, not the question of consumption that even Marx himself did not notice in this form. The worker received his restitution salary, with which he and his family had to budget cleverly, if that was at all possible—for the sake of good order I note—it was always the women who managed the small budget.

Tempus fugit, and already approximately 100 years after Marx the consumer appears as the actor in the western world, who has a surplus to be proud of and then the astonishing realization prevails that we are all consumers, even children, geriatrics, the unemployed—removed from the production process—we experience their esteem according to the volume of their piggy banks, therefore not members of a fixed class society, not members of professions, not members of strata, but highly individualized market participants, who now universally insure themselves of a market that they themselves first made possible, who have needs that have to be fulfilled, that they themselves have to make come true.

An idea of eternal peace?

But that is not all, governments also understand with all parliaments this simple truth and try to offer the consumers protection with own ministries for this. Especially according to the Agreement, the EU citizen enjoys this protection within the European Single Market.

Protection—but from what?

The consumer, once appeared on the European market, now sees himself surrounded by possibly fraudulent vendors, who mirror his own face. I'll shorten that

[1] V Packard, *The Hidden Persuaders* (New York, McKay, 1957).

certainly, also consumers can deceive to a measure and live beyond their means so that the vendors' senses fade.[2]

The opposition, so often cited between the vendor and the consumer, becomes an intellectual farce. Structural opposites, such as Marx must have had them in mind, can no longer be spoken of in this sphere.

No, the actors on this market oppose one another and it seems to be agreed that there are optional comfortable asymmetries there that summon up simple or great enragement based on the misunderstanding that the maltreated consumer is the enslaved hard-worker of past centuries. No the consumer himself, whether as an employee or as the active producer, participates in everything that goes wrong. In reality, it is a symmetry that descends over the consumer and over the vendor.

Let us note: ideally it is the vendor, the entrepreneur, once the berated capitalist, who in consideration and sensitivity persuasively offers the enlightened consumer products, the acceptance of which only the consumer decides, who produced them himself (irrespective of the fact that a wide range of consumer products nowadays are produced in the far East).

Or, to put it differently, the enlightened consumer decides which products he wants to partake of.

Not only that, we all know the almost ridiculous market practices that want to talk us into buying a frying pan or a house and we also know the saying: 'mundum vult decipit'. We know the convincing salesman of illusions, last wonderfully described by Thomas Mann in *Felix Krull* and Gabriel Garcia Márquez in *100 years of solitude*, who were well-versed with commerce and intersubjectivity and with it put narrative rocks into the world of those, who did not want to perceive the deception, who wanted to challenge this and who therefore do not always defend themselves.

This as a prerequisite, therefore the autonomy of the one and the other, result now and again in terrible conflicts, as the sphere of production and the sphere of consumption that are ultimately operated by the working consumer give birth to fear that is astonishing.

It is about health. It is about safety. It is then also about money. In this secret arrangement, it is the 'whistleblowers', who then now and again reveal the disjunction between the organized process of production, commerce and the consuming society and thus bring something to light that every single one of the participants in any case already knew. Should we believe that the breast implants of the PIP company in France were filled with industrial silicone, without the knowledge of the one or the other person? Or may we trust that there are 'merely' unforeseen calamities that no one can exclude despite best intentions and that lead to expensive recall actions once in a while?

Wise legislators have all, for this reason, formulated laws, regulations and directives. Not only that, they have also created administrations that have to carefully

[2] The most diverse studies of indebtedness bear witness to this in all of their guilelessness. Micklitz and I have carried out two such studies with the summarized result—the debtors no longer understand what debt itself could be, they make claim to their universal right to consume.

check whether everything is above board. Producers and consumers can be reassured that everything has been thought of.

However, in spite of all regulations, contrary to all controls, this classless symbiosis of nuisance, endangerment, damage and trauma bursts out—and at least then should be decided by the law.

And the law reacts. The mass of the conflicts, the wealth of decisions that see the law exposed, beyond all legal theoretical and legal philosophical discourse call for social reality. Does the social reality have anything to contribute to this? If yes, in which way does it do this?

And now we finally speak of the empiricism.

Micklitz posed this question immemorial times ago (at the beginning of the 90s of the past century), when it was about emergency management between national authorities and the interaction with the EU Commission.

What had happened?

Office chairs had exploded and blew their owners' eyes out, Austrian wine was contaminated with glycol—poisoning was threatened, in Spain olive oil had been spiked with engine oil—there were deaths.

So what—and one could think that this kind of things just happen, that will be dealt with legally.

That was not the case for the economic and commercial law specialist, who intensively dedicated himself, among other things, to product safety and consumer law beyond 'liability' and 'tort'.

In these times, the sentence was heard: 'I am not really a proper jurisprudent'. It was said by Micklitz at that time. These words alone should have made me research-strategically suspicious and I now only come slowly to the conclusion … in a certain way the man is right. He is indeed a fully fledged legal expert, an always persistent legal philosopher and a penetrating researcher.

'I want to know what is going on there', and with that he meant the 'brute facts' of social reality. A scientific jurisprudent, who pays attention to reality beyond all academically ordered processes.

That had consequences.

Instigated by him, the EU reality had to be understood. Nonchalantly he instigated a research-practical impulse in this situation, in which everything seemed to have been taken care of.

We know that that is not right, since humanity is time and time again appalled by cases of emergency and in bewilderment asks itself the question again and again and naively, how such a catastrophe could happen at all, in a well-ordered European society obligated to risk avoidance.

Research therefore: With this impulse Micklitz takes the structural character of science and research by its honour. Scientific research, paid or expressed in a more distinguished manner—supported by the society, has to perform nothing else other than to examine and to criticize prejudice and certainties that are vital to keeping society going.

Research destroys and builds—we know this principle of constructive destruction from Schumpeter.

Now and again Micklitz is a destroyer and a persistent, eternal and never relenting oppositional mind. There are enough temptations to get out of the way of this destructiveness to find a position in being supported, to produce data inexpensively. We all know of this and as little as the world leaves us in peace, just as little does the 'Faust-like' research come to a standstill and thus such temptations bounce off of it.

So the 'Faust-like' Micklitz, who sometimes has a diabolic grin, takes research seriously.

And with research he means the crisis-ridden exacerbations, emergencies, indeed the research on the living organism of this strange structure of the European Community, not the repetition and fathoming of professorial treatise. He really means plan and actual situations.

A play on words which is overtly borrowed from the 'language' of technology that wants to determine tolerances in the smallest measures, with which a machinery works, the regulations of EU law and the national laws were to be examined in their effectiveness. Operating with two technical situations promises—if the corresponding instruments of measurement are there—not to encounter too many difficulties.

In social reality, however, and that is something that the cunning Micklitz must have anticipated, behind the plan situation of the law or the directive or the regulation, the actual situation of the application of the law and of law enforcement is hidden and thus also the whole range of human action, that is concerned with such administrative tasks and now and again destroys everything. Here, there are courageous characters, as well as anxious, curious biased and overwhelmed and of course also those who try to implement the letters of the law accurately into practical action and exactly for that reason do everything wrong and those who have to give way to ideological and/or powerful intrusiveness.

Let us take the 'emergency study' as a starting point that has found form under the title 'Federalism and Responsibility'. Let us find the topos of the 'crisis' as a central motive of the examination.

A note to this:

Epistemologically every action always refers to the disparity of making decisions and giving reasons. Every decision is preceded by an experience crisis that often is disguised in the clothes of routine. Those are all those habits and decision supports that can also be found in regulated stipulations, whether we should cross a road when the lights are red, if no car can be seen far and wide, that let the crossing of the road become a dangerous experiment and finally who we should marry, the person who is similar to us or the person who seems to be the complete opposite of us. Reasoning is often not available and nevertheless a decision has to be made.

The crisis therefore that demands decisions, with whatever potential for reasoning, is our continual companion in life, is seen in the plain light of day the normal situation of all of us and which in the experience crisis harbours the seed of something new.

Behind such an empirically practical approaching decision between plans and actual, that Mickitz in young years—reduced quasi technically—raised as a question, the dialectical problem of the normative setting with all structural options for evolving is hidden. Let us benevolently assume he then had really only focussed

on the possible divergence between normality and administerial execution, then we must find today that he opened up a pit without a recognizable bottom.

And then a third component interferes, in the form of 'brute facts' and 'faits sociaux', the distinguishing of which from one another would go too far here.

Not only that in this research even the standards and normality had to be questioned with respect to their structures of meaning and produce astonishing results—how can be understood, when it is said—a discovery of thoughts from long-gone times:

'The ASMW concentrates in its activity on the acceleration of scientific-technical development by means of high effectiveness of the State Metrology and the State Quality Control and on the increasing the effectiveness of the economy, in order to thus contribute to the improvement of the material and cultural standard of living of the population (…). To do this, it works closely together with the State Committee for Standardizing the Council of Ministers of the USSR.'

Not only that:

'The ASMW supports the political-ideological work in the areas of standardization, of metrology and of quality development (…).'

Yes, how is that to be understood? Hardly at all. Well it is not any question that standardization and scientific-methodical metrology can increase the effectiveness of the economy, and that if they really do it, then this is due to their effectiveness. The emphasis of the 'high' effectiveness has the logical prerequisite, if it is not only to refer to the quality control, with which different degrees can be imagined, that concurrent standardization and concurrent metrology also bring about practical effects that therefore the standard, as an uncontended standard, exists just as little as the fundamental metrology. This is at least a semantic paradox. Practically, however, that would lead to the ASMW determining, what seen according to what ideological agreement with the USSR, should constitute a metre. A metre of exactly 100 cm, or rather to define ideologically according to solidarity, the metre with 98–102 cm as adequate.

Without a doubt we are dealing with the law of the former GDR[3]—a massively direct socialistic dictatorship of happiness and find out—standards remain contrary to their claim to normativeness by all means fluctuating.

I take that only as an irritating example of standardization that is unsettling.

What does that mean for the plan structure?

We should not be appeased by the thought that such laws that are expressly based on an ideological reassurance have long since been overcome—and Micklitz too does not trust this peace.

Micklitz also does not trust the regulations of the independence of national agencies set by the EU that should dedicate themselves to the liberalization of the 'public services' with all of their skilful arrangements of independence.

What should it then mean if absolutely independent national regulative agencies for the telecommunications sector in the National States (NRA) are enthroned for

[3] Gesetzblatt der Deutschen Demokratischen Republik zum Amt für Standardisierung, Meßwesen und Warenprüfung, Berlin, 17 April 1975.

competition and competitiveness?[4] What attention will these agencies follow, as they are technically/scientifically and socially enthroned? How great is the freedom invoking influence of the EU Commission on such agencies, that owe their existence to the commission that bind their freedom and autonomy to the conditions of the matter and in no way to their national state or the EU, as purely 'technical' appointees, but at the same time also obliged to the competitive European Single Market? In what relation do they stand to the European umbrella organizations? What does such a directive intend? People as uprooted function machines in all Member States?

We will see.

One single sentence spoken by a high-ranking official of the EU Commission, by the same EU Commission that enforced this absolute independence as indispensable, declares, without any ideological embellishment, how this independence is to be understood:

'Independence must have its limits! It is the only way that the Commission can control the NRAs because the NRAs cannot independently of all national legal considerations or EU law considerations. There must be a limit to that.'[5]

We recognize plan-situations are now and again not what they promise to be normatively. The independence of the Telecom agencies (financed by the commercial providers) whose highest aim is to dissolve state monopolies and open up the free market, are found again in the custody, this time not under the ductus (I quote again—'To do this, it works closely together with the State Committee for Standardizing the Council of Ministers of the USSR'), but with the EU Commission that has to put limits on the proliferation of independence.

Of course I know that everything is not comparable, as apples and pears may not be compared, but as fruit they need to controlled and if we keep the thought present '*The ASMW supports the political-ideological work in the areas of standardization, of metrology and of quality development*', then we notice how already the plan situation is technically no longer a legally binding agreement, but means a direct complicity via 'brute facts', that intervenes deeply in the plan reality.

After we have touched upon the perils of the plan situation, which presses for its fulfilment in the actual situation, we have come to the considerations of the actual situation, which find their place in a continuum of time and space and find there time and again astonishing interjections between subject and object that were called to attention:

Depending on the way of looking at things, the persons acting are agents of the desired objective order, executors of the over-individual standard (see above: People as uprooted function machines) in all Member States? But at the same time interpreters of exactly these standards in all of their actions.

And exactly in these dialectics, the refinement of the Micklitzstic considerations reveals itself and his demands upon the epistemic inquisitiveness of his scholars:

[4] Art 3(2) and Recital 11 of the Framework Directive.

[5] I take this transcription from Marta Cantero's empirical material.

'What does the reality do, which includes the reality of the standard-setters, with the standards that seem to have an 'objective' independent life?'

Let us go back to the times when these dialectics showed themselves for the first time in our mutual research and thus we return to research itself:

Also the actual situations have their calamities, which the Speaker of the EU Commission had his eye on, when he recognized the abysmal dangers of freedom, indeed not he alone:

When it was said in another interview with a member of an NRA:

'So, we do not receive directions when we are simply exerting core regulatory functions, but we can be asked to co-operate more actively with regard to public policies'.[6]

'Co-operate more actively' shows that there are trials to persuade independent agencies like ANACOM[7] to reflect the needs of national policy. 'Co-operate more actively' sounds very diplomatic and we may suppose the quest was formulated more directly, with what incentive, with what kind of threat if any?

On the performative level we recognize a fight between plan and actual situations, which presses for mergence that was not recognizable 20 years ago in this dimension, when it was about glycol wine and exploding office chairs.

Then the EU Commission was greatly worried about the happenings. It wanted research carried out as to the reasons for the failure of administrative national institutions and was itself vehemently interested in finding out what had happened. Thus research, listen carefully, and analyze what made this emergency situation possible.

Independent agencies and national administrations should now, with broken down experience on a similar level, avoid and withstand such questions? How does that happen?

It goes without saying, a political fight about the interpretation of the EU contracts, but it is also a fight for national private law in its fine, traditional and intellectual particularities, with which what is known as 'regulative' European Private Law tries to break through—and there are single representatives of such independent agencies who say the following:

'So, I try to see how things work in practice, you know? For instance, when I tried to analyze the impact of, let's say, redefining postal routes, I tried to analyze the impact of the model, but I also tried to do the route myself by foot and accompanying the post office clerk, to see how it works in practice. When I tried to see the impact of Next Generation Access Networks, I tried to do the fusion of fiber myself and to learn it before I take some decision on that field. So, I try to be an empiricist …' -who pace out every metre, who only serve the delivery of the privatized letter post, but who also check telephone and Internet connections, far from Brussels, in lonely and pathless terrain and make their own conclusions from that and seek to communicate them at a European level.[8]

[6] I take this transcription again from Maria Cantero's empirical material.

[7] The Portuguese national regulatory agency for telecom services.

[8] From Marta Cantero's material.

There are also even more touching examples: a young energetic women, who has to ensure product safety in one of the Baltic states, now and again is at the service of the European consumer, is the head of a public authority, a participant in countless international conferences where the plan situation and the corresponding national experiences are the subject, who is again and again in contact with the EU Commission, defends the standpoint of the European plan situation in her own country to the best of her ability, gives in an interview on the actual situation disturbing information. Plan and actual are different to what she says publicly, are not to be brought to congruence.

Within the effectiveness that she is entitled to and her vitality in her home land, the granular and also massive corruption and threats that she is told of day by day—and that is the actual situation in her country—she will not succeed in making the implementation and enforcement of EU standards more important in this than the antagonists from the economy and politics allow it to be from case to case.

When we presented this lady our analysis with the request that she inform us of factual errors and omissions, unexpectedly for us, she suddenly had fear for her life and asked us not to use this material.

Such experience is, for the academic researcher who is always obliged to data protection, a bitter experience that however shows two things:

The actual situation in friction with the plan situation, with the spontaneously appearing variables of the 'brute facts', has many different faces that do not simply comply to the jurisdiction but throw light on the presumptive cleverness of the law.

The empiricism propelled by Micklitz that is time and again directed to the reality of the inner lives of administrations of the one or the other kind that have to operate in the European area, who necessarily experience expansion with the expansions of the EU, that now advance into ethnological areas, that neither balk at the scientific experience crisis nor the veritable crises of the present days.

In the bi-polarity that seems simple between actual and plan situations, surprises are hidden that are only to be overcome with curiosity and moral courage.

'I want to know what is going on there', it echoes to courageous students and colleagues, who dare to get involved with this researcher and they become representatives of a legal science that paces out every metre, whether it is only 98 cm or even 102 cm long.

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Chapter 27
Standardisation *Prior to* or *Instead of* Information—A Fundamental Criticism of the (European) Information Model for Financial and Insurance Products

Hans-Peter Schwintowski

Abstract The following considerations attempt to show that the markets for financial and insurance products can only function if product standards are introduced into the markets, comparable for instance to the DIN standards we know in nearly all areas of technology in Germany. The introduction of standardisation is a necessary step for mass products such as financial and insurance products. Only then will it make sense to give additional and more detailed information, to ease and complete the product choice and the decision-making process. My thesis is: Standardisation prior to information—and not: Standardisation instead of information. That is to say the providing of information will always be an important requirement for a viable market for financial and insurance products. But if we do not succeed to implement standards, which virtually "guarantee" a high product quality, the information model will not be able to fulfil its function, simply because an absolutely essential condition for this model is missing: the assurance of a high quality by means of standardisation before information. This results in an ever increasing amount of complex information and ultimately in an "information overload", which does more harm than good to the market itself as well as its participants.

Hans-Wolfgang Micklitz, to whom this essay is dedicated, knows about the pitfalls of habit. Over the last 30 years we have endeavoured to turn the consumer into an *equal partner* in legal affairs by means of access to information. By giving him information—in particular before the conclusion of the contract—we enable him to make an independent and self-determined decision based on his or her private autonomy. In many ways *Hans-Wolfgang Micklitz's* life's work is shaped by the information model, with the help of which the European and the German legislators over the last decades have tried to turn the consumer into an equal partner. With the following considerations I want to try to show that we have "forgotten" an important step, without which the information model cannot work. This step is the *standardisation* of products. In a decentralized market economy, *access to information* is a requirement

The author would like to thank Cordula Modest and Viktoria Jank for the translation into English.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_27,

for the market participants' ability to make an autonomous decision.[1] However, given the increased complexity of today's products, it is more and more called into question whether the providing information can still ensure the functioning of the market.[2]

27.1 The Thesis

The following considerations attempt to show that the markets for financial and insurance products can only function if product standards are introduced into the markets, comparable for instance to the DIN standards we know in nearly all areas of technology in Germany. The introduction of standardisation is a necessary step for mass products such as financial and insurance products. Only then will it make sense to give additional and more detailed information, to ease and complete the product choice and the decision-making process. My thesis is: *Standardisation prior to information*—and not: Standardisation instead of information. That is to say the providing of information will always be an important requirement for a viable market for financial and insurance products. But if we do not succeed to implement standards, which virtually "guarantee" a high product quality, the information model will not be able to fulfil its function, simply because an absolutely essential condition for this model is missing: the assurance of a high quality by means of standardisation *before* information. This results in an ever increasing amount of complex information and ultimately in an "information overload", which does more harm than good to the market itself as well as its participants.

27.2 The Failure of the Information Model

27.2.1 General Policy Conditions Versus Prospectus

The failure of the information model starts with the question of how information is to be provided to the consumer. On insurance markets this is traditionally achieved by means of general policy conditions, while financial products are put on the market on the basis of prospectuses. General policy conditions are developed and placed on the market by insurers. They have been established increasingly since 1874 owing to the lack of an overall codification of insurance law.[3] Insurance—that

[1] BVerfG, 26/6/2002, 105 *Entscheidungen des Bundesverfassungsgerichts* 252; C Köhler, Die *Zulässigkeit derivativer Finanzinstrumente in Unternehmen, Banken und Kommunen* (Tübingen, Mohr Siebeck, 2012) 310; C Mehringer, *Das allgemeine kapitalmarktrechtliche Gleichbehandlungsprinzip* (Baden-Baden, Nomos, 2007) 40.

[2] Regarding the intransparently structured derivatives that started the financial crisis: Thesis by Köhler, *Die Zulässigkeit derivativer Finanzinstrumente*, 309 ff with further references.

[3] In more detail H-P Schwintowski, *Der private Versicherungsvertrag zwischen Recht und Markt* (Baden-Baden, Nomos, 1987) 40 ff; D Farny, 'AVB unter dem Gesichtspunkt der

is the safeguarding of an economic risk against payment (§ 1 Insurance Contract Act—*Versicherungsvertragsgesetz*, VVG) is the subject matter of the standard policy conditions; for this reason insurance is often—wrongly—understood as a legal product.[4] The combination of product description and additional general policy conditions is characterizing and typical for insurance markets. There is no similar combination for banks and saving banks (Sparkassen) or any other kind of product and service market. The cheque, the transfer, the loan, the bill of exchange or the deposit banking, to give some examples, are completely separated from the banks' and savings banks' standard terms and conditions, while shares, investment fund shares, bonds and other securities may only be put on the market by means of a prospectus (§ 3 German Securities Prospectus Act—Wertpapierprospektgesetz, WpPG). For other kinds of investments, like limited partner's shares or participating rights the same rule applies according to § 6 Investment Act (Vermögensanlagegesetz, VermAnlG).[5]

The insurers' general policy conditions were specified word for word by the Insurance Supervisory Authority until 1994.[6] Since the opening of the European market for insurance products, which was initiated by the judicature of the European Court of Justice (1994), they are developed and drafted by insurers, frequently on the basis of association recommendations. They are subject to a subsequent abuse control by the Federal Financial Supervisory Authority (BaFin) according to § 81 (1) Insurance Supervision Act (Versicherungsaufsichtsgesetz, VAG). Where securities and investments are concerned, there is an obligation to publish a prospectus. The WpPG and VermAnlG describe these requirements concerning the prospectuses in detail. No prospectus may be published before it is *approved* by the BaFin (§ 13 WpPG/§ 8 VermAnlG). However, the *accuracy of the information* stated in the prospectus is not verified by the BaFin. The BaFin limits its inspection to matters of completeness, comprehensibility and coherence (§ 13 (1) WpPG/§ 7 (2), 8 (1) VermAnlG).

The investor rubs his eyes in astonishment. If he purchases a unit-linked life insurance, the insurer creates the product description and the accompanying general policy conditions independently and entirely uninfluenced by the supervisory authority. If he purchases a comparable fund product from a bank or an investment house, an elaborate prospectus and a previous approval by the BaFin is needed. The question of why there are two different ways to place structurally comparable products on the market is not debated or even recognized as a question of law in either German or European law.

For the investor this distinction is hardly comprehensible—between the general policy conditions on the one hand and the prospectuses for financial products on the other hand lies a world of difference. While approving the prospectus the BaFin is supposed to make sure it is *comprehensible*—in spite of this requirement the prospectuses

"Produktbeschreibung"' (1975) *Zeitschrift für die gesamte Versicherungswissenschaft* 182; M Dreher, *Die Versicherung als Rechtsprodukt* (Tübingen, Mohr Siebeck, 1991) 160 ff.

[4] This is the title of the habilitation thesis by Dreher, ibid; also H Eidenmüller, 'Recht als Produkt' (2009) *Juristenzeitung* 641.

[5] Regarding the products on the grey capital market, especially closed investment funds, in more detail H-P Schwintowski, 'Neues Recht für Vermögensanlagen- und Finanzanlagenvermittler' (2012) *Neue Wirtschafts-Briefe—Zeitschrift für Steuer- und Wirtschaftsrecht* 996.

[6] In more detail Schwintowski, *Der private Versicherungsvertrag*, 63 ff.

are generally published as a *book* of 60 to 80 pages. The insurers have adapted this practice: their standard policy agreements are constructed increasingly complicated and differentiated and the documents easily reach a length of 40 to 60 pages.

Investors trust financial products to be of high quality because the BaFin has approved them. The legislator wants to relieve the BaFin from liabilities—which in turn would lead to a government liability—and ensures that the BaFin indicates that accuracy of the information is not subject to the BaFin's inspection. For the public this is neither comprehensible nor understandable. Marketing worsens the situation by ensuring the investors' belief in the quality of products approved by the BaFin.

There is no equivalent practice with regard to the general policy conditions for insurances. The consequences are obvious: The consumers are unsettled and confused. Why are there general policy conditions on the one hand and prospectuses on the other? Why are they not supposed to trust the contents of the prospectus and in the quality of the product?—What does the BaFin-approval and coherency check even mean? Why is one not supposed to trust in the quality of insurance products, when there is a subsequent abuse control by the BaFin (§ 81 of the Act on Supervision of Insurance Undertaking—Versicherungsaufsichtsgesetz, VAG). From the provider's point of view there is one basic question: Why are insurers free to create their general policy conditions—and with that the products they want to put on the market—without any form of supervision requirement, while provider of financial products are legally required to produce prospectuses beforehand and have them approved by the BaFin, even when their products are almost identical to insurance products?

Herein lies a fundamental contradiction that is the starting point for a great number of further inconsistencies and contradictions. To put it another way: This fundamental contradiction between insurance products on one hand and financial products on the other is not objectively justified and leads to an obligation to offer all information on those products in two different "wrappings". This results almost automatically in a distortion of competition between insurance and financial products and practically hinders the development of a Single Market from the start.

27.2.2 Status Information

27.2.2.1 Business Card vs. Liability Umbrella

The situation regarding status information is comparable: Two systems exist side by side without being coordinated. Insurance intermediaries are obliged to disclose whether they are (tied) agents or insurance brokers.[7] Intermediaries of financial assets (limited partner shares/ closed investment funds) have to disclose their status upon the first contact with the investor as well ("business card concept"). They are also, like the insurance intermediaries, subject to an exam of their expertise, have to be registered in an intermediary register and need a liability insurance for

[7] More information requirements can be found in § 11 VersVermV—based on the implementation of Dir 2002/92/EC.

pecuniary losses. Intermediaries dealing with securities as defined in the Banking Act/Securities Trading Act (Kreditwesengesetz, KWG/Wertpapierhandelsgesetz, WpHG) such as shares, bonds or derivatives do not need a status information. They need a banking licence as stated in § 32 KWG. If their work is limited to investment advice and investment broking—as it usually is—§ 2 (10) KWG permits them to work under a *liability umbrella*. A deposit-taking bank serves as the liability umbrella. The company is liable for the actions of a tied agent (§ 2 (10) KWG). The BaFin keeps an online register for these intermediaries. But they are not subject to an exam of their expertise. This surprises since these intermediaries are allowed to offer derivatives without even a liability insurance for pecuniary losses being mandatory. The equity resources of liability umbrellas are usually limited. This means that the liability capital that is available for the investor in a trial for damages is much lower as it is for intermediaries of insurance or financial products with mandatory insurances. There is no explanation given of why the European Union requires a liability umbrella for some intermediaries and the status information concept with its expertise exam and its obligatory insurance for others. As there is no apparent objective reason for this differentiation, distortion of competition and misinformation of investors are almost self-evident.

27.2.2.2 Status Information: No Solution to the Reliability Problem

There is a second question that we fail to ask: What is the sense and the purpose of status information? It is certainly appropriate to gather the intermediaries of insurance, financial assets and securities in a publicly available database. Furthermore, they should only be granted authorisation under commercial law after evidence of *expert knowledge* has been provided. The intermediaries are personally liable for information and advisory errors. The requirement to cover the risk with a liability insurance for pecuniary losses guaranteeing a certain minimum cover is therefore reasonable. To this extent a uniform level playing field should be created for all types of intermediaries throughout Europe. That is the only way to ensure functioning competition between the different types of intermediaries.

A matter to be treated separately is the intermediaries' duty to disclose their status towards their customers. Usually, it is being said that the intermediary discloses his status in order to enable the client to assess his partner. If an intermediary—for example—declares that he is working for Allianz (Germany) or for Generali (Italy) or Axa (France), the customer knows that he cannot expect cross-market product consulting. According to the European legislator, a rational customer will reflect on whether to continue bargaining with this tied agent or rather engage a free agent who has a market-wide overview and a market-wide range of products. Moreover, the rationally acting customer will consider to consult an advisor who does not market products at all but solely advises and makes a recommendation in return for a fee.

These are theoretical considerations, based on the idea of a rationally-acting investor. My thesis is that in real life a rationally-acting investor acts quite differently. The rational, well informed investor/consumer will always deal with somebody he

trusts.[8] The rational calculation is that having a personal and trusting relationship will make the intermediary consider not only his own interest but to include the investor's interest in his deliberations and recommendations, because otherwise the personal relationship would suffer. Furthermore, only reliable and sustainable advice ensures a strong business relationship in the long term. It is for these—rational—reasons that the investor/consumer is not going to attach great importance to whether he is dealing with a tied agent or an insurance broker or a financial adviser on fee basis, instead he is going to ask himself whether he has good reason "to trust" the intermediary. The mere status information does not enable the client to make an adequate and sufficient decision about the intermediary's trustworthiness. For the investor the personal relationship or the recommendation of a reliable third party will be more important than the information about the intermediary's status. *Niklas Luhmann* said that trust and mistrust are ultimately *functional equivalents* to reduce subjective insecurities. However, in the case of mistrust the requirements for the information's reliability are much higher.[9] For this reason trust proves to be absolutely essential for a self-determined decision based on private autonomy.

Nobody will deny that a representative of Allianz can only offer products by Allianz. Nevertheless, the Allianz is the market leader on the German market and many of their products are ranked highly by Stiftung Warentest (German product testing foundation). This means products by Allianz are usually good. To put it differently, there is no reason to classify an intermediary's attachment to the Allianz as a negative aspect just as there is no reason to say that a broker is automatically able to offer the better product because he has an overview of the market. In other words a *status information* is no solution to the principal-agent problem, that occurs with every procurement because the intermediary's interest do not match the client's.[10] This raises the basic question: why do we create a complex legal system to make the intermediary hand over his business card, a gesture which every client expects at the start of the first meeting anyhow and which will never lead to the termination of the meeting, just because the client discovers the intermediary's status and worries to be taken advantage of? That is simply "nonsense" because people do not think like this. In other words: The entire system of status information is not working, this is also confirmed by Stiftung Warentest after a study 2009.[11]

When the European legislator enforced status information for the first time with the Insurance Mediation Directive, there were indications that he was aware of its ineffectiveness: The directive does not include a sanction for intermediaries who do not (or not sufficiently) comply with the obligations. The member states did not establish any sanctions either when they transposed the directive. Whether and to what extend they were obliged to do so by the principle of sincere cooperation

[8] N Luhmann, *Vertrauen: Ein Mechanismus der Reduktion sozialer Komplexität*, 4th ed (Stuttgart, Lucius und Lucius, 2000) 118 ff; P Kollock, 'The Emergence of Exchange Structures: An Experimental Study of Uncertainty, Commitment, and Trust' (1994) 100 *American Journal of Sociology* 313; Köhler, *Die Zulässigkeit derivative Finanzinstrumente*, 169 with further references.

[9] Luhmann, *Vertrauen*, 92 ff.

[10] In more detail M Mathissen, *Die Principal-Agent-Theorie: Positive und normative Aspekte für die Praxis* (Hamburg, Igel Verlag, 2009).

[11] Stiftung Warentest (2009) 10 *Finanztest* 63.

(Art. 4 (3) TEU—effet utile) is presently an open but not discussed question. Upon the author's request the responsible consultant at the Federal Ministry of Economics and Technology (Bundeswirtschaftsministerium), Mr Schönleiter, pointed out that there is no legal basis for sanctions or control by the trade supervisory board and/or Chamber of Industry and Commerce, but he also did not see any need for action in this respect. To put it differently: Whether the intermediaries abide by the rules of status information does not matter in the reality of mediation of financial and insurance products. In a way this makes sense because status information is not able to solve the principal agent problem—the conflict of interest between intermediary and client—anyhow. One question remains: Why did we establish status information in the first place? The impression is given that clients are being protected by status information. This, however, is not the case.

27.2.3 General Information Requirements

The European legislator's basic idea is to protect the clients from poor-quality products, cheating and wrong decisions by laying down requirements for general information, in particular prior to the conclusion of the contract. The client needs to be adequately informed in order to be able to make a self-determined decision about each financial and insurance product. To make this decision, to be able to negotiate on equal terms, he needs to "comprehend" the product. This basic idea has become the advertising slogan of the ERGO Group.

27.2.3.1 The "Protection Model" Private Law

This idea is based on the sanction measures of the "*protection model private law*"[12]. The private law of contract partly ensures the elimination of the structural imbalance between insurers, banks and consumers by mandatory laws and especially by requirements for pre-contractual information. In addition to this the law of fair trading as well as functional competition causes a disciplining in advance—not to mention the threat-potential of the subsequent abuse control by the BaFin (§ 81 VAG/§ 6 (2) KWG).[13] *Achim Tiffe* devoted an entire work to this model.[14] The modern capital market theory also assumes there is an *institutional capacity* of the market if adequate and sufficient information is provided.[15]

[12] Also Schwintowski, *Der private Versicherungsvertrag*, 99 ff, with further references.

[13] An overview of the model: Schwintowski, *Der private Versicherungsvertrag*, 112 ff.

[14] A Tiffe, *Die Struktur der Informationspflichten bei Finanzdienstleistungen* (Baden-Baden, Nomos, 2006).

[15] H Merkt, *Unternehmenspublizität: Offenlegung von Unternehmensdaten als Korrelat der Marktteilnahme* (Tübingen, Mohr Siebeck, 2001) 301 ff; Köhler, *Die Zulässigkeit derivativer Finanzinstrumente,* 308 ff, with further references; RA Kasten, *Explorations- und Informationspflichten* (Berlin, Duncker & Humblot, 2009) 145; J Damrau, *Selbstregulierung im Kapitalmarktrecht* (Berlin, Tenea, 2003) 45.

Obligations to provide information have been established for many types of contracts. Among these are consumer loan agreements, insurance contracts, pension provision agreements as well as transfer contracts. The obligations to provide information are laid down in the regulations on price quotations (Preisangabenverordnung, PAngV), the Banking Act (KWG), the Securities Trading Act (WpHG) and the Investment Act (InvestmentG).[16] Worth highlighting are the refined obligations for pre-contractual information in § 7 VVG. In due time before the delivery of the client's contract declaration, the insurer has to provide him with his contractual clauses including his general policy conditions and multiple further information in a clear and comprehensible form. There is a complimentary Ordinance on Information Obligation for Insurance Contracts (Verordnung über Informationspflichten bei Versicherungsverträgen, VVG-InfoV): In addition to the general contract terms, the insurer is obliged to provide the client—before he delivers his contract declaration—with a *product information sheet*, which contains the core information about the product. There are similar rules for intermediaries of financial investments (§§ 34 ff Trade Regulation Act—Gewerbeordnung, GewO). § 13 Ordinance on the Mediation of Financial Investments (Finanzanlagenvermittlungsverordnung, FinVermV) states that intermediaries are obliged to provide the investor with information about the nature and the risks of the offered investments. This is to enable the investor to make a sensible decision about his investment. Additionally the intermediary is required by law to provide the investor with a *product information sheet* and to perform a suitability test (§ 16 FinVermV).

27.2.3.2 Private Law vs. Public Law

These obligations of the intermediary are based on § 7 VVG on the one hand and § 31 (4/4a) WpHG on the other hand. However, there is one important structural difference: While the information requirements in § 7 VVG and § 13 FinVermV are obligations under *private law*, the requirements stated in the WpHG are *public law* in their nature. The difference in effect is obvious. Rules of private law are binding in private law relationships—rules of public law have no binding effect in private law. To put it differently: The provider of investment services is not obliged to fulfil the obligation to provide information as stated in §§ 31 ff WpHG to the client, who is dependent on it, but to the supervisory authority (BaFin), who does not have the personnel to monitor and to examine whether these obligations are met. Nevertheless, the Federal Court of Justice (BGH) has made it clear that most of the rules in §§ 31 ff WpHG "radiate" into private law.[17] However, it is still questionable whether the obligations to provide information are identical in form and content for financial services and insurances.

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[16] For an overview: Tiffe, *Die Struktur der Informationspflichten*, 50 ff.

[17] BGH, 19/2/2008, (2008) *Zeitschrift für Bank- und Kapitalmarktrecht* 294; BGH, 19/12/2006, (2007) *Wertpapier-Mitteilungen* 487, 489; in more detail H-P Schwintowski, *Bankrecht*, 3rd ed (Cologne, Heymanns, 2011) 702 margin notes 30 ff; A Fuchs, 'vor § 31' in A Fuchs (ed), *Wertpapierhandelsgesetz* (Munich, Beck, 2009) margin note 59, with further references.

27.2.3.3 Comprehension by Way of Information?

The crucial question is whether the information model is suitable to achieve the effect that it was created for. The diverse pieces of information the client receives prior to the conclusion of the contract are supposed to enable him to make an independent, self-determined and sensible decision. The client does not follow his advisor's recommendation but makes his own decision—on the basis of assured knowledge. The client familiarizes himself with the insurance and financial products on the market, checks whether they are suitable to optimize his personal life and ultimately chooses the product that suits him best.

The only reason he needs an advisor is to help him get an overview of the market and to provide the information the client needs to check the products and their quality.

The idea is that the client works like an inspector from the TÜV, which is the German Technical Control Board and responsible for the inspection of vehicles. For a start the inspector completes a comprehensive technical basic training to then test the presented products' (e.g. cars or fridges) suitability for use. The criteria are technical DIN standards, which the inspector has studied for years and now takes into consideration.

But in reality the markets for insurance and financial products work completely different. The clients do not have detailed knowledge about these products.[18] Often their first encounter with insurance products is when they buy their first car because they need a liability insurance for it. That is when they learn that there are such things as partially and fully comprehensive insurance policies and they hear about life, accident and health insurance without knowing all the different risk exclusions and obligations in detail. When people move into their first flat they discover household and building insurances, often because that is what their neighbours have, and it is usually around that time that they get their first private liability insurance, too. The public debate about the collapse of statutory pension schemes (biometrical gap)[19] leads to a first contact with the Riester Pension and other kinds of life insurance. Often these considerations arise in the working place because employers offer their employees a supplementary company pension scheme including a conversion of earnings into pension contributions ("Entgeltumwandlung"). If a little more money is being earned the bank usually suggests investing some of it in a savings agreement or a stock portfolio. Starting a family often leads to buying a house with the help of a home loan bank. And then there are people who believe that having a bit of luck helps to reach your goals faster—these are the candidates for the lottery and for certificates and certificated derivatives transactions (keyword: Lehman Brothers).[20]

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[18] *Markus Rehberg* states that the insured persons on the German market are no longer able to make an independent decision. Their cognitive capabilities are being overestimated and they are unable to cope with the magnitude of information. See M Rehberg, *Der Versicherungsabschluss als Informationsproblem* (Baden-Baden, Nomos, 2003) 423.

[19] In more detail H-P Schwintowski, 'Das Recht der Alternden Gesellschaft' in S Grundmann, M Kloepfer and CG Paulus (eds), *Festschrift zum 200-jährigen Bestehen der Juristischen Fakultät der Humboldt-Universität zu Berlin* (Berlin, de Gruyter, 2010) 1149.

[20] Detailed: Köhler, *Die Zulässigkeit derivativer Finanzinstrumente*, 397 ff. He shows that the complex construction of contracts about derivative financial instruments was a major cause for

How these various products work, under which conditions payments are made and under which circumstances they are refused, whether the hopes and promises of a perfect provision for one's old age are fulfilled or fail remains unclear for the customers, because for an average insurance holder or investor it is not possible to even remotely comprehend the way these very different products work. This is difficult even for lawyers, who deal with them, because the constant changes in the jurisdiction influence these products. To put it differently: It is an illusion to think that clients who want to buy the product "comprehend" it, as the ERGO slogan suggests. It has to work the other way: The legal system has to ensure that the clients are not forced to fully "comprehend" the financial and insurance products. It has to be possible to purchase products of this kind without understanding how they work, the same way we do with cars, fridges, washing machines, mobile phones and a lot of other objects we use in our daily life. If we had to "comprehend" all these products, we could never buy any of them. It is simply impossible to make somebody understand the way a mobile phone or a laptop works, if he does not know anything about electrical engineering and computer science. Even the concept of "electricity" is difficult to explain—the simple reference that it is a *state of stress between plus and minus poles* is not very helpful.[21]

It is hardly surprising that the financial crisis happened despite of—or should you say because of?—all the information requirements. Neither the people nor in many cases the institutions "comprehended" the bundles of claims of American real estate (Credit Default Obligations and Credit Default Swaps). They were not able to understand them, because the underlying financial mathematical assumptions, that are based on the Gaussian distribution curve, were not disclosed to them. Even if they had been disclosed the resulting risks would not have been comprehensible and identifiable for the small investors or even institutional investors.[22] Authors like *Michael Lewis* are of the opinion that "a handful of traders gambled away the world".[23]

The message is that none of the investors—small ones or institutions—knew how the products they bought worked, they just assumed that they were dealing with good and quality-certified products. This belief was strongly supported by the three rating agencies that operate internationally. Until shortly before the outbreak of the financial crisis these agencies were of the opinion that the trillions worth of bundles of claims that circled the world were almost risk-free and deserved an AAA rating. What is an investor supposed to do if a rating agency tells him that the bond he intends to purchase has a default risk of "zero"? Ought he really ask with which model of probability the rating agency calculated the risk of default?[24] Which

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the financial crisis.

[21] Very plausible and comprehensible: H Boëtius, *Geschichte der Elektrizität* (Weinheim, Beltz, 2006); more difficult but very good: E Hoppe, *Geschichte der Elektrizität* (Wiesbaden, Sändig, 2007).

[22] In more detail Köhler, *Die Zulässigkeit derivativer Finanzinstrumente*, 397 ff; *Köhler* shows an economic relation between the complexity of derivative financial instruments and systemic risks.

[23] M Lewis, *The big Short* (Frankfurt, Campus, 2010).

[24] See NN Taleb, *Der schwarze Schwan* (Munich, Hanser, 2010). He describes vividly how the rating agencies worked with unrealistic probability models (Gaussian normal probability). They

realisation would an investor have gained from the knowledge that rating agencies worked with unrealistic probability models? Would he have become sceptical like the hedge fund manager *Paulson* did and refrained from purchasing CDOs? At Morgan Stanley's—so you can read in the press—there are said to have been portfolio managers who thought similarly to *Paulson*. *Paulson* changed his strategy shortly before the outbreak of the financial crisis because of an empirical study of the real estate market in the US and speculated on falling prices. He earned more than 30 billion US$ for his hedge fund in 1 year. At Morgan Stanley's there are said to have been similar tendencies with the effect that the investment bankers withdrew from these products, but still recommended them to their clients. Several lawsuits about this practice are pending.[25]

27.2.3.4 The Information Model has Failed

The lesson that can be learned from this is: "The information model has failed". We cannot expect the investors to systematically check the financial and insurance products in order to then be able to decide, if such a product is good and suitable for them. This would be comparable to expecting of people who buy cars to understand the construction of the vehicles in every detail in order to be able to decide whether the vehicle is driveable, roadworthy and of a high quality. We have relieved the consumers of these technical examinations by means of product standardisation. The legislator and the industry know that customers are not able to check and see through technical qualities of cars, fridges, mobile phones or washing machines. To achieve this you need expert knowledge, which often takes several decades to acquire.

Instead, we should follow the conclusion that "progress starts with primitiveness, leads to complexity and results in simplicity"—however, people tend "to remain on the development stage of complexity and define progress as a constant increase of it".[26]

27.2.3.5 Standardisations in Law

The choice customers make is based on a *quality test* that is carried out before the products enter the market. These are various technical standards that are established worldwide and in Germany known as DIN standards. Their value for the German economy is tremendous: According to a study by the German Institute for

should have worked with the Mandelbrot distribution (fractals) instead, which is still not used for the calculation of CDS today.

[25] In more detail P Schantz, *Haftung von Rating-Agenturen* (forthcoming, 2014).

[26] KH Biedenkopf, 'Die wirtschaftliche Entwicklung in den neuen Bundesländern' in KH Biedenkopf, HP Dürr and J Trojahn (eds), *Marktwirtschaft auf dem Prüfstand* (Berlin, Wichern, 1994) 15, 28 f.

Standardisation (DIN) in 2011, the benefit of the current existence of standards amounts to 16.77 billion € per year.[27]

The necessity of these standards has long been recognized and described in the context of legal structures as well. The work on law and standardisation in the industrial revolution by *Milôs Vec*[28] and *Tilman J. Röder's*[29] are pointing the way on the issue. *Christoph Alexander Kern* developed this concept further in his habilitation thesis about typicity as a structural principle of private law.[30] *Kern* sees his considerations as a contribution to the standardisation of transferable goods. His thesis will be a surprise for lawyers: property law is nothing but an expression of typification of legal structures, for instance to work out standardised securities like the mortgage. The same applies, as *Kern* develops neatly, to securities legislation, especially the bill of exchange, the check but also the share, the debenture bond and the investment fund certificate.[31] In securities law, says *Kern*, "the high level of typification of bills of exchange, checks (…) confirms the significance of typification as a structural principal of transferable goods".[32] The overall low level of typification of capital market instruments is not convincing.[33] This could be solved, says *Kern*, by introducing typified basic forms. Despite difficulties regarding the practical implementation he thinks it is worth considering backing this up by quantitative restriction of individual design and a corresponding obligation to invest a minimum percentage in these basic forms.[34]

In this sense *Köhler* analysed the structure of the derivative financial instruments that triggered the financial crisis.[35] He arrives at the conclusion that the necessary information to reliably assess the derivatives based on pooling (e.g. CDOs) were systematically no longer available to market participants.[36] He adds: "There is an economic correlation between the complexity of derivative financial instruments and systemic risks".[37]

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[27] K Blind, A Jungmittag and A Mangelsdorf, *Der gesamtwirtschaftliche Nutzen der Normung* (Berlin, DIN, 2011) 18 f.

[28] M Vec, *Recht und Normierung in der industriellen Revolution* (Frankfurt, Klostermann, 2006).

[29] T Röder, *Rechtsbildung im wirtschaftlichen "Weltverkehr"* (Frankfurt, Klostermann, 2006). See also, on standardisation in the field of company law, H Paulick, *Die eingetragene Genossenschaft als Beispiel gesetzlicher Typenbeschränkung, zugleich ein Beitrag für Typenlehre im Gesellschaftsrecht* (Tübingen, Mohr Siebeck, 1954).

[30] A Kern, *Typizität als Strukturprinzip des Privatrecht* (Tübingen, Mohr Siebeck, 2011).

[31] Ibid, 253 ff.

[32] Ibid, 543 ff.

[33] The requirements for long-term securities vary as a comparison of *Pfandbriefe* and property backed mortgage bonds shows—see M Thom, *Die Hypothekenanleihe als Instrument der Immobilienfinanzierung* (Berlin, Duncker & Humblot, 2013).

[34] Kern, *Typizität*, 543.

[35] Köhler, *Die Zulässigkeit derivativer Finanzinstrumente*.

[36] Ibid, 397, thesis 7.

[37] Ibid, 397, thesis 8.

The fundamental insight is: Typification—in my opinion the term standardisation is better suited—is an indispensable precondition for all types of contracts with which uniform financial and insurance products are transferred on a large scale.

Kern is right when he refers in this context to the non-mandatory law of debt contracts,[38] the law of the general terms and conditions,[39] the industry standards with or without a state acknowledgement,[40] company law,[41] intellectual property law[42] and emission rights.[43] This shows that the law has already recognised that, where contracts about services of general interest are concerned, it is its task to supply the standardisations that are needed to make these products suitable to be used on a massive scale. It is not the primary function of the law to make the client/investor understand how the insurance or financial product works—the client is not supposed to become the product's constructor and inspector. All requirements of information which are aiming to achieve this—and that is the large majority—are out of place. In the first instance the law has to ensure that the products on offer are of a high quality and thus marketable. The law has to provide the standardisation of these products as it did globally with bills of exchange and checks and the same way it does with DIN standards.

Only after the products are standardised—when it can be assumed that every product is of a high quality[44]—does it makes sense to provide the client with information. Even with a high quality product the client needs to know what the product cannot provide. If you—for instance—travel to turkey by car, you have to be informed that your motor insurance does not cover travelling to the Kurdish region in the eastern part of Turkey. You also have to know whether your insurance covers only drivers who have a driving licence and whether the cover might automatically end after drinking two beers. Information of this kind has nothing to do with the quality of the third party motor insurance. Everybody knows that the car is covered by insurance so that you can safely get in and drive off. This would be completely different in a legal system that links the insurance cover not to the car itself but to the driver—in that case victims of traffic accidents could not rely on the car with which they collide to be insured. Standards like this for financial services and insur-

[38] Kern, *Typizität*, 537.

[39] Ibid, 538.

[40] Ibid, 538 ff.

[41] Ibid, 540.

[42] Ibid, 542.

[43] Ibid, 542 ff.

[44] The centre for Research in Experimental Economics and Political Decision Making (CREED) at the Amsterdam School of Economics showed in their Study by A Schram and J Sonnemans, *How Individuals Choose Health Insurance* (2008), http://www1.fee.uva.nl/creed/pdffiles/Healthinsurance.pdf, that an increase in the number of alternative choices decreases the quality of a subject's decision. This effect can be avoided by means of standardisation: If all products on the market are of a high quality, there is no longer such a thing as a bad decision.

ances could in all likelihood reduce, if not prevent, the financial crises that recur virtually cyclically.[45]

27.2.3.6 Documentation

For the sake of completeness it should be noted out that the necessity of standardisation *prior to* information has not become dispensable because of the documentation requirements that have now been established for insurance and financial products[46]. It is certainly right and sensible to document the consultation about financial and insurance products to prevent subsequent disputes and to minimise problems of evidence. The documentation cannot, however, compensate for the necessary standardisation of the products. The products on the market are being documented, whether or not they meet the standards that are lege artis. It would be comparable to waiving the technical rules for a car's approval for using the public roads and then, when the car is already in use, to document whether it is roadworthy at all. This is to late—by now several accidents have already occurred—just as it did in the financial crisis.

27.2.3.7 Product Competition Despite of/Because of Standardisation?

Lastly the question arises whether the concept "standardisation *prior to* information" leads us back to the way things were during the *time of regulation* (until 1994) and whether this destroys the competition on the markets for insurance products. On the contrary: Standardisation of products is the precondition of functional competition. The typified "sensible" consumer is only able to make a product decision if the products are clearly and comprehensibly differentiable. He has to be able to assume that the products were admitted to the market because they meet the minimum quality requirements the legal order imposes. For financial services this means they have to be constructed in a way that the "interests of the investors/insured person" are met in each case.

Effectively this means is that the investor/insured person can expect the supervision authority to ensure product checks so that no product enters the market that can only damage the investor. Based on this the CDOs and CDSs that started the financial crisis should not even have existed. These products were so intransparent that even institutional investors were not able to recognize and rate the risks inherent in these complex derivative financial instruments.[47] For products to optimise interests rate (Spread Ladder Swaps) the Federal Supreme Court (Bundesgerichtshof) has recently made it clear that products that are developed in a structurally intransparent

[45] Well worth reading CM Reinhart and K Rogoff, *Dieses Mal ist alles anders: Acht Jahrhunderte Finanzkrisen* (Munich, Finanzbuchverlag, 2010).

[46] The documentation requirement regarding insurance law is codified in § 62 VVG; regarding the law of financial services in § 34 para 2 WpHG and regarding investments in § 16 FinVermV.

[47] Köhler, *Die Zulässigkeit derivativer Finanzinstrumente*, 397 ff.

manner are not marketable and therefore the contracts are void according to § 138 BGB.[48]

The necessity of product standardisation *prior to* the providing of information is self-evident and established in many other market segments. This is clear from a glance at the car industry. The legislator makes sure that the technical rules are observed so that the buyer of a car can rely on the brakes, the clutch, the gearshift and all the essential technical requirements to be working. On the basis of such product standardisation competition on the market is possible. Markets for small cars, mid-range cars, luxury vehicles, vans, lorries and busses have developed—and are characterised by intense competition not despite of but *because of* standardisations. The same goes for markets for mobile phones, TV sets, food, pharmaceuticals and textiles. There is even intense competition on markets for *homogeneous goods* like electricity, gas or water with regard to prices and conditions (e.g. "green" or "grey" energy).

Standardisation does not lead us back to the time of regulation before 1994. On the contrary, standardisation helps to reach the goal that was meant to be reached with the market opening in 1994: Competition on the markets for financial and insurance products. To this day there is no cross-border competition for insurance products. For financial products it is a little but not very different.

And yet such international insurance and financial products would be another step to a strengthening of the Single European Market, which would have further positive effects on the economy.[49] When it comes to markets however, the more they are linked globally, the less they coincide in regard to the legal institutions that they are supposed to regulate.[50] The main reason why it is difficult to create financial and insurance products that are usable in different countries is the lack of clear product standardisations.

The attempt to introduce competition by means of *information* especially before conclusion of the contract has failed only because the preceding step was "forgotten": the necessity of product standardisations.

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[48] BGH, 22/3/2011, (2011) *Neue Juristische Wochenschrift* 1949.

[49] See *Cecchini report*, European Commission, *The Cost of non-Europe* (Baden-Baden, Nomos, 1988), whereupon the costs of a non-realisation of Europe were projected at 200 billion ECU. Through the completion of the Single European Market an additional growth of 4.5% of the gross domestic product as well as a creation of about 1.8 million new jobs were predicted.

[50] H-P Schwintowski, *Verteilungsdefizite durch Recht auf globalisierten Märkten—Grundstrukturen einer Nutzentheorie des Rechts* (Berlin, Humboldt Univ., 1995), http://edoc.hu-berlin.de/humboldt-vl/schwintowski-hans-peter/PDF/Schwintowski.pdf, 4. See also Prognos, *Quantifizierung des Nutzens von Regelungsvorhaben—Internationale Erfahrungen im Vergleich* (2013), available at http://www.normenkontrollrat.bund.de, which analyses the costs and benefits of the legislative and regulation procedure, but does not examine the introduction of standards for insurance and financial products.

27.3 Basic Standards for Financial and Insurance Products

In the following section a proposal for basic standards for financial and insurance products is made. There is no claim for accuracy and completeness—the aim is to start a debate on standards for financial and insurance products.

27.3.1 Basic Standards for all Products

Standard 1: Service descriptions and general terms and conditions take the place of prospectuses.
Standard 2: Separation of service descriptions and general terms and conditions.
Standard 3: The services and the terms and conditions are to be described in a clear and comprehensible way. The text consists of main clauses, sub-clauses are to be avoided. The words are taken from everyday language, visual and expressive. Legal and bureaucratic language is to be avoided as far as possible.
Standard 4: Exemption clauses have to be stated clearly and comprehensibly—no multiple exceptions and counter-exceptions. The same goes for conduct obligations and their exceptions.
Standard 5: If something cannot be said clearly and comprehensibly it is left unsaid.
Standard 6: Product costs and costs for mediation/consultation are to be separated on principle (two-markets-model).
Standard 7: Repercussions of costs for mediation/consultation for the product have to be disclosed—applying the Zillmer method is prohibited.
Standard 8: Product-immanent risks are to be identified and quantified using transparent methods; the client has to be able to take the financial risks.

27.3.2 Additional Standards for Insurance Contracts

Standard 1: The insurer's performance is described as follows:

1. Insured benefits
2. Excluded risks
3. Rules of conduct
4. Loss of insurance cover.

Standard 2: Supplementary contractual conditions (General Terms and Conditions of Insurance—AVB) contain information regarding:

1. Premium payments—premium adjustments
2. Termination of the contract (also in event of a claim)
3. Settlement of claims

4. Forum selection clause
5. Choice of law clause.

Standard 3: If something is codified it is not to be repeated in the contract.
Standard 4: The structure responds to the readers' expectations.
Standard 5: Exceptions and counter-exceptions are only used if absolutely necessary.
Standard 6: The application and the insurance policy contain everything that is essential for the contract—there are no additional information sheets.
Standard 7: The essential content of application and insurance policy:

1. Insured risks/exemption clauses
2. Method of payment for insurance premiums—premium adjustments
3. Contract inception—termination of the contract
4. Provisional cover.

27.4 The Implementation of Standards

Standards as proposed above can be implemented by the insurance and financial industry without any help from the legislator.[51] *Lepsius* says, *standards are not legally binding but they are effective*.[52] There is no reason to doubt their a priori legal nature on formal grounds.[53] The mere normalisation does not lead to a legal norm. The law always addresses acting persons and never corporeal objects or products and their features.[54] *Lepsius* says this is the reason why technical standardisations only become a legal rule if they are the basis of a legally binding rule of conduct, or to put it differently if they are enforceable.[55]

Regarding the standards proposed above at least an *obligation* has to be pursued. This could be accomplished by a *public commitment* with an entry in the cartel register. Another way would be for the legislator to codify the basic idea of standardisation. The best way would be a European directive that leaves the detailed implementation (by means of regulation) to the EIOPA on the European level and the BaFin on the national level.

[51] O Lepsius, 'Standardsetzung und Legitimation' in C Möllers et al (eds), *Internationales Verwaltungsrecht: Eine Analyse anhand von Referenzgebieten* (Tübingen, Mohr Siebeck, 2007) 345.

[52] Ibid, 350.

[53] Ibid, 350.

[54] Ibid, 351.

[55] Ibid, 351.

27.5 Industrial Property Rights

The necessary standardisation of financial and insurance products is closely related to the matter of their industrial property rights. In short it can be said: Presently financial and insurance products have virtually no industrial property rights.[56] This incomplete protection for industrial property intensifies the tendency to put products on the market that ultimately fail because they are structurally incorrectly designed, like the Spread Ladder Swaps of the Deutsche Bank. In other words: there is no incentive to invest money in good, standardised insurance and financial products.

If one looks at the capital expenditures needed for a new product series by BMW or VW one will find that it is not unusual for the pre-investments to amount to several billion of euros. If one asks insurers and banks on the other hand, what their budget for restructuring their products and general terms and conditions is, one is met with a *shake of the head*. These institutes do not have a budget for product innovation—the reason for this is not only the lack of standards and standardisations, but also the fact that these products simply do not enjoy any patent protection or protection of registered designs in Germany and Europe. Only in the US are products of this kind protectable within certain limits by patents as *business models*.[57] There is, in addition, a protection by copyright law for these products in Germany that is hardly recognised as yet.[58] But a copyright is not enough to encourage the developers of insurance and financial products to create good, standardised, marketable, reliable and sustainable products. This means that in the context of creating product standards there should also be a development of industrial property rights for insurance and financial products—if at all possible on a European level right from the start.

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[57] In detail Schwintowski, 'Urheberrechtsschutz', 305.

[58] Ibid., 308, with further references.

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Part V
Consumer Contract Law

Chapter 28
Law and Choice in Consumer Contracts: Views from Law and Economics

Fernando Gomez and Juan José Ganuza

Abstract Choice in Contract Law, including consumer contracts, has become a focal point for theoretical and policy debate on contracting. In this essay we do not cover all issues of choice surrounding optional sets of Contract Law rules such as CESL. At the same time we do not intend to limit the reach of some of our ideas to CESL. But we do intend to explore several issues concerning choice of legal rules in settings of contracts between firms and consumers, as being revealed by the debate following the publication of CESL. We frame our contribution along two different, albeit related, lines. One is—sorry for the lack of modesty—our own previous work on legal harmonization and European Contract Law. In a first wave of papers we analyzed how efficiency-minded lawmakers should set legal standards in settings of pre-existing divergent legal systems and where building markets across national borders can be expected to produce social welfare gains. The second wave addressed more directly optional sets of legal rules governing contractual interactions, and tried to provide an stylized model of firm's choice when confronted with optional European rules and diverse national rules. Now we introduce a broader set of economic arguments concerning Law and choice in consumer contracts. The article will be organized as follows: in Sect. 28.2 we present the issue of choice in consumer contracting. In Sect. 28.3 we address the view that optional sets of rules would produce choice only for the wrong (having consumers' welfare in mind) reasons. Section 28.4 refers to the effectiveness of choice in the presence of optional rules, focusing on the behaviour of the firm. Section 28.5 analyzes the claims of insufficient (for firms) choice in the current legal framework of consumer contracts in Europe, and present economic arguments to undermine the soundness of those claims. Section 28.6 briefly concludes.

We are grateful to participants in Seminars at the University of Amsterdam and Universitat Pompeu Fabra for helpful comments on earlier versions of the manuscript. The usual disclaimers apply.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_28,

28.1 Introduction

If one would have raised the term "choice" associated with Consumer Contract Law in Europe twenty, and perhaps even ten years ago, the likely reactions among legal academics would mostly have been of incredulity and skepticism, even of rejection. Choice was limited to product, brand and vendor (when variety was available), but the rest was imposition under the shadow of the applicable laws and regulations governing the transaction. Asymmetries in bargaining power and information, the widespread use of standard terms and standardized contracting protocols, even before the diffusion outside of a very limited circle of psychologists and experimental economists of the prevalence of not-so-rational biases and heuristics in consumer behaviour, would have suggested that an inquiry about choice in consumer contracting would essentially be a fruitless, almost objectless endeavor.

When one considers the present state of the legal debate in Europe, the issue of choice in consumer contracting is experiencing a sizable surge in interest, perhaps specially after the publication by the Commission on 11 October 2011 of the Proposal for a Regulation on a Common European Sales Law (CESL),[1] a text that, as is well known, has been launched in the Proposal as an optional instrument for European firms and consumers. Choice in Contract Law, including consumer contracts, has become a focal point for theoretical and policy debate on contracting. Notice that the emphasis is now placed on choice of laws and legal rules, what was formerly the relatively narrow and technical realm of Conflict of Laws, scholarship. Now, it is at the forefront of Private Law policy in Europe.

In this essay we do not cover all issues of choice surrounding optional sets of Contract Law rules such as CESL, and at the same time we do not intend to limit the reach of some of our ideas to CESL. But we do intend to explore several issues concerning choice of legal rules in settings of contracts between firms and consumers, as being revealed by the debate following the publication of CESL.

We frame our contribution along two different, albeit related, lines. One is -sorry for the lack of modesty- our own previous work on legal harmonization and European Contract Law. In a first wave of papers we analyzed how efficiency-minded lawmakers should set legal standards in settings of pre-existing divergent legal systems and where building markets across national borders can be expected to produce social welfare gains.[2] The second wave addressed more directly optional sets of legal rules governing contractual interactions, and tried to provide an stylized model of firm's choice when confronted with optional European rules and diverse

[1] COM(2011) 635 final.

[2] See, J Ganuza and F Gomez, 'Optimal Standards for European Law: Maximum Harmonization, Minimum Harmonization, and Coexistence of Standards' (2011) *Universitat Pompeu Fabra Department of Economics and Business, Working Paper*; F Gomez and J Ganuza, 'An Economic Analysis of Harmonization Regimes: Maximum Harmonization, Minimum Harmonization or Optional Instrument?' (2011) 7 *European Review of Contract Law* 275; F Gomez and J Ganuza, 'How to Build European Private Law: An Economic Analysis of the Lawmaking and Harmonisation Dimensions in European Private Law' (2012) 33 *European Journal of Law and Economics* 481.

national rules.[3] Now we introduce a broader set of economic arguments concerning Law and choice in consumer contracts.

This essay is also part of the ongoing policy debate about European Contract Law and the desirable strategies for the European lawmakers (at the EU and the national levels) to use Contract Law in a purposeful and productive way to promote social welfare. We believe that Hans Micklitz has been a powerful and influential voice in this debate, so we thought that this would be an appropriate tribute to his distinguished career.

The article will be organized as follows: in Sect. 28.2 we present the issue of choice in consumer contracting. In Sect. 28.3 we address the view that optional sets of rules would produce choice only for the wrong (having consumers' welfare in mind) reasons. Section 28.4 refers to the effectiveness of choice in the presence of optional rules, focusing on the behaviour of the firm. Section 28.5 analyzes the claims of insufficient (for firms) choice in the current legal framework of consumer contracts in Europe, and present economic arguments to undermine the soundness of those claims. Section 28.6 briefly concludes.

28.2 Introduction: Dimensions Of Choice In Consumer Contracting

When economists (as well as consumers themselves, but also firms and marketers) think of consumer choice, they mostly entertain views of the large variety of options consumers face as to products, services, quality levels, add-ons, brands, and so on[4]. This was, and still is, true in the well-stocked, bricks-and-mortar shopping environment of affluent countries at least in the past several decades. This is even more so in the virtual environment of electronic commerce in more recent years, where geography and distance place no boundaries to consumers as to the number and location of vendors, and thus variety is vast, almost limitless. Private lawyers, in turn, although aware of the above dimension of consumer choice, both for conscious and for inadvertent (perhaps due to professional and intellectual bias) tend to make their notion of choice gravitate more towards alternative contracts, alternative contract terms and, more recently, as we will discuss, different contract laws.

[3] F Gomez and J Ganuza, 'The Economics of Harmonizing Private Law Through Optional Rules' in L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart Publishing, 2013) 177; J Ganuza and F Gomez, 'Optional Law for Firms and Consumers: An Economic Analysis of Opting into the Common European Sales Law' (2013) 50 *Common Market Law Review* 29; F Gomez and J Ganuza, 'Optional Law for Firms and Consumers: Economic Benefits of Opting into the Common European Sales Law' in L Moccia (ed) *The Making of European Private Law: Why, How, What, Who* (Munich, Sellier, 2013) 93.

[4] This dimension of choice is obviously crucial for marketing research, consumer research, and consumer psychology, in addition to economics. For a summary of consumer choice research, Z Babutsidze, 'How Do Consumers Make Choices? A Survey of Evidence' (2011) 26 *Journal of Economic Surveys* 752.

Not that the two dimensions are separate, that the material and economic world, on the one hand, and the legal world, do not penetrate each other. Obviously, consumer choice of the first kind takes place in settings heavily relying on legal infrastructure -mostly beyond Contract Law in the narrow sense- and is channeled through mechanisms that are deeply influenced by Contract Law rules. Moreover, contract terms and contractual solutions, both designed by the parties or determined by the Law, become features of the good or service, become "a thing" that the buyer gets in return of the price and has important effects on the expected and actual utility derived from the "consumption" of the product. That is, product and contract are not distinct entities, but are intertwined in a single mix of outcomes for the buyer in the future states of the world. There is no clear gap between object and term, between materiality and textuality, if one prefers[5]. Referring to standard form contracts, Lewis Kornhauser frames it this way: "(…) *regarding the standard form not as a contract, but as a thing like an automobile, a carpet, or a new drug*"[6].

Choosing among contract formats and contract terms has been for centuries part and parcel of contractual consent and freedom of contract, both notions lying at the core of Contract Law and contract doctrine across legal traditions and national boundaries. The liberal theory of contract -and probably even earlier theories in the early Modern Era, the Middle Ages and late Roman times- was grounded on the model of voluntary exchange between free and knowledgeable individuals.

Choices underlying contracting have been, and continue to be made in the context of a specified legal system, which provides the legal framework for legal formats to emerge and achieve market acceptance, and for legal terms to be created, assessed, introduced, and eventually implied into a given contract. Both Contract Law theorists and practitioners have been fully aware that the legal system of reference for a certain contract, at least in many cases, is not exogenously determined, but in itself a product of choice by the parties: Contract formats and contract terms are designed, selected, chosen, and eventually bargained for against the background of a Law that is not God-given, but chosen by the contract parties. This latter choice, however, has largely been considered the province of Conflict of Laws, a separate legal discipline not always fully integrated within general Contract Law theory and practice.

In the consumer context, it has been a while since the idea of consumer choice in the "legal" meaning of the notion has widely enjoyed good reputation. Asymmetries of bargaining power between firms and consumers, consumer's lack of information, experience and expertise, and the pervasive use of standard forms and terms in B2C contracting have made many contract theorists blink at the mention of consumer's true consent in consumer contracts, let alone genuine choice[7]. Consent as to contract

[5] This has long been observed in the legal literature: A Leff, 'Contract as Thing' (1970) 19 *American University Law Review* 155; MJ Radin, 'Humans, Computers, and Binding Commitments' (2000) 75 *Indiana Law Journal* 1125; MJ Radin, *Boilerplate* (Princeton, Princeton University Press, 2012).

[6] L Kornhauser, 'Unconscionability in Standard Forms' (1976) 64 *California Law Review* 1180.

[7] Again, an old and distinguished literature has identified and elaborated on the death of consent in contracting in mass consumer markets: L Raiser, *Das Recht der allgemeinen Geschäftsbedingun-*

terms in consumer interactions is considered to be a conceptual relict of the past. In an apt formulation, it is not even vestigial, it is purely fictional[8]. When terms are nowhere to be seen and read, when terms are screens away on the web, and when almost unanimously consumers sheepishly click the ready onscreen boxes declaring agreement to terms one has not known about, let alone read and understood, to think about choice in consumer contracts appears to be absolutely misguided.

There is evidence of various sorts that consumers, in e-transactions and in other forms of contracting relying on standard form terms governing the contract, do not commonly read the contract terms before entering into it, do not have the capacity, or the willingness, to read and understand the implications of standard contract terms, and do not value the opportunity to read the terms prior to contract, nor they value typically the more advantageous contract terms they may hypothetically be able to find if they read standard contract terms in advance and shop around for more favorable ones.[9]

Moreover, there is also evidence that the opportunity to read the standard terms before signing the contract does not change the substantive content of the contract terms, as the rights and obligations of consumers go: an empirical analysis of more

gen (Hamburg, Hanseatische Verlagsanstalt, 1935); T Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' (1983) 96 *Harvard Law Review* 1173. For more recent views, F Cafaggi and H-W Micklitz (eds), *New Frontiers of Consumer Protection—the Interplay between Private and Public Enforcement* (Cheltenham, Edward Elgar, 2009).

[8] MJ Radin, 'Boilerplate Today: The Rise of Modularity and the Waning of Consent' in O Ben-Shahar (ed), *Boilerplate. The Foundations of Market Contracts* (Cambridge, Cambridge University Press, 2007) 196. The argument is elaborated upon further in Radin, *Boilerplate*.

[9] See, for a summary of evidence of consumers not reading the terms, R Hillman and J Rachlinski, 'Standard-Form Contracting in the Electronic Age' (2002) 77 *New York University Law Review* 429. For an excellent discussion of the factors that make reading the standard terms an unattractive—and hopeless—course of action for consumers, see O Ben-Shahar, 'The Myth of the Opportunity to Read in Contract Law' (2009) 5 *European Review of Contract Law* 1. On the potential valuation of consumers of the opportunity to read and of favourable terms in the set of standard terms, using a large sample of real-world contracts (End User License Agreements in online transactions on software products), it has been found that the absence of presumptively unfavourable –for the consumer, that is, pro-seller- choice of Law and choice of forum clauses does not affect the price consumers pay for the goods: F Marotta-Wurgler, '"Unfair" Dispute Resolution Clauses: Much Ado About Nothing?' in Ben-Shahar (ed), *Boilerplate*, 45. Additionally, this study does not reveal any statistically significant difference between consumers and business buyers of the same software goods. Using the same database of online software contracts, and after constructing a comprehensive index of the 'quality' in terms of consumer friendliness of the set of standard terms (covering aspects as the acceptance of the license, the scope of the license, the transfer of the license, warranties and warranty disclaimers, limitations of liabilities, maintenance and support, and conflict resolution) it has been found that there is no evidence that consumers of a given type of product are willing to pay higher prices in order to get more favourable contract terms of a standard nature: F Marotta-Wurgler, 'Competition and Quality of Standard Form Contracts: An Empirical Analysis of Software License Agreements' (2008) 5 *Journal of Empirical Legal Studies* 447. As with the study previously cited on dispute resolution clauses, a third related study [F Marotta-Wurgler, 'Are "Pay Now, Terms Later" Contracts Worse for Buyers? Evidence from Software License Agreements' (2009) 38 *Journal of Legal Studies* 309] shows no perceptible difference in the overall buyer-friendliness of the terms between consumer and business buyers, nor between products typically oriented to consumers and more business-like types of products.

than 500 types of contracts—online software transactions- does not show that the standard terms that were not made available to the consumer prior to the transaction, but sent together with the good to the consumer after the contract was binding, were any worse, in terms of consumer friendliness across all dimensions of the transaction, than the standard terms that were made available to the consumers prior to the purchase decision.[10] It is the size of the firm and the number of years the seller has been in operation what seem to drive the main influences upon the quality of the standard terms.[11]

So the available empirical evidence does not seem to give a clear indication that imposing duties to disclose standard contract terms and providing consumers with opportunities to read them actually improve the material situation of consumers in terms of the welfare they obtain from the transaction.[12]

From this starting point, some try to revitalize consent[13], while others adopt a very skeptical view about the ability of Contract Law, or Law more generally, to

[10] See Marotta-Wurgler, 'Are "Pay Now, Terms Later" Contracts Worse for Buyers?'.

[11] Ibid. The market structure (whether there is less or more competition in the relevant product market) does not seem to play a role either in the forces leading to more or less consumer-friendliness of the standard terms: Marotta-Wurgler, 'Competition and Quality of Standard Form Contracts'.

[12] Some even argue that concentrating effort on disclosure duties may actually be harmful for consumers, if these 'procedural' sorts of protections associated with the opportunity to read are negatively correlated with the willingness of Courts to strike down individual clauses—and not the entire set of standard terms- for substantive reasons, or adopt more effective means to reject those clauses that are actually detrimental to consumer welfare: Ben-Shahar, 'The Myth of the Opportunity to Read'.

[13] R Hillman, 'Online Boilerplate: Would Mandatory Web Site Disclosure of e-Standard Terms Backfire?' in Ben-Shahar (ed), *Boilerplate*, 83 (disclosure as a possible remedy); M Boardman, 'Contra Proferentem: The Allure of Ambiguous Boilerplate' in Ben-Shahar (ed), *Boilerplate*, 176 (contract interpretation rules as a remedy); G Low, 'A Psychology of Choice of Laws' (2013) *European Business Law Review* 363 (although emphasizing the problem of choice overload, pointing at increasing familiarity with the domain of choice, prompting previous preferences about the content of future choices, the existence of salient or dominant options, and increased differentiation of options as potential strategies to improve choice); Y-K Che and A H Choi, 'Shrink-Wraps: Who Should Bear the Cost of Communicating Mass-Market Contract Terms?' (2009) *Working Paper, University of Virginia School of Law* (restricting the number of potential terms, where reading costs are not too high, may lead firms to offer good quality terms that consumers will read with positive probability, which implies forgone sales if firms try to cheat by offering bad quality terms); D Gilo and A Porat, 'Viewing Unconscionability Through a Market Lens' (2010) 52 *William and Mary Law Review* 133 (considering that under certain circumstances competitors of a given firm may have incentives to educate consumers about unfair or undesirable terms used by the incumbent firm selling to consumers). Others propose solutions that, while improving the outcome in consumer contracting in the presence of information and reading costs for consumers, do not imply actual 'informed consent' by consumers, meaning that consumers will actually read and be aware of the content of contract terms. Standardization, coupled with a certain upper limit to consumers' costs of reading terms may lead to an efficient allocation of contract types (depending on their terms) to consumer types, and consumer 'reading and actually consenting' is an off-the equilibrium threat that makes firms offer the right terms within the standardized set: A Wickelgren, 'Standardization as a Solution to the Reading Costs of Form Contracts' (2011) 167 *Journal of Institutional and Theoretical Economics* 30.

significantly and positively change consumer's apathy as to reading contract terms and choosing on the basis of their information about those terms[14].

The possible adoption of optional sets of rules to govern consumer transactions adds a new dimension to the choice problem. The focus, given the optional Law dimension, shifts to choosing among laws and legal regimes rather than contract terms, let alone products and vendors. This doesn't imply that the choice contract terms ceases to be important,[15] but a new dimension opens up which may not only affect directly the admissibility and enforceability of certain standard terms, but many other legal elements that shape the outcome of the transaction. Thus, what formerly was a distinctive feature of international trade transactions between firms would seem to be fair game for thinking about consumer markets and contracts. Not that issues that have been discussed above concerning terms as parts of the "product", or informational and reading costs in consumer transactions cease to be relevant in this new and slightly different scenario. Much of that also applies to "laws" that can be chosen to govern the contract. But there are also some new and distinctive elements in the setting that deserve ad hoc analysis. Moreover, in policy terms, the alternatives, constraints and views experience significant changes from the more established setting of alternative contract formats and contract terms. Some of those new elements will be addressed in the following sections.

28.3 Can choice in consumer contracts be only excessive and undesirable?

The strong European interest about Law and choice in contracting, including consumer contracting, is obviously not merely a product of the CESL initiative or the European Commission's ambitions in terms of harmonization policies in Private Law. As will be discussed below, these developments found fertile ground for debating Law and choice after the reception by a substantial group of European Private Law scholars of the relevance of Law as a product offered by market participants in the legal market and where competitive forces may be at work to shape the content and prevalence of Private Law rules[16].

[14] A Katz, 'Your Terms or Mine? The Duty to Read the Fine Print in Contracts' (1990) 21 *Rand Journal of Economics* 518; Ben-Shahar, 'The Myth of the Opportunity to Read'; O Ben-Shahar and C Schneider, 'The Failure of Mandated Disclosure' (2011) 159 *University of Pennsylvania Law Review* 101; I Ayres and A Schwartz, 'The No Reading Problem in Consumer Contract Law' (2013) *Working Paper, Yale Law School* (forthcoming, *Stanford Law Review*) 17.

[15] As emphasized by H Collins, 'Regulatory Competition in International Trade: Transnational Regulation through Standard Form Contracts' in H Eidenmüller (ed), *Regulatory Competition in Contract Law and Dispute Resolution* (Oxford, Hart, 2013) 121.

[16] The ideas of Law as a product, and of the existence of competition among lawmakers to provide legal rules that users, directly or indirectly, buy, originate in the US Corporate Law scholarship, adapting older ideas of regulatory competition in the provision of local public goods: R Romano, 'Law as a Product: Some Pieces of the Incorporation Puzzle' (1985) 1 *Journal of Law, Economics*

With respect to consumer contracts, there are several views that strongly criticize the excessive and undesirable room for choice (by the firm, not the consumer) of legal regime that optional instruments such as CESL promote. Some commentators argue that the choice left to firms by an optional set of rules governing consumer contracts is just an instrument of social dumping. Firms will impose the optional set of rules to consumers for one single bad motive: to get rid of high levels of mandatory consumer protection that firms would otherwise be legally required to comply with under the national Contract Laws. Thus, firms would only choose an optional law such as CESL if one condition is satisfied, namely that the substantive rules undercut the level of consumer protection provided by the other legal orders -those of national states- that are the alternatives to the choice of legal rules offered to the firms selling to consumers.[17]

We have already shown formally that this social dumping condition for the choice of an alternative, optional, Contract Law (CESL or some other body of rules) is theoretically unsound.[18] Firms selling to consumers may be voluntarily choose an optional set of rules, depending on the level of consumer protection embodied in the rules (and the costs that the provision of such protection entails for firms), if the savings in the costs of verifying compliance with a given level of consumer protection, and in the costs of doing business under more than one applicable set of rules (legal diversity costs) are large enough. Depending on how those cost functions are, given the level of the relevant standards (national and/or European), we show that firms may end up operating solely with the European set of rules, or with the European standard in one market and with the national standard in the other market.

Notice that the argument is independent of factors influencing why certain contract terms or certain laws may become "sticky" (that is, being widely used despite their loss in of appeal to many users), or that new terms or laws are adopted too quickly, given the majority preferences of users. Network externalities are often, and rightly, viewed as reasons behind the common observation that many firms -and

and Organization 225. They have been extended to other areas of the legal system, including contracts [E O'Hara and L Ribstein, *The Law Market* (Oxford, Oxford University Press, 2009)] and imported into the European Private Law set of theoretical and empirical debates: S Grundmann, 'The Role of Competition in the European Codification Process' in H-W Micklitz and F Cafaggi (eds), *European Private Law after the Common Frame of Reference* (Cheltenham, Edward Elgar, 2009) 36; H Eidenmüller, 'Recht als Produkt' (2009) 64 *Juristenzeitung* 641; H Eidenmüller, 'The Transnational Law Market, Regulatory Competition, and Transnational Corporations' (2011) 28 *Indiana Journal of Global Legal Studies* 707; H Eidenmüller, 'Regulatory Competition in Contract Law and Dispute Resolution' in H Eidenmüller (ed), *Regulatory Competition in Contract Law and Dispute Resolution* (Oxford, Hart 2013) 1.

[17] See H Collins, *The European Civil Code, The Way Forward* (Cambridge, Cambridge University Press, 2008) 74; JW Rutgers, 'Optional Instrument and Social Dumping' (2006) 2 *European Review of Contract Law* 199; B Lurger, 'The Common Frame of Reference/Optional Code and the Various Understanding of Social Justice in Europe' in T Wilhelmsson, E Paunio and A Pohjolainen (eds), *Private Law and the Many Cultures of Europe* (The Hague, Kluwer Law International, 2007) 177; JW Rutgers, 'An Optional Instrument and Social dumping revisited' (2011) 7 *European Review of Contract Law* 350; R Sefton-Green, 'Choice, Certainty and Diversity: Why More is Less' (2011) 7 *European Review of Contract Law* 134.

[18] Ganuza and Gomez, 'Optional Law for Firms and Consumers'.

perhaps other legal actors different from firms- use the same set of laws, or the same contract terms: a certain product -including a legal rule or a contract term- becomes more valuable to users as the number of users of the same product increases.[19] The causes underlying why this positive network effect is present in a particular setting or with respect to a particular product may be manifold: learning, increased presence of complementary goods, liquidity and tradability facilitated by the ability to price something that is "standard" and not idiosyncratic, etc.

Negative signaling is also a factor explaining why a firm may decide to resort to the most familiar or widely used contract term or set of laws (be they the traditional ones, or new ones that have suddenly become trendy in the market) even if they are not the ones that best suit its preferences or would maximize the joint surplus from a given contract, be it with consumers or with business parties. If the counterparties may find strange that the familiar term or law is not used, they may suspect that the firm's decisions to deviate from the standard contract term or law, and to choose an alternative one, is suggesting some unknown and undisclosed problem with the contract or with the firm offering the unfamiliar alternative.[20] Of course, in a perfect and symmetric information interaction, such considerations of negative signaling play no role, but when parties do not know everything about each other, and important information is not known to the counterparty, these negative inferences that may be drawn by unfamiliar choices may explain why some parties with ability to choose terms or laws prefer not to arouse suspicions of any kind and simply reassure counterparties by conforming to what most other parties do. Although this logic has been specially applied to debt relationships, if may be present in the setting of firms suggesting terms to consumers (of course, terms referring to elements of the transaction that consumers are familiar or experienced with) or optional sets of rules. Contrary to network externalities, it is not correlation of valuations by different users what drives the logic of the argument, but asymmetric information and adverse selection considerations. As with network externalities, the outcome is conformity with the standard practice, be it an old or a recent one. Thus, network externalities and negative signaling may reinforce the force of verification and legal diversity costs in moving firms to choose a new, optional set of rules. Of course, whether this will actually happen is very hard to predict, and estimating the frequencies would require significant amount of information about real world data underlying the magnitude of those effects.

[19] Network externality is a notion that appeared in economics to characterize some properties of network goods (communication and information goods, mostly), and later on it was adapted to the legal sphere, initially in the corporate contract setting: M Klausner, 'Corporations, Corporate Law, and Networks of Contracts' (1995) 81 *Virginia Law Review* 757; M Kahan and M Klausner, 'Standardization and Innovation in Corporate Contracting (Or, "The Economics of Boilerplate")' (1997) 83 *Virginia Law Review* 713. In a broader contract context, see M Gulati and RE Scott, *The 3 and 1/2 Minute Transaction: Boilerplate and the Limits of Contract Design* (Chicago, University of Chicago Press, 2013) 34; A Engert, 'Networks and Lemons in the Market for Contract Law' in Eidenmüller (ed), *Regulatory Competition*, 304.

[20] O Ben-Shahar and J Pottow, 'On the Stickiness of Default Rules' (2006) 33 *Florida State Law Review* 651; Gulati and Scott, *The 3 and 1/2 Minute Transaction*, 35.

However, the somewhat dismal forecast that firms will only choose a new set of optional rules when this is bad for consumers' welfare is not at all warranted in theoretical terms. For a wide range of values of the relevant parameters, the exercise of choice of optional rules by firms in consumer contract settings can (but only "can") be beneficial, or at least not detrimental, to consumers.[21]

28.4 Is Choice of Legal Regime in Consumer Contracting Doomed to be Ineffective?

There are several strands of the literature focusing on the effectiveness of choice before optional sets of rules governing consumer contracts. A group of contributions focus on the consumer's actual choice possibilities, and shares with the social dumping literature a critical stance towards optional rules governing consumer transactions. This literature essentially challenges the idea that the optionality of rules involves in any meaningful way any kind of choice or option for consumers. These views emphasize that it is always the strong party, the firm, the one who would unilaterally, and based upon its egoistic and one-sided calculation of costs and benefits, decide and impose on the other party whether to choose, or to waive, a given optional set of governing rules. Consumers would be left, at best, and depending on the nature of the goods and services, and on the market structure, with the option to contract under the rules chosen by the firm, or not to contract at all.[22] The criticism, in some cases, goes beyond the lack of genuine enhanced consumer choice, and point to an actual net deprivation of consumers' choice opportunities: Given that consumers are not aware of the full range of alternatives and the consequences of contracting under one or the other set of rules, they may even experience some restriction in the chances to look for another vendor of the same or a similar good or service under the laws of his or her home country.[23]

A second group of approaches to the effectiveness of choice of legal rules governing the transaction under optional instruments essentially considers that firms would not consider worthwhile the additional costs of choice regarding new optional sets of rules, given that they substantially enjoy more than enough scope for choice under the traditional area of Conflicts of Laws rules and doctrines.[24] The list

[21] Ganuza and Gomez, 'Optional Law for Firms and Consumers'.

[22] See, J Cartwright, 'Choice is Good. Really?' (2011) 7 *European Review of Contract Law* 335; G Howells, 'European Contract Law Reform and European Consumer Law—Two Related But Distinct Regimes' (2011) 7 *European Review of Contract Law* 176; C Twigg-Flesner, 'Good-Bye Harmonisation by Directives, Hello Cross-Border only Regulation?—A Way Forward for EU Consumer Contract Law' (2011) 7 *European Review of Contract Law* 250; W Doralt, 'The Optional European Contract Law and why success or failure may depend on scope rather than substance' (2011) *Max Planck Private Law Research Paper* 8; M Loos, 'Scope and Application of the Optional Instrument' (2011) *Amsterdam Law School Legal Studies Research Paper* No. 2011–14.

[23] Cartwright, 'Choice is Good. Really?'.

[24] See G Low, 'The (Ir)Relevance of Harmonization and Legal Diversity to European Contract Law: A Perspective from Psychology' (2010) 18 *European Review of Private Law* 285; G Low,

of arguments marshaled in favour of this view is a long one. First, legal disparities and divergences are not an important factor behind consumers' decisions to enter into transactions with foreign firms, and search and negotiating costs are, so it is argued, essentially invariant with respect to legal factors. Thus, the harmonization advantage of trans- or supra-national optional laws would become moot. Second, inertia, status-quo biases and endowment effects would make new optional sets of legal rules powerless in order to mobilize firms and consumers to abandon the legal rules they are currently using to govern their economic transactions. Third, many firms are happy with their national legal framework, and even if they would seek some alternatives, they would naturally go to legal rules of similar legal traditions and/or neighbouring jurisdictions. Fourth, additional sets of rules of an optional character would produce for firms, let alone consumers, problems of choice overload, which, moreover, would be aggravated by the complex and novel character of newly drafted optional sets of rules.

The third group has a different outlook and aim. It essentially tries to underline the importance of scope of legal rules for inducing increased levels of choice of legal rules, or addresses the technical side of choice in order to make it safer, smoother and eventually more appealing.[25] Although this literature may be critical, even very critical, with scope and choice of law solutions adopted in CESL, and that perhaps may be copied in other future optional sets of laws, as a whole it tends to consider that choice of rules is both meaningful and important for consumer contracting, and thus tries to suggest ways to improve the process of opting into a set of a rules that will govern a consumer transaction. We will not address this strand of the literature here, since it does not seem, in our view, to pose a challenge to the way in which we approach choice of rules in the consumer setting.

As to the two previous strands of the literature, the one focusing on consumer choice failure or even deprivation largely rests upon two theoretical claims -or assumptions, as they often remain implicit. First, that there cannot be an optional set of rules that is attractive for firms to choose, while ensuring a high degree of consumer rights for consumers in the contract. Second, that firms will never willingly operate under more than one set of rules, and thus, unless forced to do it, would always refuse to offer consumers the choice of transacting under one or the other.

'Will firms consider a European optional instrument in contract Law?' (2012) 33 *European Journal of Law and Economics* 521; G Low, 'A Psychology of Choice of Laws' (2013) *European Business Law Review* 363. To some extent, J Smits, 'Party Choice and the Common European Sales Law, or: How to Prevent the CESL from Becoming a Lemon on the Law Market' (2013) 50 *Common Market Law Review* 51, shares a somewhat skeptical view about the value of optional laws (or, at least, of CESL) to meaningfully enlarge the choice set of firms already operating in consumer markets.

[25] Doralt, 'The Optional European Contract Law', 13; G Rühl, 'The Common European Sales Law: 28th Regime, 2nd Regime or 1st Regime?' (2012) 19 *Maastricht Journal of European and Comparative Law* 148; S Whittaker, 'The Optional Instrument of European Contract Law and Freedom of Contract' (2011) 7 *European Review of Contract Law* 371; J Basedow, 'The Optional Instrument of European Contract Law: Opting-in through Standard Terms' (2012) 8 *European Review of Contract Law* 82; G Dannemann, 'Choice of CESL and Conflict of Laws' in G Dannemann and S Vogenauer (eds), *The Common European Sales Law in Context* (Oxford, Oxford University Press, 2013) 21.

As we showed formally in previous work,[26] none of those two claims is theoretically correct. It is possible to show that there are conditions in which the following two propositions may be satisfied at the same time: Optional rules for consumer contracts that firms will find attractive to choose in their contracts have levels of consumer protection that are higher than the alternative sets of rules, most notably those of pre-existing laws, or laws of other jurisdictions; second, that firms may offer a choice of the applicable set of rules to consumers, so that different sets of rules may co-exist, and be offered alongside, national laws.

Thus, the fact that the basic decision to choose the governing set of rules would most likely go to the firm—as a consequence of it being a repeat and more experienced player, of typically possessing higher knowledge of the legal alternatives, and more importantly, because it is for the firm to decide which consumers and markets it is interested in serving—does not mean that consumers will never have a choice and, even less, that they will be deprived of choices they now enjoy.

Let's now briefly turn to choice of legal rules not being effective because firms will not consider worthwhile to have an optional set of rules, additional to the possibilities (wide or narrow, is a matter of taste, for many) they now enjoy under traditional Conflicts of Laws principles. It is true that one has to be cautious concerning overoptimistic claims about firms benefitting from choice as to legal rules governing consumer transactions (both under general Private International Law Principles and under newer optional laws approaches).[27]

The level of actual use of the CESL would most definitely constitute the object of an empirical prediction and not a theoretical result, and we do not have data on which to make such a prediction. We conjecture, however, that complete autarky is unlikely to be the equilibrium outcome. When one combines the efficiency gains of lower production costs by some firms who may be able to enter other European national markets more easily, with the savings in verification and legal diversity costs, it seems that there is at least room for a sizable number of firms deciding to take advantage of the increased possibilities offered by optional laws. In fact, there are precedents in the European context of optional regimes that successfully co-exist with national laws, when the European rules, even if more exacting than many, if not all, pre-existing national ones, allow firms to save legal costs.

Moreover, for the firms who are currently active in cross-border trade with consumers, trans-national optional sets of rules may be particularly attractive, and they may be very willing to exit the "national legal systems" framework for such transactions. If a sufficient mass of such firms choose the optional rules, it is likely that network externalities and negative signaling, for the reasons explained in the previous section, may provide an added push to the more reluctant participants in those markets.

[26] Ganuza and Gomez, 'Optional Law for Firms and Consumers'.

[27] See how an empirical approach, using Eurobarometer survey data, places in perspective the European Commission's overselling of CESL: WHJ Hubbard, 'Another Look at the Eurobarometer Surveys' (2013) 50 *Common Market Law Review* 187.

28.5 The Alleged Insufficiency of Firm Choice in Consumer Contracts

In this section we will basically analyze using Law and Economics arguments the positions of those who consider that even with optional sets of rules such as CESL, the European legal framework still does not go far enough to allow firms to choose the legal regime that best suits their needs for serving consumers. That is, firms should enjoy unlimited (or at least expanded) choice of legal regime for consumer contracts, and thus be able to subject the contract to the national (or supra-national) legal regime they see fit.

The basis for these positions, that will be explained more in detail below, is, unsurprisingly, the regulatory competition model. This model implies that, at least in some areas of the Law (Corporate Law was the original area, and now Contract Law and others have been added[28]) competition among jurisdictions will force them to improve the quality of the legal rules to satisfy the preferences of the "consumers" or "buyers" of legal rules—companies, in the case of Corporate Law; contract parties in the case of Contract Law. In their drive to attract customers, the "sellers"—the jurisdictions- will be under the competitive pressure to adopt rules that provide maximum benefits to the customers of the legal system. Like in other markets, also in the market for legal rules, product quality would in the end be optimal.[29] Not only competition would provide a forceful engine towards finding the legal solution that maximizes the satisfaction of legal customers, if the preferences of the customers are not significantly heterogeneous (as those of firms may be: they seek profit maximization) the satisfaction-maximizing legal response would be essentially similar across jurisdictions, thus leading to a sort of competitively harmonized legal regime: Given that the efficient solution would be –roughly- the same for all jurisdictions, being the relevant preferences quite similar, the competitive process would push all jurisdictions to choose the uniquely efficient legal regime.

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[28] O'Hara and Ribstein, *The Law Market*; Eidenmüller (ed), *Regulatory Competition*.

[29] This view of the Corporate Law market has been—and still is—very influential in the US, and so is in Europe: F Easterbrook and D Fishel, 'The Race to the Bottom Revisited: Reflections on Recent Developments in Delaware´s Corporation Law' (1982) 76 *Northwestern University Law Review* 913; Romano, 'Law as a Product', 225. In Europe Eidenmüller, 'The Transnational Law Market', 717. Many do not share the idea that such a competitive market exists in Corporate Law, at least in a recognizable form: M Kahan and E Kamar, 'The Myth of State Competition in Corporate Law' (2002) *Stanford Law Review* 679; M Roe, 'Delaware Competition' (2003) *Harvard Law Review* 588; O Bar-Gill, M Barzuza and L Bebchuk, 'The Market for Corporate Law' (2006) *Journal of Institutional and Theoretical Economics* 134; F Gomez and M Saez, 'Competition, Inefficiencies and Dominance in Corporate Law' (2006) *Journal of Institutional and Theoretical Economics* 161. In Contract Law, the faith in regulatory competition seems to have both believers and non-believers in Europe. As to the first, H Eidenmüller, 'Regulatory Competition', 1; G Rühl, 'Regulatory Competition in Contract Law: Empirical Evidence and Normative Implications' (2013) 9 *European Review of Contract Law* 61. Among the second, the meta-study by S Vogenauer, 'Regulatory Competition through Choice of Contract Law and Choice of Forum in Europe: Theory and Evidence' (2013) *European Review of Private Law* 13, 74.

As is well-known, Art. 6(1) and (2) of Rome I Regulation, for most consumer transactions (not when the consumer is physically shopping abroad, or is actively seeking transactions in a foreign country, since then the principle of freedom of choice prevails[30]) choice of legal regime is significantly constrained, since it is not allowed that choice of law clauses deprive consumers of the level of protection provided by the mandatory rules of the legal system of the country in which the consumer has her habitual residence.

A number of influential European legal commentators argue,[31] with slightly different emphasis, but substantial agreement as to the core of the basic criticism and the essence of the solution, that it would be welcome to significantly expand choice of legal rules in consumer contracts. The current preferential treatment in favour of the legal regime of the consumer's home country should be abandoned in order to foster fuller horizontal competition of legal systems, at least of those of the EU Member States. The present regulatory regime under Art. 6.2 Rome I Regulation prevents "*any meaningful legislative competition at the horizontal level between States, as the consumer's domestic law will always prevail unless foreign law offers a higher standard of protection*".[32] As arguably the constraints set by Rome I Regulation do not apply to the choice of CESL as set of rules governing the consumer contract, there is unequal treatment of EU Law (CESL) and national law (the different laws of the EU Member States, and also of the other countries in the world) and thus the process of regulatory competion becomes fundamentally distorted to the advantage of EU Law. The natural remedy would then be to eliminate the distortion tilting the outcome in favour of CESL and EU Law, by exempting also the choice of the legal rules of the different countries from the unduly discriminatory -against national legal orders- constraints determined by Art. 6(2) Rome I Regulation. This would imply unconstrained, or at least greatly expanded, ability of contract parties to a consumer contract to choose the governing law, regardless of whether the chosen set of rules satisfies the level of mandatory protection of the consumer's home country legal system.

[30] Art 6(4) Rome I Regulation provides for other exceptions to the application of Art 6(1) and 6(2). For an analysis of the entire Art 6 Rome I Regulation, F Ragno, 'The Law Applicable to Consumer Contracts under the Rome I Regulation' in F Ferrari and S Leible (eds), *Rome I Regulation. The Law Applicable to Contractual Obligations in Europe* (Munich, Sellier, 2009) 129.

[31] See T Ackermann, 'Public Supply of Optional Standardized Consumer Contracts: A Rationale for the Common European Sales Law?' (2013) 50 *Common Market Law Review* 11, 26; H Eidenmüller, 'What Can Be Wrong with an Option? An Optional Common European Sales Law as a Regulatory Tool' (2013) 50 *Common Market Law Review* 69, 77; S Grundmann, 'Costs and Benefits of an Optional European Sales Law (CESL)' (2013) 50 *Common Market Law Review* 225, 241. G Rühl, 'Consumer Protection in Choice of Law' (2011) 44 *Cornell International Law Journal* 569, 597 considers that the choice of law model underlying Art 6(2) Rome I Regulation is an economically viable compromise between ensuring sufficient choice and ensuring adequate consumer protection. However, in Rühl, 'Regulatory Competition', the author advocates the elimination of the restrictions in Arts 5 (contracts of carriage) and 7 (insurance contracts) Rome I Regulation. True, the way in which those two provisions constrain choice of legal regime is not the same as in Art 6(2), but the reason for criticizing the other two provisions is squarely the expansion of freedom of choice as a condition for regulatory competition.

[32] Ackermann, 'Public Supply of Optional Standardized Consumer Contracts', 26.

There are several and important reasons why we do not share these views, and we will present them in the following pages. It is however important to remark from the outset that the focus on undistorted and fair competition between EU Law and national legal orders is a misguided basis to understand and evaluate the consequences of enlarging or restricting choice of legal orders in consumer contracts. Obviously, "distorted" and "unfair" are terms with immediate negative connotations, and thus raise almost automatic rejection: How can something "distorted" or "unfair" be good? Competition, however, is not a value in itself, it is merely a tool (often, a very useful and powerful one) to achieve the outcomes that better serve society's goals. In economics, competition is not valued for its own sake, and having "nondistorted" competition is not something prized as an ultimate goal. Competition is desirable when the allocation it produces is superior in terms of social welfare to those under alternative mechanisms. This is something, as standard elementary microeconomics teaches, that is often true case concerning the allocation of private goods. But it is not always true. And it is not actually the case that we always prefer full, undistorted competition to "less" or "distorted" competition. Sometimes less competitive mechanisms produce better allocations than more competitive or less distorted ones.[33] Our choice should be based (at least for economists, who are, at heart, consequentialists as to decision rules) on the outcomes, not on the characteristics of the process. This means that appeals to the "distortions" of regulatory competition are by themselves largely uninformative about the desirability of a certain regulatory environment. It is the consequences of the distortions -and of the removal of the alleged distortions- that matter.

We will not fully review the theoretical and empiricial contributions on the regulatory debate, not even those that refer more specifically to Contract Law. But we will mention a few points that should make us somewhat more skeptical about observing true regulatory competition in the real world.

First, the theoretical assumptions that underlie the result of efficient regulatory competition, both in the initial model of mobility of individuals[34] and in the model of mobility of capital[35] are numerous, and very stringent concerning the goals of lawmakers, the informational requirements, the policy instruments, the distribution of costs and benefits, and more. It appears unlikely that they will all hold in most

[33] A well-known (since the French economist and mathematician Cournot found out in 1838) illustration is that of the provision of pure complementary goods, where perfect competition between producers of each good generates worse results than less competitive mechanisms, in fact, worse than monopoly. It is thus not surprising that introducing distortions in a competitive mechanism may lead to better results than undistorted competition: See, for an application to public procurement of how less competition may enhance welfare under very plausible conditions, J Ganuza and F Gomez, 'Procurement and Accidents: Bidding for Judgement Proofness and the Limited Liability Curse' (2013) *Working Paper, Department of Economics and Business, Universitat Pompeu Fabra*.

[34] See, the initial and pioneering contribution on competition in local public goods provision by C Tiebout, 'A Pure Theory of Local Expenditures' (1956) *Journal of Political Economy* 416.

[35] See W Oates, *Fiscal Federalism* (New York, Harcourt Brace Jovanovich, 1972).

real world circumstances in which jurisdictions and lawmakers adopt measures and rules.[36]

Second, although the empirical evidence concerning whether the presence of competitive sources of rules and regulations do actually benefit or harm the feasibility of efficient outcomes in the affected population is not unidirectional, some of the most recent evidence, at least in the environmental sphere, should lead us to be even more cautious and less cavalier with respect to the possibility of finding actual cases of races to the bottom that, in the end, are hurtful for social welfare. Whereas the earlier literature on regulatory competition in environmental standards did not find conclusive evidence of an erosion of standards due to regulatory competition,[37] some of the recent evidence seems to point in the opposite direction.[38]

Again, none of this is decisive or entirely carries the day in the debate. Indeed, one should look to further evidence to estimate the empirical relevance of the potentially efficient and inefficient consequences of regulatory competition. Also, new theoretical work may uncover some dimensions that may reveal lower levels of costs or of benefits resulting from regulatory competition.[39]

Thus, the regulatory competition model and its (positive) effects is not something one can generally and unquestionably take for granted to base expanded choice in consumer contracting.

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[36] For the Tiebout kind of 'voting with the feet'—either physically or virtually—models, see G Wagner, 'The Economics of Harmonization: the Case of Contract Law' (2002) 39 *Common Market Law Review* 1007. For fiscal federalism models, see A Levinson, 'Environmental Regulatory Competition: A Status Report and Some New Evidence' (2003) 56 *National Tax Journal* 94. In both cases, the contrast between the exacting set of assumptions for regulatory competition leading to optimality, and the likely characteristics of the settings in which lawmakers, however well-intended they may be, have to operate, cast some doubt about the implementability of optimal results through competition of lawmakers and regulators. Of course, the preceding argument does not imply that regulatory competition is inexistent, or is doomed to fail, simply that it is not very likely to happen in the real world as a mechanism to implement socially optimal outcomes.

[37] See, for instance, J List and S Gerking, 'Regulatory Federalism and Environmental Protection in the United States' (2000) 40 *Journal of Regional Science* 453. Most of this evidence is aptly reviewed, with an eye on the harmonization debate, in M Faure, 'How Law and Economics May Contribute to the Harmonization of Tort Law in Europe' in R Zimmermann (ed), *Grundstrukturen des Europäischen Deliktsrechts* (Baden-Baden, Nomos, 2003) 47.

[38] See R Becker and V Henderson, 'Effects of Air Quality Regulations on Polluting Industries' (2000) 108 *Journal of Political Economy* 379; M Greenstone, 'The Impacts of Environmental Regulations on Industrial Activity: Evidence from the 1970 and 1977 Clean Air Act Amendments and Census of Manufactures' (2002) 110 *Journal of Political Economy* 1175; P Fredriksson and D Millimet, 'Is There a "California Effect" in US Environmental Policymaking?' (2002) 32 *Regional Science and Urban Economics* 101; A Levinson, 'Environmental Regulatory Competition' (2003) 98. For a survey of the recent evidence, see A Levinson, 'pollution haven hypothesis' in S Durlauf and L Blume (eds), *The New Palgrave Dictionary of Economics* (London, Macmillan 2008).

[39] See J Ganuza and F Gomez, 'Soft Negligence and the Strategic Choice of Firm Size' (2011) 40 *Journal of Legal Studies* 439, showing how when potential injurers –for instance, firms that may cause harm to consumers, to investors or to the environment- enjoy discretion about the choice of level of assets and may decide to become potentially insolvent, if legal systems use rules that adapt to the actual levels of assets, firms will have less incentive to lower assets, and also cause lower levels of harm, which means that decentralized choice of rules will be less harmful.

However, even assuming that regulatory competition works for B2B contracts, where parties bargain about the applicable law and the choice of forum clauses, the expansion of choice of legal regime under Art. 6(2) Rome I Regulation is likely not to be warranted.

When fully-informed parties bargain about contract terms and governing law, one may perhaps predict that the choice will be welfare-maximizing for the joint situation of both sides. There is no guarantee of this, certainly, even in this scenario. External market factors and the sequence of negotiating the terms (price first, and then governing law and other non-price terms), and differences in bargaining power when there are asymmetries of information between the parties (not concerning knowledge of the law, or the effects of certain legal rules or contract terms, but concerning the underlying parameters of the transaction, such as cost, valuation, magnitude of contingencies and so on) may affect contract design and induce rational parties[40] to choose sub-optimal terms.[41] These distortions may affect also the choice of governing legal regime.

In the typical consumer contract, it is hardly imaginable that consumers will have decent information about the consequences of choosing for the contract a legal regime different from a "familiar" or "expected" regime, such as that of the consumer's place of residence. Familiarity with the consumer's domestic legal order should not be automatically assumed. Even when information about the consequences of one or the other choice is available for the consumer, it is rarely the case that parties to the consumer contract will bargain over such dimension of the transaction. In practice, the choice of legal regime will be a unilateral decision by the firm, buried in the fine print, and consumers would not have known about it, let alone "actually" consented to the choice. Even when the consumer has clicked on a box declaring that the consumer has read and understood all the terms, in reality the consumer would typically not have read, would not have understood, had she read, and had she understood, she would not have been in the position to grasp the entire set of costs and benefits of the choice of a given set of legal rules for the transaction.

Under these conditions, there is no reason to think that the unilateral choice of legal rules will maximize the joint welfare of the parties (absent third party externalities, this is the optimal goal of contract parties, and thus of Contract Law). Even if legal systems are sensitive and responsive to the demand by "buyers" of legal rules, and would try to design and implement rules that serve the goals of those "buyers" (as the regulatory competition model predicts), the substantive content of the rules would not be the one maximizing joint contract surplus, since this is not the goal pursued by the party—the firm—who "buys" legal rules from the jurisdictions.

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[40] The argument in the text disregards firms' myopia about the advantages of different legal regimes and contract terms, or the presence of biases (attachment to the home country legal system) that would further distort the optimal choice of legal regime and contract terms by firms. Thus, the argument in the text is independent and cumulative to behavioural factors as those mentioned in this footnote.

[41] See, A Choi and G Triantis, 'The Effect of Bargaining Power on Contract Design' (2012) 98 *Virginia Law Review* 1665.

One could possibly ask if the problem is consumers' lack of information about the alternatives in terms of choice of legal regime, perhaps firms may be interested in educating consumers on this respect. For instance, if firm A, who is very much interested in using German Law to serve consumers in other large European markets (France, UK, Italy, Spain, etc.) may be willing to invest resources in educating prospective customers in those markets about the advantages of German Law as a set of rules to govern the transaction. In this way, consumers will be, at the same time, informed about the importance of the choice of law term, and the substantive benefits of German Law. There are a number of problems concerning this imagined scenario.

First, informing about the content of a legal system is a complex and time consuming task,[42] and given these properties, a likely result would be a high risk of consumer's informational overload.

Second, such information is of a public good (non-rival and non-excludable) nature, and thus the incentives for its provision are suboptimal: if firm A spends resources in educating foreign consumers about choice of law clauses and the relative advantages of German Law, the value from that investment could be reaped also by firm B, C, D, etc. who also cater to similarly situated consumers and also would like to use German Law as a governing law for the contract. Firm A would not be able to charge firms B, C, D, etc. for the benefit of facing better educated consumers about German Law. The other firms would free ride on firm A's investment, which makes it an unlikely one to happen. Again, this does not mean that the level of investment will be necessarily zero, but it will be expected to be below, perhaps far below, the desirable level of educational investment of consumers.

Third, the curse of shrouded attributes is likely to be at work here.[43] Imagine that firm A is using a hidden choice of law clause selecting the legal system of country X, that allows firms to charge undisclosed prices for add-ons or additional services. Imagine that the competitive price for the basic good is 100, and the hidden prices for add-ons would allow the firm to charge 25 for the add-ons, which would be sold competitively at 10. In order to attract customers, firm A offers the basic good at 95, thus looking as a very attractive seller. Consumers that are naïve would end up paying 120 for a package (basic goods plus the add-ons) whose competitive price is only 110.[44] One would think that A's competitors would have an incentive to inform

[42] Pointing to the complexities and costliness of informing about the content of national Contract Laws to consumers and, in general, to parties who are not willing and/or able to pay for legal experts, Low, 'A Psychology of Choice of Laws', 377; Smits, 'Party Choice and the Common European Sales Law', 59.

[43] For the founding model of shrouding consumers, X Gabaix and D Laibson, 'Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets' (2006) 121 *Quarterly Journal of Economics* 505. An informal presentation of the arguments in X Gabaix, A Landier and D Thesmar, *La protection du consommateur: rationalité limitée et regulation* (Paris, Conseil d'Analyse économique, 2012) 13.

[44] Sophisticated consumers, who are able to anticipate the overcharge for add-ons would avoid getting the add-ons from firm A, and would get them from other providers at the competitive price of 10. They will enjoy the package at 100, less than the overall competitive price of 110.

consumers about what is going on, and tell them that they will sell the basic good at 100 (the competitive price) and that they operate under a different set of rules that forbids undisclosed prices for add-ons. With this information, firm B, say, would expect to attract all customers from firm A. Is this so? The model predicts that this is not going to happen, since that information actually would induce the initially näive consumers to essentially mimick the sophisticated ones: stick to A for the basic good (at a price of 90 instead of 100, the competitive price) and get the add-ons from other sellers who do not have undisclosed prices for add-ons. Given this expected "clever" reaction by consumers, firm B has nothing to gain from informing näive, uninformed consumers, and it will not do so.

Thus, when consumers will turn "sophisticated" when informed about the consequences of certain excessive prices or negative attributes that can be imposed as a consequence of a certain choice of legal regime, no firm in the market has an incentive to adequately educate consumers, and the choice of legal order intended to exploit consumer näiveté concerning undisclosed features, charges or add-ons, will persist, even if there are many sellers and there is competition in the provision of the goods and services.

Fourth, the incentives of firms to inform consumers about the actual effects of a given choice of laws are systematically biased. Firms would have an incentive to correct pessimistic beliefs of consumers about the consequences of that choice of law (say, for example, choosing German Law) but they will have no incentives to correct wrong beliefs about the legal order when these beliefs are overoptimistic.[45] Assume that foreign consumers' beliefs about the impact of German Law on the surplus they would obtain from the contract may be wrong or insufficiently informed. Some consumers may be too pessimistic concerning German Law, they may think it ensures them lower surplus than their domestic Law, when this is not the case, because German Law is actually more protective of consumers' interests than the consumers' home country Law. Thus, other things being equal, the willingness to pay for the contract with German Law of these pessimistic consumers will be lower than it would be, were the consumers in possession of the right information about the impact of German Law. The firm would have an incentive to educate pessimistic consumers, since this would increase business. However, there may be also overoptimistic consumers, who hold mistaken positive beliefs about the comparative advantages of German Law for their transaction. Consequently, these consumers are, other things being equal, willing to pay more for the contract under German Law than they would if their beliefs were the correct ones. Obviously, firms who were able to sell under German Law as a result of the enhanced freedom to choose legal regime in a consumer contract, would have no incentive to correct these false, overoptimistic expectations of foreign consumers.

As a result of these systematic biases, only pessimistic beliefs will be eliminated from the imagination or expectation of consumers, but optimistic beliefs about the effects of contracting under a given foreign legal regime will survive, thus leading to inefficient levels of contracting using that set of rules.

[45] Ayres and Schwartz, 'The No Reading Problem in Consumer Contract Law', 21.

Fifth, given selective and limited consumer attention, relatively esoteric contract terms such as those dealing with choice of legal regime are likely to generate self-confirming incorrect beliefs by consumers,[46] and will be prone to exploitation of limited attention by consumers, given the low salience of the issue.[47]

Sixth, consumers with lower levels of wealth and education are likely to be additionally hurt by a choice of contract terms or a choice of governing rules that allow firms to offer teasing initial prices, but then reduce the value of the transaction through add-ons, reduced warranty coverage that decreases substantially the utility from the good, late payment fees, and similar features that may be possible under certain legal regimes but not others. As has been recently shown,[48] consumers with scarce resources are more likely to focus only on savings in the front price for the contract, and disregard, perhaps completely, later consequences. Thus, if the choice of a given governing law allows the firm to obtain extra surplus from the contract (through late fees, or reduced production and after-sales costs due to the limited warranty) that permit an aggressive up-front price, this is likely to be appealing to firms that currently interact with consumers of modest means, since they will disproportionately focus on the immediate savings, and thus will find the contract disproportionately more attractive.

If we go back to Art. 6(2) Rome I Regulation, what we find if we understand the provision functionally is the introduction of a flexible floor to the "basic legal quality" of the contract, by allowing choice of law provisions, but subject to the constraint of the mandatory protective rules of the legal system of the consumer's habitual residence. At first blush (although we will come later to this point) the set of rules of the consumer's home legal system are the ones with which the consumer is likely to be more familiarized, and thus, is likely to become the best guess concerning the average consumer's expectation about the basic legal quality of the contract.

In consumer markets, the introduction of minimum quality levels concerning the transaction has been subject to an extensive literature. The earlier papers identified a negative impact upon consumers with the lowest willingness to pay for quality.[49]

The more recent literature is notably more positive about the introduction of such "quality floors". In the most important paper in this literature,[50] it is shown that the introduction of adequately chosen "quality floors" may improve welfare when

[46] J Schwartzstein, 'Selective Attention and Learning' (2013) *Working Paper, Department of Economics, Dartmouth College*.

[47] V Stango and J Zinman, 'Limited and Varying Consumer Attention: Evidence from Shocks to the Salience of Bank Overdraft Fees' (2013) *National Bureau of Economic Research Working Paper* 17028.

[48] S Mullainathan and E Shafir, *Scarcity. Why Having Too Little Means So Much* (New York, Times Books, 2013) 19.

[49] HE Leland, 'Quacks, Lemons and Licensing: A Theory of Minimum Quality Standards' (1979) 87 *Journal of Political Economy* 1328; C Shapiro, 'Premiums for High Quality Products as Returns to Reputations' (1983) 98 *Quarterly Journal of Economics* 659.

[50] U Ronnen, 'Minimum quality standards, fixed costs and competition' (1991) 22 *Rand Journal of Economics* 490.

there is vertical competition between producers of different levels of quality, and where the costs for the firms do not rise too steeply with quality (as is likely the case with choice of governing law clauses, that typically do not fundamentally affect the production technologies of firms, although they may have important impact). A reasonable quality floor would increase the degree of vertical competition due to the reduced quality space, and firms will raise quality, but quality-adjusted prices would not rise. As a consequence, more consumers will buy the good after the minimum legal quality is introduced, and at better legal quality-adjusted prices. It is important to mention that the model predicts that no consumers are made worse-off, even those with lower willingness to pay for legal quality.

These basic ideas have been extended[51] to an imperfect information setting, and to scenarios allowing for both horizontal and vertical competition, and find that the quality floors increase equilibrium qualities, as well as firms' profit and total welfare, and under plausible assumptions about the imperfect information, consumer welfare undeniably increases.

These advantages from "basic legal quality floors" arise from increased vertical competition in consumer markets. Thus, when increased competition would not help, the positive effects would not be present. Notice that competition may not always help consumers and may in fact be hurtful to them. For instance, it has been recently shown[52] that when firms face two types of consumers, sophisticated and näive, were the former would suffer less than the latter from an inefficient or oppressive contract term (including a choice of law clause), increased competition would induce firms to use more one-sided and inefficient (for joint surplus) terms, because enhanced competition would reduce their profit from sophisticated consumers, and thus they are more willing to resort to increased exploitation of the näive customers. Thus, in this setting, firms have a larger incentive to introduce undesirable clauses when there is more effective competition in the market, or when they can easily separate the two types of consumers by offering a menu of differentiated contracts. Thus, the more vulnerable consumers may expect a fairer treatment from a monopolist who is in the position of exploiting the sophisticated consumers more fully.

The above imply that it is not easy to draw quick policy implications from the stock of economic knowledge on these matters. Thus, it seems at best premature to advocate lifting the constraints on selection of governing law currently in force under Art. 6(2) Rome I Regulation.

One could argue that if the constraints are removed, but the choice is limited to EU national legal systems, there will be an implicit floor provided by the minimum level of consumer protection set by the EU consumer Directives. That national legal systems have to comply with the minimum requirements of the minimum harmonization Directives is of course true, and thus the "basic legal quality" cannot go to zero if one restricts choice to EU Member States national legal systems.

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[51] P Garella and E Petrakis, 'Minimum quality standards and consumers' information' (2008) 36 *Economic Theory* 283.

[52] E Friedman, 'Competition and Unconscionability' (2013) 15 *American Law and Economics Review* 443.

Still, if one thinks (as we do) that the expectations of the average consumer are important to set the floor, it may be best to continue using the benchmark of the consumer's home country and not the minimum common denominator of the EU Consumer Directives. Although the knowledge by consumers of the basic legal quality under their national Law is likely to be rough at best, we conjecture that in expectation is highly probable to be much more precise than knowledge about the content of the minimum harmonization Directives. Preserving the current Rome I Regulation benchmark, it is however possible to increase choice of governing law in a way that is much less likely to harm consumers, while eventually being able to generate the alleged cost savings for firms associated with the choice of their own national law also in cross-border trade.

The proposal would be as follows:[53] The starting point is the same as in Art. 6(2) Rome I Regulation, that is, choice of governing law is feasible in consumer contracts, but the outcome cannot deprive the consumer of the mandatory protection of the Law of its residence (the one with respect to which she is more likely to hold more accurate, or less inaccurate, expectations). However (and here comes the expanded choice of law), the solution of the chosen governing law, even if it is less protective of the consumer than the corresponding one in the consumer's national law, would apply if the differences between the two had been clearly and expressly disclosed, and adequately explained in the contract. A vague and general reference in standard terms buried in fine print or screens away from the consumer would not work. In fact, some kind of standardized[54] (in dimension, location in the contract, appearance, language) and attention-calling warning should be inserted in the contract, so as to minimize the chances that consumers do not read, or do not become reflectively aware of the departure from the more protective solution in the consumer's home law.

We are not fundamentally against exploring the possibilities of expanded choice (be it through the choice of CESL or the choice of national legal orders) as to governing law in consumer contracts. But many unknowns are yet to be dispelled before we can safely adopt major changes. A more incremental approach, that is both cautious and economically informed, is likely to generate higher social benefits.

28.6 Conclusions

Recent developments in European Law have restored importance to issues of legal regime and choice in consumer contracts. The debates already under way are likely to be with us for some time. We think that bringing Law and Economics views to them will be helpful to assess the merits of the claims that have been made, and to illuminate the consequences of different options. Deploying a Law and Economics

[53] The proposal resembles that of Ayres and Schwartz, 'The No Reading Problem in Consumer Contract Law', 34 in the national context, concerning terms unexpected by consumers as evidenced by actual consumer surveys.

[54] For a possible example of such standardized warnings, see Ayres and Schwartz, 'The No Reading Problem in Consumer Contract Law', 54.

approach, and making use of previous work of ours in the area, we have analyzed three distinct claims concerning governing law and choice in consumer contracts: the undesirability of almost any choice, and especially that of a European transnational set of rules; the ineffectiveness of choice regarding a new legal instrument governing consumer contracts; the insufficiency of current levels of choice of law and the need to lift the current restrictions to choice of law contained in Rome I Regulation.

Our view is that, seen through economic lenses, those three claims present significant flaws. Our view of choice in this area is neither wholly pessimistic nor overtly optimistic. Many things may go wrong, but many may work, too. We advance a modest proposal that, preserving the benchmark of Art. 6(2) Rome I Regulation, may allow some degree of expanded choice as to legal regime in consumer contracts.

Acknowledgements Fernando Gomez wishes to acknowledge the financial support of ICREA, an agency of the government of Catalonia, and of the Spanish Ministry of Education and Science. Juan Jose Ganuza wishes to acknowledge the support of the Barcelona GSE Research, the government of Catalonia (ICREA), and the Spanish Ministry of Education and Science. It must be disclosed from the outset that one of the authors of this contribution is a member of the Expert Group on a Common Frame of Reference in the area of European contract Law set out by the European Commission, although the opinions expressed in this paper are strictly individual, and unrelated to the membership in that Group, and thus, are not those of the Expert Group, nor of any other of its members, nor of the European Commission.

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Chapter 29
Against a New Architecture of Consumer Law—A Traditional View

Ewoud Hondius

Abstract In 2012, Hans Micklitz published his widely read *Gutachten* for the German Law Association (*Deutscher Juristentag—DJT*) on a new architecture of consumer law: 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?' In this paper, Micklitz proposes, among others, to replace current German legislation in consumer matters—which is scattered over various statutes including the Civil Code (*Bürgerliches Gesetzbuch*)—by a single Consumer protection act. At the *DJT* meeting in München, I was among those who opposed such plans, although only from a Dutch perspective. The discussion, as befits an organisation which aims at having an impact on *German* legislation, was held in the German language. Because not everyone who takes an interest in consumer law masters this language, Hans Micklitz has had the happy idea to have his paper translated into English. The translation has recently been published. In this paper for my friend Hans Micklitz I will likewise present my point of view, which I originally presented in German, in English.

29.1 Introduction

In 2012, Hans Micklitz published his widely read *Gutachten* for the German Law Association (*Deutscher Juristentag—DJT*) on a new architecture of consumer law: 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?'[1] In this paper, Micklitz proposes, among others, to replace current German legislation in consumer matters—which is scattered over various statutes including the Civil Code (*Bürgerliches Gesetzbuch*)—by a single Consumer protection act. At the *DJT* meeting in München, I was among those who opposed such plans, although only from a Dutch perspective. The discussion, as befits an organisation which aims at having an impact on *German* legislation, was held in

[1] H-W Micklitz, 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?', *Gutachten A zum 69. Juristentag* (Munich, Beck, 2012).

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_29,

the German language. Because not everyone who takes an interest in consumer law masters this language, Hans Micklitz has had the happy idea to have his paper translated into English.[2] The translation has recently been published.[3] In this paper for my friend Hans Micklitz I will likewise present my point of view, which I originally presented in German,[4] in English.

2012 was not the first time, that the German Law Association discussed consumer law. Nearly 40 years before, in 1974, similar ideas were discussed at its Hamburg meeting, then under the—at the time fashionable—banner of unfair contract terms (*allgemeine Geschäftsbedingungen*). I vividly recall—I not only participated in the 2012 meeting, but also in that of 1974– the discussion, on the basis of a *Gutachten* by Hein Kötz, whether consumer law should be integrated in the Civil Code or dealt with separately.[5] A major concern at the meeting was the question whether small and medium size enterprises should be protected and if so, how they should be demarcated from large enterprises. These are issues which have once again been brought into the limelight by the proposal for a Common European Sales Law of October 2011,[6] which has resulted in a plethora of books and law review articles.[7]

[2] This was before the German political parties CDU, CSU and SPD in their government programme of 26 November 2013 agreed to strive for an equal position of German in Europe, with English and French.

[3] H-W Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law—A Thought Provoking Impulse' (2013) 32 *Yearbook of European Law* 266.

[4] A German language summary of my arguments may be found in *Verhandlungen des 69. Deutschen Juristentages* (Munich, Beck, 2012).

[5] H Kötz, 'Welche gesetzgeberischen Maßnahmen empfehlen sich zum Schutze des Endverbrauchers gegenüber Allgemeinen Geschäftsbedingungen und Formularverträgen?', *Verhandlungen des fünfzigsten Deutschen Juristentages* (Munich, Beck, 1974).

[6] Proposal for a Regulation on a Common European Sales Law, COM(2011) 635 final.

[7] See among others R Schulze (ed), *Common European Sales Law (CESL)* (Baden-Baden, Nomos, 2012), with chapters by C Wendehorst on the 'chapeau' and Arts. 58–65 (interpretation), H Schulte-Nölke on Arts. 1–6 and 9–12 (general principles), D Mazeaud and N Sauphanor-Brouillaud on Arts. 7 and 79–86 (unfair contract terms), F Zoll on Arts. 8, 87–122 (digital content) and 140–158 (transfer of risk, rights and duties), G Howells on Arts. 13–29 (precontractual relations), T Watson on Arts. 13–29 (precontractual relations) and 140–158 (transfer of risk, rights and duties), E Terryn on Arts. 30–39 (formation), R Schulze on Arts. 40–47 (right to withdraw), T Pfeiffer on Arts. 48–57 (defects of consent), E-M Kieninger on Arts. 66–78 (contents and effects), G Dannemann on Arts. 123–139 (duties of the buyer), D Možina on Arts. 159–171 (compensation and interest), M Lehmann on Arts. 172–177 (restitution) and P Møgelvang-Hansen on Arts. 178–186 (prescription); G Dannemann and S Vogenauer (eds), *The CESL in context* (Oxford, Oxford University Press, 2013), with chapters by G Howells, B Marten and W Wurmnest on linguistic aspects, K Steensgaard and C Twigg-Flesner respectively C Harvey and M Schillig on pre-contractual duties and formation, R Schulze and J Morgan on the cooling-off period, G McMeel and C Grigoleit on interpretation, J Cartwright and M Schmidt-Kessel on 'Willensmängel', P Hellwege and L Miller on unfair contract terms, R Freitag and T Krebs on agency, A Burrows and C Busch on contracts and third parties, H Beale and W-G Ringe on assignment, the late H Unberath and E McKendrick on unforeseen circumstances, C Schuller and A Zenefels on the duties of seller and buyer, H MacQueen, B Dauner-Lieb and P Tettinger on specific performance and the right to cure, M Chen-Wishart and U Magnus on termination, price reduction and compensation of damages and J Devenney and T Pfeiffer on the control of unfair contract terms by collective action; I Claeys

It is submitted that consumer law could occasionally profit from contemplating past experiences: lessons learned from the not so distant past.

29.2 Un peu d'histoire

The architecture of consumer law is not uncontested in Germany and the Netherlands. Germany at first opted for separate treatment of consumer law. Several reasons may have been behind this choice: the idea that consumer protection is something ethereal, which eventually will pass away—not sufficiently serious to spoil the eternal beauty of the *Bürgerliches Gesetzbuch*, or the idea that European directives—and consumer law often is inspired by the EU—should be incorporated in separate legislation because EU rules must be interpreted differently from domestic law, or the vision that consumer law encompasses both public, private and procedural law and it would be improper to separate these issues. Whatever may have been the reason, the first wave of consumer statutes, such as the *AGB-Gesetz* and the *Produkthaftungsgesetz*, were not incorporated in the *BGB*. This all changed with the *Schuldrechtsreform*. The German legislature stood before the choice of implementing the Consumer sales directive by way of *kleine Lösung* (small solution) or to use the directive as a catalyst to overhaul contract law in general by way of *grosse Lösung* (big solution)—and in the meantime sneak in a number of other reform proposals which had been dormant for some 20 years. Germany opted for the latter and in the meantime also chose to include most—not all: the Product liability act was left outside—consumer statutes in the Civil Code.[8] Because of the German constitutional rule that bills have to be decided upon within one parliamentary period, there was considerable pressure on the German Parliament to accept the reform of the Civil Code.

The Germans did not stop here: in 2013, they enacted a medical contract law, which was also incorporated in the Civil Code.[9] In this, they followed—probably unwittingly[10]—the Dutch example, where the Medical contract statute had already

and R Feltkamp (eds), *The draft common European sales law: towards an alternative sales law?* (Antwerp, Intersentia, 2013).

[8] See R Zimmermann, *The new German law of obligations/Historical and comparative perspectives* (Oxford, Oxford University Press, 2005).

[9] See C Katzenmeier, 'Der Behandlungsvertrag—Neuer Vertragstypus im BGB' (2013) *Neue Juristische Wochenschrift* 817 ff, especially 818.

[10] Although K Kubella in her PhD thesis *Patientenrechtegesetz* (Heidelberg, Springer, 2011) 38–51, does mention the earlier Dutch statute. See also I Slabbers and CJJM Stolker, 'The Netherlands' in M Faure and H Koziol (eds), *Cases on Medical Malpractice in a comparative perspective* (Vienna, Springer, 2001) 146 (also tranlated in German) and the German translation of the Dutch medical contract statute by F Nieper and AS Westerdijk, *Niederländisches Bürgerliches Gesetzbuch—Bücher 7 und 7A Besondere Verträge* (Munich, Beck, 1994) 177–468. See in English I Giesen and E Engelhard, 'Medical liability in the Netherlands' in BA Koch (ed), *Medical liability in Europe* (Berlin, de Gruyter, 2011) 361.

been incorporated in the Civil Code some 20 years earlier.[11] Likewise, the integration of consumer law in the narrower sense in the German *BGB* had its predecessor in the Netherlands in 1992, when a new Civil Code was enacted. One of the purposes of the new Dutch Code was to bring back substantive private law into the Civil Code. And indeed, the once unitary Landlease statute (*Pachtwet)* for example, which contained private substantive, administrative and procedural paragraphs, was split up, with the substantive private law moving into the Civil Code. On a more limited level, the Door-to-door sales act, at the occasion of the implementation of the Consumer rights directive, will move into the Dutch Civil Code as well. The integration of Dutch civil law is not wholly complete: financial transactions are still scattered over various statutes.[12]

The integration movement has never been wholly uncontested in the two countries. Inpired by the French *Code de la consommation*, in the Netherlands Willem van Boom has argued that keeping together two different systems—consumer contract law and commercial contract law—appears forced.[13] The author enters a plea for dividing contract law into two divisions: one for contracts with natural persons and the other for contracts with commercial companies.[14]

In Germany a similar battle has evolved. Hannes Rösler in his Münchner PhD thesis pleads for a separate consumer law,[15] as does Thomas Zerres in his Rostocker *Habilitationsschrift*.[16] The integration in civil law has likewise been contested by writers such as Pierre Frotscher,[17] Bettina Heiderhoff,[18] Kai Udo Wiedenmann[19] and of course Micklitz. Caroline Meller-Hannich on the other hand in her Bonner *Habilitationsschrift* 'Verbraucherschutz im Schuldvertragsrecht'

[11] See E Hondius, 'The development of medical liability in the Netherlands' in E Hondius (ed), *The development of medical liability* (Cambridge, Cambridge University Press, 2010) 132.

[12] On the quality of this legislation see R Wibier, *De kredietcrisis en privaatrecht* (Inaugural lecture Tilburg, 2011).

[13] WH van Boom, 'Algemene en bijzondere regelingen in het vermogensrecht' (2003) *RM Themis* 297, 305.

[14] See for similar arguments RRR Hardy, *Differentiatie in het (Europees) contractenrecht/Rechtsvergelijkende studies naar de consument, de ondernemer en hun overeenkomsten* (The Hague, Boom, 2009) and RJ Tjittes, *De hoedanigheid van contractspartijen* (Deventer, Kluwer, 1994).

[15] H Rösler, *Europäisches Konsumentenvertragsrecht/Grundkonzeption, Prinzipien und Fortentwicklung* (Munich, Beck, 2004). See also id, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts* (Tübingen, Mohr, 2012).

[16] T Zerres, *Die Bedeutung der Verbrauchsgüterkaufrichtlinie für die Europäisierung des Vertragsrechts—Eine rechtsvergleichende Untersuchung am Beispiel des deutschen und englischen Kaufrechts* (Munich, Sellier, 2007).

[17] P Frotscher, *Verbraucherschutz beim Kauf beweglicher Sachen* (Frankfurt, Lang, 2004).

[18] B Heiderhoff, *Grundstrukturen des nationalen und europäischen Verbrauchervertragsrechts* (Munich, Sellier, 2004).

[19] KU Wiedenmann, *Verbraucherleitbilder und Verbraucherbegriff im deutschen und europäischen Privatrecht* (Frankfurt, Lang, 2004).

pleads for incorporation of the present consumer contract law in existing codifications.[20]

The Micklitz school has strong support in Southern Europe. Apart from France,[21] that is the case in Italy,[22] Luxembourg,[23] Portugal[24] and Spain.[25] Austria, with on the one hand its *Konsumentenschutzgesetz* and on the other the incorporation of consumer contract provisions in the Civil Code, is somewhere in between.[26] Belgium, where a Consumer Code has also been proposed,[27] has recently opted for the adoption of a Code of Economic Law. The solution of a Consumer Code has also been deplored, either for practical reasons—several authors have criticised the bad drafting technique of the *Code de la consommation*—or for more theoretical reasons as we shall see below (at 7.).

At the moment, the main focus of the battle is in Central and Eastern Europe.[28]

At the political—in the sense of *Rechtspolitik*—level, the movement for integration seems to have the upper hand at least in countries such as Germany and the Netherlands. A clear indication is the rejection by the *DJT*—by a vote of 52 against 20, with five abstentions—of the Micklitz proposal for an integrated consumer protection statute.

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[20] C Meller-Hannich, *Verbraucherschutz im Schuldvertragsrecht/Private Freiheit und staatliche Ordnung* (Tübingen, Mohr, 2006).

[21] Code de la consommation. See J Calais-Auloy and H Temple, *Droit de la consommation,* 8th ed (Paris, Dalloz, 2010); G Raymond, *Droit de la consommation* (Paris, Litec, 2008) and more generally L Fin-Langer, *L'équilibre contractuel* (Paris, Librairie générale, 2002).

[22] Act of 30 July 1998, Gazzetta *Ufficiale* 14 August 1998, on which G Alpa, *Il diritto dei consumatori* (Bari, Laterza, 2002) and C Amato, *Per un diritto europeo dei contratti con i consumatori—Problemi e tecniche di attuazione della legislazione comunitaria nell'ordinamento italiano e nel Regno Unito* (Milan, Giuffrè, 2003).

[23] Code de la consommation of 10 August 2011.

[24] Lei de defesa do consumidores. See the annotated code by E Cardoso, *Lei de defesa do consumidores—Comentada e anotada 2012* (Coimbra, Coimbra Editore, 2012) and on mandatory law J Morais Carvalho, *Os contratos de consumo, Reflexão sobre a autonomia privada no direito do consumo* (Lisbon, Almedina 2012).

[25] Ley general para la defensa de los consumidores y usuarios. See S Cámara Lapuente (ed), *Comentarios a las normas de protección de los consumidores* (Madrid, Colex, 2011) and LM Miranda Serrano and J Pagador López, *Derecho (privado) de los consumidores* (Madrid, Pons, 2012).

[26] B Lurger and S Augenhofer, *Österreichisches und Europäisches Konsumentenschutzrecht,* 2nd ed (Vienna, Springer, 2008).

[27] T Bourgoignie , *Éléments pour une théorie du droit de la consommation/Au regard des développements du droit belge et du droit de la Communauté économique européenne* (Brussels, Bruylant, 1988). See also T Bourgoignie et al. *Voorstel voor een algemene wet inzake de bescherming van de consument* (Brussels, Ministry of Economic Affairs, 1995).

[28] See for instance M Karanikic, H-W Micklitz and N Reich (eds), *Modernising consumer law—The experience of the Western Balkan* (Baden-Baden, Nomos, 2012); J Lazar, 'Entwicklung des slowakischen Privatrechts' (2013) *Zeitschrift für Europäisches Privatrecht* 789; R Schulze and F Zoll (eds), *The law of obligations in Europe—A new wave of codifications* (Munich, Sellier, 2013).

29.3 Consumer Law in Germany

Before coming to my opposition to the Micklitz thesis, let me first say something about German consumer law, more especially consumer contract law. There is in my view no doubt, that German consumer law is the best developed in Europe. Every other nation has much to learn from their German colleagues. This is apparent in all four main sources of the law, although perhaps it is less pronounced in legislation, which—in Germany as elsewhere—is heavily influenced by EU directives. Case law emanating from Germany is of major interest for several reasons—here I have Dutch law in mind. The first reason is that there is so much of it: almost everytime in which a Dutch lawyer will look in vain for a Dutch precedent, a search in German case law will provide an answer.[29] Not that the German precedent will necessarily be followed, but at least it provides Dutch practitioners with the arguments which have to be pondered. A second reason is the impact of constitutional law—absent (save for the influence of the European Convention on Human Rights) in the Netherlands. A third reason is the discussion in case law of European law, although that admittedly is mainly going on in the highest courts. But the main source which attracts foreign lawyers to Germany is its doctrinal work. There are the great commentaries,[30] including those who bear on civil law but because of the incorporation of consumer law include the latter. There are the many PhD dissertations, there are the many law review articles. And there are the *Habilitationsschriften*, this beautiful German institution for lawyers to prepare for a chair.

Let me give some examples—without in the least striving for completeness. There is the book by Josef Drexl on 'Die wirtschaftliche Selbstbestimmung des Verbrauchers'.[31] Then there is the above-mentioned study by Bettina Heiderhoff on European consumer contract law[32]. This author defends the thesis that the original aim of consumer law: protecting the weak party, has paradigmatically changed in Europe towards and protection of the well-advised consumer.[33] Christoph Reimann analyses the partition in three separate parts of classical *BGB* civil law, the

[29] An example from my own research: when I had to deal with 'Briefkastenverschmutzung'-one's mail box being used for commercial advertising notwithstanding a 'no' sticker—there was not a single court case to be found in the Netherlands, but in Germany a whole jurisprudence existed.

[30] The most thorough book on European consumer law, with 32 chapters, is the German language commentary by N Reich and H-W Micklitz, *Europäisches Verbraucherrecht,* 4th ed. (Baden-Baden, Nomos, 2003). In 2009, under the title *Understanding EU consumer law* and now with P Rott as third author, an English language version was published (Antwerp, Intersentia, 2009) . See also M Tamm and K Tonner (eds), *Verbraucherrecht* (Baden-Baden, Nomos, 2012).

[31] J Drexl, *Die wirtschaftliche Selbstbestimmung des Verbrauchers—Eine Studie zum Privat- und Wirtschaftsrecht unter Berücksichtigung gemeinschaftsrechtlicher Bezüge* (Tübingen, Mohr, 1998).

[32] Heiderhoff, *Grundstrukturen*, 456.

[33] Ibid, 189.

special private law for commercial contracts and the special law for consumer transactions.[34]

European consumer law in specific areas may be found in the Freiburger *Habilitationsschrift* by Alexander Bruns on exemption clauses[35], in the Regensburger *Habilitationsschrift* of Phillip Hellwege on unfair contract terms and general contract law,[36] in the study from Hannover on consumer sales by Andreas Schwartze[37] and in the Oldenburger *Habilitationsschrift* by Wolfgang Seiler on consumers and the internet.[38] The latter author concludes that consumer protection measures should rather be deleted and deregulation should set in.[39] European private law may also be found in the Hagener *Habilitationsschrift by* Markus Stoffels on specific contracts which have not been regulated by statute.[40] In his Frankfurter *Habilitationsschrift* on cross-border consumer transactions, Gralf-Peter Calliess finds German and European law on cross-border consumer contracts to be so utterly incoherent and complicated, that they cannot establish legal certainty and justice on the electronic market.[41]

29.4 Competition of Legal Systems

Should we strive for a unitary private law at all, or is a competition of legal systems as envisaged by CESL preferable? The question is well known from American company law, where corporations are allowed to choose their own system for incorporation, which usually results in the law of the State of Delaware being chosen. In her Hamburger *Habilitationsschrift* Eva-Maria Kieninger looks into the possibility which the opt-in system has for European company and consumer law.[42] Her conclusion is that such competition of legal systems may be of interest for European

[34] C Reymann, *Das Sonderprivatrecht der Handels- und Verbraucherverträge—Einheit, Freiheit und Gleichheit im Privatrecht* (Tübingen, Mohr, 2009).

[35] A Bruns, *Haftungsbeschränkung und Mindesthaftung* (Tübingen, Mohr, 2003).

[36] P Hellwege, *Allgemeine Geschäftsbedingungen, einseitig gestellte Vertragsbedingungen und die allgemeine Rechtsgeschäftslehre* (Tübingen, Mohr, 2010).

[37] A Schwartze, *Europäische Sachmängelgewährleistung beim Warenkauf—Optionale Rechtsangleichung auf der Grundlage eines funktionalen Rechtsvergleichs* (Tübingen, Mohr, 2000).

[38] W Seiler, *Verbraucherschutz auf elektronischen Märkten—Untersuchung zu Möglichkeiten und Grenzen eines regulativen Paradigmenwechsels im internetbezogenen Verbraucherprivatrecht* (Tübingen, Mohr, 2006).

[39] See also A Wiebe, *Die elektronische Willenserklärung—Kommunikationstheoretische und rechtsdogmatische Grundlagen des elektronischen Geschäftsverkehrs* (Tübingen, Mohr, 2002).

[40] M Stoffels, *Gesetzlich nicht geregelte Schuldverträge/Rechtsfindung und Inhaltskontrolle* (Tübingen, Mohr, 2001).

[41] G-P Calliess, *Grenzüberschreitende Verbraucherverträge—Rechtssicherheit und Gerechtigkeit auf dem elektronischen Weltmarktplatz* (Tübingen, Mohr, 2006).

[42] E-M Kieninger, *Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt* (Tübingen, Mohr, 2000).

company law, but in consumer protection competition is of such minimal financial interest that suppliers probably could not care less.

29.5 The German Experience

A functional approach of the structure of the law is not wholly inconceivable. Actually, there is a number of domains, such as banking & insurance, construction law, entertainment law, environmental law, health law, juvenile law, labour law, landlease, military law, sport & the law, which have achieved some form of independence. Often they have their own infrastructure : associations, faculty chairs, law reviews, ministerial positions and sometimes even statutory provisions. Mostly this is on a piecemeal basis. Occasionally, a more systematic approach of a functional division is promoted. A major example was the division of the law in the former German Democratic Republic. There, the *Zivilgesetzbuch* was based on a functional division as between the various activities in one's life. A similar division has sometimes even been defended in Western countries.[43] The practical impact of the German Code has been limited. But whatever the outcome, from a theoretical perspective the objection is clear. The great advantage of integrating civil law in a civil code, procedural law in a procedural code etc, is that a unity of civil law, of procedural law etc is attained.

29.6 The Case for Integration

I finally come to the point raised by Hans Micklitz. Incorporation of all consumer law in a separate statute has a number of advantages. Having together in a single statute all rules relating to consumers, whether of an administrative, civil or procedural nature may be handy for users of the law. It also may promote a uniform terminology. Such a code will do away with the traditional division between public law and private law, which no longer is tenable. A Consumer code may also facilitate implementation of EU directives. Finally, according to Micklitz, civil law and consumer law simply do not go together: 'the dynamic of consumer law cannot be reconciled with the stability of the BGB'[44]. The integration in Germany in his view has only been formal and not substantive. Civil law is like a heavy tanker ship 'which can change its direction in only a limited way and needs time for every change of direction. In contrast to this, specific rules appear to be almost sailing boats which can change their direction quickly and easily, but which are exposed to wind and

[43] FW Grosheide, 'Invoering vermogensrecht NBW aanstaande? Of beter ten halve gekeerd dan ten hele gedwaald?' (1977) *Weekblad voor Privaatrecht, Notariaat en Registratie* nos 5407/5408.

[44] Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law', 270.

weather—that is to say political current—in a far stronger way'.[45] Although the metaphor is admirable, it is incorrect. A quick look at for instance family law shows that this supposedly heavy tanker ship is in need of new legislation or constitutional review almost on an annual basis and that political views (on gay marriage or neutral gender) are of the essence.

Some of the disadvantages are also clear. One such disadvantage is obvious : the careful fabric of law, divided over various codifications, is lost. The consumer sale of goods is a very likely candidate for inclusion in a Consumer Code. Because duplication of such provisions in both a Consumer Code and the Civil Code seems undesirable, this would mean that the consumer sale of goods would have to be moved out of the Civil Code. This in turn would mean that the most visible of all specific contracts would not be dealt with in the Civil Code. It is suggested that this is not a good idea. There is also the very practical argument, raised in Munich: why should the legislature waste time on an exercise which will be costly and time-consuming.

There is another argument shared by a more limited number of authors[46]—and apparently not by Hans Micklitz who does not address it in his *Gutachten*. It runs like this. Civil Codes used to be based on the paradigm of freedom of contract. This is still the case, but it has been suggested that this principle is now accompanied by a second principle, that of protection of the weak party.[47] Civil Codes have first encompassed such rules in the area of employee protection, later extended to hire-purchase and the law of landlord and tenant. Consumer law, when incorporated in a Civil Code, constitutes a major part thereof.

As we have witnessed above, patient protection is now also regulated by Civil Codes in Germany and the Netherlands. Consumer protection now constitutes a major part of contract law. The result is that protection of the weak party may now be found in many parts of the Civil Code. To such an extent, that the authors mentioned are correct in no longer qualifying such protection as an exception, but rather a principle on the same level as freedom of contract. A theoretical debate? Certainly, but one with practical consequences as well. Firstly, exceptions tend to be constructed in a restrictive way; general principles do not. Secondly, once protection of the weak party is considered a paramount principle, this has the consequence that it may even be applied where no specific statutory rules exist, in the area of new specific contracts for example, or when small and medium enterprises are concerned. It is not contended here that if consumer protection were to be removed from a Civil Code, this general principle of protecting the weak would be abandoned straigth away, but chance would be that it would. And it is better not to risk the chance.

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[45] Ibid.

[46] B Lurger, *Grundfragen der Vereinheitlichung des Vertragsrechts in der Europäischen Union* (Vienna, Springer, 2002). At the *DJT* meeting in München, this idea was brought forward by Stefan Grundmann.

[47] E von Hippel, *Der Schutz des Schwächeren* (Tübingen, Mohr, 1982).

29.7 Conclusions

One of the recurrent themes of consumer protection in Europe is that of its place in the legislative architecture: where to deal with the statutory provisions. Several options are available. There is the integration in private law codification, currently in fashion in Germany and the Netherlands. There is the model of a separate statute, at the moment en vogue in Southern Europe. Central and Eastern Europe still are a battle ground. Belgium, with its upcoming Code of Economic Law, is in a third group all by itself. If the Common European Sales Law is approved, the question may at one time also be raised at a European level.

Hans Micklitz has entered a strong plea for a separate statute. I have likewise argued in favour of integration. *Que sera, sera. Whatever will be, will be. The future's not ours to see. Que sera sera. What will be, will be*.[48]

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[48] Lyric by Doris Day, 1956.

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Chapter 30
The Regulation of Digital Content B2C Contracts in CESL

Marco B. M. Loos

Abstract This paper investigates if and to what extent CESL solves consumers' problems with regard to digital content contracts concluded at a distance.

30.1 Introduction

Hans-W. Micklitz has always been at the forefront of developments in European consumer law. Together with Norbert Reich and Peter Rott he published *Understanding EU consumer law*,[1] which is a landmark-publication in the area of literature and research on European consumer law. That the development of European private law would not stop there, was clear already then: in a postscript to the book the authors point to the publication of the proposal for a consumer rights directive,

This paper builds and expands on three previous publications I (co-) wrote. The first is MBM Loos, N Helberger, L Guibault and C Mak, 'The regulation of digital content contracts in the Optional Instrument of contract law' (2011) *European Review of Private Law* 729. It further builds on MBM Loos, N Helberger, L Guibault, C. Mak, L Pessers, KJ Cseres, B van der Sloot and R Tigner, *Analysis of the applicable legal frameworks and suggestions for the contours of a model system of consumer protection in relation to digital content contracts, FINAL REPORT: Comparative analysis, Law & Economics analysis, assessment and development of recommendations for possible future rules on digital content contracts*, 2011, a report prepared for the European Commission and available online at http://ec.europa.eu/justice/consumer-marketing/files/legal_report_final_30_august_2011.pdf. Finally, Sect. 3.2 is based on MBM Loos, 'Incorporation and making available of standard contract terms under the proposal for a Common European Sales Law (Articles 70–71 CESL)' in A Colombi Ciacchi (ed), *Content and Effects of Contracts: the CESL in the European Multi-Level System of Governance* (forthcoming).

[1] N Reich, H-W Micklitz and P Rott, *Understanding EU consumer law* (Antwerp, Intersentia, 2009).

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shortly after the manuscript of the book was finished. Together with Reich Micklitz also wrote a very critical paper on that proposal.[2] In this paper they criticize the European Commission's decision to proceed with the development of European consumer law on the basis of full harmonisation. Cornerstone of the European Commission's course of the last years is the idea that the completion of the internal market depends on identical rules in key areas of consumer contract law, such as pre-contractual information, sales law, and unfair terms. It is precisely that idea that Micklitz and Reich called an 'unspecified and unproven belief'.

Their opposition, and that of many others academics and practitioners, have ultimately led to the much watered-down Consumer Rights Directive,[3] which hardly contains rules on sales law and unfair terms. The Consumer Rights Directive, for now, marks the end of the failed full harmonisation approach. However, the ink of the Consumer Rights Directive had not even dried when already a next large European project in the area of (consumer) contract law was announced: on 11 October 2011 the European Commission submitted a proposal for a Regulation on a Common European Sales Law.[4] This Common European Sales Law or CESL would be introduced in the national legal systems of the Member States of the European Union as a 'second national system of contract law' to be applied if the parties to a contract so choose.[5] The full harmonisation approach thus seems to have been abandoned and replaced by an optional instrument of contract law. The CESL has incorporated the existing *acquis communautaire*, in particular the Consumer Rights Directive, the Unfair Contract Terms Directive[6] and the Consumer Sales Directive,[7] and sometimes offers additional protection to consumers. CESL is intended in particular for cross-border contracts,[8] but Member States may decide to allow parties to opt-in to CESL also for domestic contracts.[9] Moreover, the scope of the CESL is not limited to B2C contracts; parties may also opt into CESL if both parties are traders and at least one of them is an SME,[10] and Member States are free to allow parties to opt-in to B2B contracts where none of the parties is an SME.[11]

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[2] N Reich and H-W Micklitz, 'Crónica de una muerte anunciada: The Commission Proposal for a 'Directive on Consumer Rights' (2009) 46 *Common Market Law Review* 471.

[3] Dir 2011/83/EU on consumer rights, [2011] OJ L 304/64.

[4] Proposal for a Regulation on a Common European Sales Law, COM(2011) 635 final. Hereinafter I will refer to the provisions of the regulation itself as 'Regulation', and to the provisions of the Common European Sales Law (Annex I to the Regulation) as 'CESL'.

[5] Hence its characterization as an optional instrument in previous draft-versions.

[6] Dir 93/13/EEC on unfair terms in consumer contracts, [1993] OJ L 95/29.

[7] Dir 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees, [1999] OJ L 171/12.

[8] See Art 4(1) Regulation.

[9] Cf. Art 13(a) Regulation.

[10] Cf Art 7 Regulation.

[11] Cf Art 13(b) Regulation.

In a paper prepared for the Austrian Ministry of Consumer Affairs, Micklitz and Reich discuss CESL.[12] Both are critical about CESL, but not negative *per se*. However, they rightly conclude that as the choice for CESL in practice will be made by the trader and offered to the consumer on a take-or-leave-it basis, CESL in the end may result in the *de facto* adoption of the full harmonisation approach through the back door.

The scope of CESL is not limited to sales contracts proper: recital (17) of the proposal sets out that '(i)n order to reflect the increasing importance of the digital economy, the scope of the Common European Sales Law should also cover contracts for the supply of digital content. The transfer of digital content for storage, processing or access, and repeated use, such as a music download, has been growing rapidly and holds a great potential for further growth but is still surrounded by a considerable degree of legal diversity and uncertainty. The Common European Sales Law should therefore cover the supply of digital content irrespective of whether or not that content is supplied on a tangible medium.' Micklitz and Reich rightly indicate that the European Commission thus approaches digital content contracts as a sort of quasi-sales contract.[13] Micklitz and Reich write that this 'seems to be a departure from the classical approach of licensing of intellectual property rights' and that it 'can be justified by the "commodification" (Verdinglichung) of digital content through modern technologies, in particular through downloading on the Internet which makes them a candidate for a standardized transaction similar to the traditional sales concept.'[14] From these comments, I understand that they welcome the application of the provisions of sales law to digital content contracts whereby digital content is transferred on a permanent basis and for repeated use. With this in mind, it is interesting whether and to what extent sales law indeed is suited for application to such digital content contracts.

That there is a need for regulation of digital content contracts is crystal clear. In a comparative study I have conducted with colleagues at the University of Amsterdam on behalf of the European Commission,[15] we indicated that there is substantial uncertainty in all Member States included in our study as to the classification of digital content contracts as contracts for the provision of goods or services.[16] This uncertainty causes problems in legal practice, as the classification of digital content as either a good or a service often determines the answer to questions

[12] H-W Micklitz and N Reich, 'The Commission Proposal for a 'Regulation on a Common European Sales Law (CESL). Too Broad or Not Broad Enough?' (2012) *EUI Working Papers LAW* No. 2012/04, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2013183.

[13] Cf Micklitz and Reich, n 12 above, part I, 15. It should be noted that the Commission's proposal is limited to digital content contracts whereby digital content is transferred on a permanent basis and for repeated use and not merely provided for one-time use as is the case when the digital content is provided through streaming. See below, Sect. 30.2.

[14] Micklitz and Reich, n 12 above, part I, 15.

[15] Loos et al., *Analysis*, 32–41, 155–156, and 172–174.

[16] See also M Schmidt-Kessel, L Young, S Benninghof, C Langhanke, G Russek, 'Should the Consumer Rights Directive apply to digital content?' (2011) *Zeitschrift für Gemeinschaftsprivatrecht* 10.

such as whether information duties apply, and which information must be disclosed; whether the provider of the digital content may be held liable for hidden defects or lack of conformity; and which remedies are available for which type of deficiency. The regulation of digital content contracts within the scope of CESL thus offers to the market a legal regime to deal with contracts that are becoming more and more important in practice.

In this paper I will look into the rules applicable to such contracts. Given the fact that it is currently expected that the scope of CESL will be limited to distance contracts, I will focus on distance contracts for the supply of digital content.[17] Moreover, I will limit my claims to digital content contracts concluded with consumers, albeit that many of the claims made in this paper will probably also apply to digital content contracts where the buyer is an SME.

I will start, however, with preliminary question: how are the notions of 'digital content', and 'digital content contracts' defined under CESL. In other words: what is the scope of CESL with regard to digital content contracts?

30.2 The Scope of CESL with Regard to 'Digital Content Contracts'

Digital content is defined in Article 2(j) of the proposed Regulation on a Common European Sales Law as 'data which are produced and supplied in digital form, whether or not according to the buyer's specifications, including video, audio, picture or written digital content, digital games, software and digital content which makes it possible to personalise existing hardware or software' but excluding financial services, legal or financial advice provided in electronic form, electronic healthcare services, electronic communications services and networks, and associated facilities and services, gambling, and the creation of new digital content and the amendment of existing digital content by consumers or any other interaction with the creations of other users'.[18]

Article 5(b) Regulation, *in fine*, indicates that the parties may opt for the application of CESL to digital content contracts whether or not the consumer is required to pay a price in money for the digital content. There are good reasons for such a broad scope of application. Whereas the payment of a price in money is still the predominant counter-performance for 'ordinary' goods and services, in the case of digital

[17] See to that extent also Amendment 26 and Amendment 61, as adopted on 26 February 2014, by the European Parliament in its first reading of the proposal of the European Commission, P7-TA(2014)0159.

[18] This is clearly a much more limited notion than the one used in the Consumer Rights Dir, as the exclusions do not appear in the definition given there; cf Art. 2(11) Consumer Rights Dir. See further also Loos et al., *Analysis*, 174–175, where a similar scope as adopted in the Consumer Rights Dir was suggested; the differences between on the one hand our proposal and the scope of the Consumer Rights Dir, and the scope of CESL on the other hand are easily explained by the fact that the focus in CESL is on sales-like transactions, ie on contracts by which digital content is transferred to a consumer or an SME, and services have largely been excluded from the scope of CESL.

content the provision of 'gratuitous' digital content is just another business model, in which consumers pay with their personal data rather than with money. In the digital environment it seems rather artificial to include contracts where micropayments are being made—e.g. contracts with a monetary value of € 0.99 per downloaded music file—and not to include contracts where payments are made in other forms. Moreover, virtual currencies—e.g. those used in games played online—represent a monetary value in themselves. In so far as consumers pay by providing their personal data, this data also represents a monetary value as that data may be collected, used for marketing purposes and even sold to other traders—in so far as allowed under data protection law. In other business models, consumers effectively pay by accepting to be forced to watch advertisement before being able to (continue to) use the digital content. Finally, the possibility for parties to opt for the applicability of the CESL also to 'gratuitous' contracts for the provision of digital content opens the possibility for sellers[19] to have CESL applied to all contracts they conclude with consumers, and thus enforces the attractiveness of CESL as the law governing digital content contracts with consumers. This does not mean that the absence of an obligation to pay a price in money is irrelevant. The fact that the digital content was not provided in exchange for a price in money may influence the expectations the consumer may have of the digital content and will thus affect the application of the conformity test: typically 'gratuitous' versions of digital content offer a more limited functionality than the version for which the consumer pays in money. As consumers generally are aware of these differences, their expectations will generally be lower than in the case where the consumer has paid the market price.

It should be noted, however, that Article 5(b) Regulation introduces an additional limitation of the scope of CESL: parties may opt for the application of CESL only with regard to digital content contracts where the digital content 'can be stored, processed or accessed, and re-used by the user'. This implies that only contracts where digital content can be repeatedly accessed and used fall under the scope of CESL. In particular, contracts for streaming of digital content are thus excluded from the scope of CESL, as in such cases the digital content may be accessed only once. In my view, such exclusion should be welcomed, as streaming contracts resemble sales contracts to a much lesser degree than the digital content contracts that currently fall within the scope of CESL, and the chances that sales rules produce undesired effects when applied to streaming contracts are much higher.

At first glance it appears doubtful to what extent CESL may be applied to cloud computing. In the case of cloud computing the digital content is not downloaded by the consumer, but made available to the consumer in the seller's or a third party's 'cloud'. Effectively this means that the digital content is delivered and stored at the servers of the seller or of a third party. In so far as the digital content is stored in the third party's cloud, the delivery of the digital content may be covered by CESL, but not the storage thereof, as in that case the relationship between the consumer and

[19] Throughout this paper I will refer to suppliers of digital content as 'sellers', even if the digital content is not concluded in exchange for a payment of money.

the third party is not a sales-like contract.[20] However, when the storage facilities are made available by the seller, this service may be regarded as a 'related service' within the meaning of Article 2 (m) Regulation and may therefore be governed by CESL. This is true in particular where the consumer may subsequently download the digital content from the seller's cloud or store it in a third party's cloud.[21]

30.3 Problems When Applying Sales Law to Digital Content Contracts

If one wishes to take 'digital situations' into account—and restrict the scope of CESL to sales-like transactions—one may wonder what specific problems consumers and sellers face with regard to digital content contracts. Are there in fact particular issues that require specific legislation? In this Sect. I will address the main areas that require attention: information obligations (3.1), incorporation of standard terms, in particular in the form of click-wrap- and browse-wrap licences (3.2), unfair terms (3.3), non-conformity (3.4) and remedies (3.5). Within these subsections, I will first indicate to what extent and how these matters are regulated under the CESL. I will then indicate whether these rules actually solve the problems consumers face with regard to digital content contracts. As CESL does not provide rules regarding the validity of contracts concluded with minors,[22] I will not touch upon this matter in this paper.[23]

30.3.1 Information Obligations

30.3.1.1 Regulation Under CESL

The provisions of the Consumer Rights Directive on information obligations for digital content contracts have been taken over more or less *verbatim* in the CESL.[24]

[20] See in this sense also the justification of Amendment 8 of the European Parliament, which leads to the new recital (17a), EP document A7-0301/2013.

[21] See the justification of Amendment 8 of the European Parliament. Cf also Amendment 10, which adds the words 'or temporary storage of digital content in the provider's cloud' to recital (19).

[22] Cf recital (27) of the preamble to the Regulation.

[23] In MBM Loos, 'Scope and application of the Optional Instrument' in D Voinot and J Sénéchal (eds), *Vers un droit européen des contrats spéciaux/Towards a European Law of Specific Contracts* (Brussels, Larcier 2012) 117 ff, I have argued that (what now is) the CESL should in fact contain specific rules on this matter.

[24] Already in the 2010 Green Paper on policy options, the European Commission indicated that '[f]or reasons of consistency, the instrument of European Contract Law will have to complement the relevant consumer acquis, *by integrating its requirements*, including progress made on consumer protection in the internal market in the Consumer Rights Directive' (emphasis added by me), see European Commission, *Green Paper from the Commission on policy options for progress towards a European Contract Law for consumers and businesses*, COM(2010) 348 final, 11 fn 30.

Firstly, Article 13(1)(g) and (h) copies the corresponding provision of Article 6(1)(q) and (r) Consumer Rights Directive.[25] This provision requires the seller to disclose, before the contract is concluded and before the consumer is bound by an offer, any information regarding the functionality and interoperability of the digital content. This implies that in so far as the seller is or should be aware of any potential limitations regarding the possibility to freely use the digital content, he is required to warn the buyer thereof. In this respect one may think of technical protection measures that may hinder the use of the digital content, such as the use of area codes, as a result of which digital content purchased in the US may not be used in Europe, but also of the fact that the digital content can only be used on devices produced by a specific producer of hardware.[26] This obligation may also entail the obligation to ask the consumer about the hardware or software with which the digital content must be compatible in order to determine whether or not the digital content is suitable for the needs of the consumer. The information must be provided before the contract is concluded to ensure that the buyer, given the restrictions mentioned by the seller, may still decide not to purchase the digital content. Moreover, under Article 25(2) CESL,[27] where the buyer is to pay in money he must have agreed to this expressly to ensure that the obligation to pay in money does not come as a surprise—which in the case of the supply of digital content otherwise could easily happen given the fact that digital content is often not supplied against payment in money. A failure to inform the consumer in accordance with these provisions may trigger the remedies for mistake. Moreover, as the information provided in accordance with Article 13 CESL forms an integral part of the contract, when the digital content is not in conformity with that information the rules on non-conformity apply as well.[28]

30.3.1.2 Does CESL Solve Consumers' Problems with Regard to Information in Digital Content Contracts?

The current information obligations cover most of the specific information needs of digital consumers. The question is rather whether suppliers act in conformity with these rules, and in a way that is useful and understandable for consumers: in an empirical study conducted in 2011, lack of information figured prominently at second place (after access issues) among the most frequently mentioned problems that consumers experienced, whereas complexity and lack of clarity of information took third place.[29] Even though information obligations are an important feature

[25] Art 20 CESL and 5 Consumer Rights Dir contain similar rules for contracts concluded in shops. As the scope of the CESL is expected to be restricted to distance contracts, I will leave out references to provisions pertaining to contracts on contracts concluded in shops or off-premises.

[26] Causing lock-in or lock-out problems. On this, see Loos et al., *Analysis*, 20 f.

[27] Which copies Art 8(2) (2nd subparagraph) of the Consumer Rights Dir.

[28] Cf Art 13(2) CESL, which copies Art. 6(5) Consumer Rights Dir.

[29] Europe Economics, *Digital content services for consumers: assessment of problems experienced by consumers (Lot 1), Report 4: Final Report*, London: 2011, 74 ff., http://ec.europa.eu/justice/consumer-marketing/files/empirical_report_final_-_2011-06-15.pdf.

of EU consumer law, it appears that these obligations are not very effective unless they are accompanied by measures making sure that consumers actually are able to understand the information given.

In this respect, the regulation of information obligations in CESL is going in the right direction. CESL does not only regulate extensively what information is to be provided, it also offers some guidance as to *how* the information is to be provided to the consumer. Firstly, in the case of consumer contracts, the seller is required to provide the consumer with a so-called standard information notice, in which the consumer's core rights are listed in simple language.[30] The seller is required to provide the notice to the consumer before the contract is concluded.[31] Even though there is some doubt whether the standard information notice will be effective,[32] it seems worthwhile to experiment with the idea to present the consumer with a brief overview of his core rights in simple language and in not too many words, as the standard information notice aims to do. Similarly, the model instructions for withdrawal and the model withdrawal form, included in Appendices 1 and 2 to CESL offer clear instructions for the consumer how to withdraw from the contract if he chooses to do so.

An important caveat, however, is the absence of an obligation for the seller to provide the information he is required to give in a language the consumer masters (or may be expected to master, given the fact that the contract was concluded in that language). Article 13(1) CESL[33] merely requires the information to be provided 'in a clear and comprehensible manner' without specifying what this actually means in a given case. Under the Consumer Rights Directive, Member States are allowed to introduce or maintain linguistic requirements, 'so as to ensure that such information is easily understood by consumers'.[34] Obviously, a corresponding provision is missing in CESL, but equally missing are provisions setting such linguistic requirements.[35] In an instrument that is intended in particular for cross-border consumer contracts, this is odd, to say the least. A consumer-friendly interpretation of CESL may possibly solve this particular problem: Article 13(3) CESL requires the seller to provide the information in plain and intelligible language and that, when it is

[30] The standard information notion is specifically intended to help consumers understand their rights in CESL; see the Explanatory Memorandum accompanying the European Commission's proposal, 11.

[31] See Art 9 of the proposed Regulation. Where the information notice is provided in electronic form, it must contain a hyperlink, and otherwise a reference, to a website where the text of CESL is made available free of charge. As the text of the standard information notice is included in Annex II to the Regulation and both CESL and Annex II are available in all languages, in this indirect way it is safeguarded that the consumer may obtain the information in a language he actually masters.

[32] See critical on the standard information notice MW Hesselink, 'How to opt into the Common European Sales Law. Brief comments on the Commission's proposal for a Regulation' (2012) *European Review of Private Law* 208.

[33] Art 13(1) CESL copies Art. 6(1) Consumer Rights Dir.

[34] Cf Art 6(7) Consumer Rights Dir.

[35] Art 24(3)(d) CESL does require the seller in the case where the distance contracts is concluded by electronic means to indicate which languages are offered for the conclusion of the contract, but is silent on the matter in which language information is to be given.

provided on paper or on a durable medium, it is legible.[36] Moreover, Article 24(3)(d) CESL requires the seller in the case where the distance contract is concluded by electronic means to indicate which languages are offered for the conclusion of the contract. Even though these provisions are silent on the manner in which language information is to be given, the Court of Justice could interpret them in such manner that the information is to be provided in the contracting language. Nevertheless, one would expect that an instrument intended specifically for cross-border consumer contracts would expressly deal with this matter. However, not even the amendments of the European Parliament provide for such a provision.

30.3.2 Incorporation of Standard Terms

30.3.2.1 Regulation Under CESL

One of the key issues in online contracting is how standard terms are incorporated into the contract. At first glance, CESL does not appear to have specific provisions regarding the incorporation of standard terms into the contract. This implies that the provisions on the conclusion and interpretation of contracts also apply to the question of whether standard contract terms are part of the contract between the parties.[37] Where the contract is a B2C-contract that is concluded electronically, Article 24(3)(e) and (4) CESL require the seller to make the contract terms available to the consumer in alphabetical or other intelligible characters and on a durable medium which permits reading, recording of the information contained in the text and its reproduction in tangible form. The seller bears the burden of proof that it has provided the required information.[38] The duty must be performed before the consumer makes an offer to the seller or accepts an offer made by the seller.[39] The CJEU's ruling in *Content Services* clarifies that when the information is placed on the seller's website and made available to the consumer through a hyperlink, the information has not been provided to or received by the consumer. This is different only when the website that may be reached through clicking on the hyperlink itself may be regarded as a durable medium. According to the Court, this is the case only when the website enables the consumer to store the information, when it is guaranteed that the seller cannot change the information, when the website is available throughout a period which is suitable for the contract at hand, and when the website allows consumers to reproduce the text unaltered.[40] This suggests that in many cases the seller can only meet the requirements set by Article 24 CESL if he has sent the text of the standard terms to the consumer.

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[36] See also Art 8(1) Consumer Rights Dir.

[37] Cf MBM Loos and HN Schelhaas, 'Commercial sales: the Common European Sales Law compared to the Vienna Sales Convention' (2013) *European Review of Private Law* 113.

[38] Cf Art 26 CESL.

[39] See the opening words of Art 24(3) CESL.

[40] CJEU, judgment of 5 July 2012, Case C-49/11 *Content Services Ltd*, not yet reported, paras 37–38, 40 and 42–45.

From this it follows that at least with regard to digital content contracts concluded electronically a duty exists for the seller to provide the standard terms prior to the conclusion of the contract. This does, however, not mean that these obligations are necessarily also effective. There is certainly reason for doubt here, as the remedies are not particularly useful: Article 29(1) CESL basically requires the seller to pay damages for any damage sustained as a result of the failure to timely inform the consumer of the contract terms—but what damage could that be? Similarly, the remedies of mistake and fraud remain available,[41] but it will be difficult to prove for any consumer that he would not have concluded the contract had he received the contract terms in time or that the seller had withheld the terms *on purpose* (and not by mere negligence). In effect, this implies that there is a serious risk that these precontractual obligations are but tigers without teeth—they do not really bite.

However, this is only part of the story. Even if terms are incorporated into the contract, this does not mean that the seller may rely on them. He may not when a term is unfair to the consumer, Article 79 CESL provides.[42] Moreover, under Article 70 CESL, the seller can only invoke standard terms against a consumer if the consumer was either aware of the terms or if the seller took reasonable steps to draw the consumer's attention to them, before or when the contract was concluded. In a consumer contract a mere reference to the standard contract terms in the written contract is not sufficient, not even if the consumer signs the contract document. Since in many B2C-contracts a duty to provide the standard terms follows already from Article 24 CESL, it would stand to reason that the seller would only be able to invoke his standard terms against a consumer if he has provided them to the consumer before the contract was concluded or at that moment.

30.3.2.2 Does CESL Solve Consumers' Problems with Regard to the Incorporation of Standard Terms in Digital Content Contracts?

The main problems with regard to the incorporation of standard terms in digital content contracts concluded electronically with consumers pertain to the use of 'click-wrap' and 'browse-wrap' agreements. In a click-wrap licence, the terms of the licence (allowing the consumer the right to use the digital content) are presented to the consumer electronically, and the consumer agrees to these terms by clicking on a button or ticking a box labelled 'I agree' or by some other electronic action. Depending on how the click-wrap licence is technically set up, the consumer's consent may be required either at the moment when the contract is concluded, when the digital content is downloaded, or when the digital content is installed on the consumer's hardware, or a combination thereof. In the case of a browse-wrap licence, the terms of the agreement are simply accessible via a hyperlink on the website of the trader. Contrary to the click-wrap method, the browse-wrap method does not offer the consumer the possibility to 'agree' to the terms by actively clicking on a

[41] Cf Arts 29(3), 48 and 49 CESL.

[42] This provision copies Art 6(1) Unfair Contract Terms Dir.

button or ticking a box. Instead, the consumer is presumed to assent to the terms by merely using the website.[43] Whether the presentation of licence terms through click-wrap or browse-wrap is sufficient to incorporate these terms into the contract concluded with a consumer, or give rise to a separate legal act between the consumer and the producer of the digital content is a question that receives varying answers in European legal systems.[44]

Article 24(3) CESL brings clarity with regard to click-wrap license terms that are presented only when the digital content is downloaded or installed: such terms are not incorporated into the contract between consumer and seller. The CJEU's ruling in *Content Services* implies that it is unlikely that the standard terms are validly incorporated in the case of a browse-wrap license. Moreover, from Article 70 CESL it follows that even if browse-wrap license terms—that have not been expressly accepted by the consumer—have been validly incorporated into the contract between seller and consumer, the seller may nevertheless not invoke them against the consumer as the browse-wrap method in effect implies a mere reference to the terms. On the other hand, a click-wrap license where the consumer prior to the conclusion of the contract needs to agree to the terms in order for the contract to be concluded meets the requirements of both Articles 24 and 70 CESL and will therefore be effective.

From this it follows that CESL provides clarity as to the incorporation of standard terms and the possibility for the seller to invoke them against a consumer in the case of click-wrap and browse-wrap licenses.[45]

30.3.3 Unfair Terms

30.3.3.1 Regulation Under CESL

Unfair terms are not binding on the consumer, Article 79 CESL provides.[46] The open clause for consumer contracts in Article 83(1) CESL is directly taken from Article 3(1) Unfair Contract Terms Directive. In addition, Articles 84 and 85 CESL provide for lists of terms that are deemed or presumed to be unfair in a consumer contract: the black list of Article 84 CESL consists of 11 terms, and the grey list of

[43] Paradoxically, the website must be used in order to read the contract, or even become aware of its existence; see L Guibault, T Rieber-Mohn and PB Hugenholtz, *Study On The Implementation And Effect In Member States' Laws Of Directive 2001/29/EC On The Harmonisation Of Certain Aspects Of Copyright And Related Rights In The Information Society* (Amsterdam, Institute for Information Law, 2007), Part I, 140 ff, http://www.ivir.nl/publications/guibault/Infosoc_report_2007.pdf.

[44] See Loos et al., *Analysis*, 66 f, with references to debates in Dutch, Finnish, French, Polish and UK law.

[45] Given the scope of CESL, it cannot provide clarity as to the validity of a supposedly concluded separate legal act with the producer of the digital content and the incorporation of these terms in such a legal act.

[46] As indicated above, this provision copies Art 6(1) Unfair Contract Terms Dir.

Article 85 CESL of 23 terms. In this respect CESL clearly goes beyond the Unfair Contract Terms Directive, the Annex of which merely consists of an indicative and not exhaustive list of terms that may (or may not) be considered unfair. By and large the black and grey lists are in line with national lists.[47] The European Parliament added just one more term to the grey list. Its Amendments 157–174 largely serve to transfer the majority of terms from the grey list to the black list.

30.3.3.2 Does CESL Solve Consumers' Problems with Regard to Unfair Terms in Digital Content Contracts?

In general, the black and grey lists of Articles 84 and 85 CESL (whether or not amended in accordance with the proposals of the European Parliament) will offer sufficient relief to prevent sellers from relying on unfair terms. For less clear cut-cases, the open clause of Article 83 CESL will normally provide sufficient additional protection, albeit that the evaluation of such a term would then have to be conducted on a case-by-case basis. However, with regard to digital content contracts, at least three types of terms deserve additional attention: terms restricting the possibility for private copying, restrictions on the right to respect privacy, and bundling clauses.

Terms Restricting the Possibility of Private Copying

Digital content typically is copyright-protected. Consumers are confronted more and more often with contract terms that attempt to restrict the privileges normally recognised to them under copyright law, in particular the right to make private copies. In theory, consumers could be considered to have been protected sufficiently if they are made aware of such restrictions through information obligations. However, as set out above, such obligations typically fail to make consumers actually aware of these limitations. Moreover, in practice it is rather unlikely that consumers that have read and understood these limitations, would be able to shop for digital content offered to them with better terms. An alternative approach is to set boundaries against *unfair* restrictions of the possibility to make private copies.

In my view, Article 85 CESL's grey list of contract terms that are presumed to be unfair should be supplemented with terms that depart from the copyright exceptions. A presumption of unfairness would have the advantage of having a broad application, relating to all limitations and exceptions on copyright. Such a rebuttable presumption of unfairness would have the advantage of not undermining the emergence of new, potentially attractive business models since a trader would be able to provide counter-evidence for the need to include such a restrictive clause in

[47] See MBM Loos, 'Standard Terms Regulation in the Proposal for a Common European Sales Law. Comment to Nils Jansen' (2012) *Zeitschrift für Europäisches Privatrecht* 790; M Ebers, 'El control de las cláusulas abusivas en un futuro instrumento opcional' (2012) *InDret* 29 f.

his standard terms.[48] The European Parliament's Committee on the Internal Market and Consumer Protection proposed an amendment to the proposal for a Consumer Rights Directive in this sense. Amendment 1584 provided: 'Annex 3–paragraph 1–point l d (new)(*ld*) *restricting the use of digital products permitted under copyright law;'* which should be given consideration.[49] In the final version of the Consumer Rights Directive ultimately the Unfair Contract Terms Directive was not revised or updated. As a result, also this specific Amendment was not included. Unfortunately, the European Parliament failed to take this provision over in its Amendments to CESL.

Restriction of Data Protection Rights

In our report for the European Commission, my colleagues and I noted that in most legal systems studied, a contractual term restricting or breaching privacy rights is considered unfair, but the legal argument for this conclusion is often absent or vague.[50] Given the importance of privacy protection in the digital environment, where consumers often are not aware of the use made of their personal data, it seems desirable to create more legal certainty on this matter.

One way to deal with privacy protection in contract law is through mandatory rules that regulate the validity of contractual clauses restricting fundamental rights, such as the right to respect for privacy. In the academic Draft Common Frame of Reference, it was proposed that contracts infringing fundamental principles would be considered void.[51] Under CESL, the fundamental rights and principles recognised by the Charter of Fundamental Rights of the European Union are respected.[52] However, matters of (in)validity for reasons of morality, illegality or public policy have been left outside CESL and left to national law.[53] This would suggest that even though CESL is applicable to the contract, it is left to the otherwise applicable national law to determine whether or not a term restricting or excluding privacy right is void or valid, and what the consequences of invalidity would be—would (only) the term be considered void, or even the whole contract? And may consumers directly invoke the fundamental rights and principles recognised by the Charter of Fundamental Rights

[48] As both Helberger and Hugenholtz, and Guibault point out, an absolute ban on contractual clauses that prohibit private copying could result in less choice for consumers and should therefore be prevented; see N Helberger, and PB Hugenholtz, 'No place like home for making a copy: private copying in European copyright law and consumer Law' (2007) *Berkeley Technology Law Journal* 1095; L Guibault, 'Accommodating the Needs of iConsumers: Making Sure They Get Their Money's Worth of Digital Entertainment' (2008) 31 *Journal of Consumer Policy* 409.

[49] See Loos et al., *Analysis*, 199 f. This approach is not unprecedented since a number of Member States of the European Union have declared the rules of copyright mandatory, namely Belgium, Portugal, and Ireland, see Art 23bis of the Belgian Copyright Act of 1994, Art. 75(5) of the Portuguese Copyright Act, and Art 2(10) of the Irish Copyright Act.

[50] See Loos et al., *Analysis*, 162 f.

[51] Cf Art II.-7:301 DCFR (Contracts infringing fundamental principles)

[52] Cf recital (37) of the preamble to the Regulation.

[53] Cf recital (27) of the preamble to the Regulation.

of the European Union in order to challenge a contract term? Clearly, this would lead to legal uncertainty, as it would differ from contract to contract whether or not such a term could be invoked depending on the applicable national law.

A second approach could be to leave the matter to data protection law. Article 7(1) of the proposal for a General Data Protection Regulation[54] requires the controller, that is, the natural or legal person that determines the purposes, conditions and means of the processing of personal data,[55] to obtain the consent of the person whose personal data are to be processed. According to paragraph (4) of this Article, the consent 'shall not provide a legal basis for the processing, where there is a significant imbalance between the position of the data subject and the controller'. This seems to suggest that the consent is void in the case of an unfair term. If this is the case, Article 7(4) General Data Protection Regulation would not offer protection in addition to the open clause of Article 83 CESL.

For that reason, I believe a third approach is needed: to deal with contractual restrictions on data protection rights under unfair terms legislation. In particular, in my view terms concerning a change of the data collection's purpose without informing the consumer should be placed on the black list of Article 84 CESL.

Bundling Clauses and Tying Agreements

Making the purchase of digital content conditional upon the conclusion of an additional contract,[56] either with the digital content's seller or with a third party indicated by the seller, or forcing the consumer to make use of specific hardware to enable the purchased digital content's use restricts the consumers' ability to exercise free choice between different contents and sellers. As such, tying arrangements can conflict with important interests of consumers, even if the tying is the result of a viable and perfectly legitimate business strategy. The interest of consumers in being able to exercise choice between different digital contents, devices and businesses is also worthy of protection, as it is an important element of functioning competition and of effective consumer protection.

Bundling clauses are clauses that force the consumer who has purchased digital content to conclude another contract. Such clauses are not infrequent and may be entirely justified, in particular when the consumer was properly informed thereof before purchasing the digital content in the first place. For instance, the seller may sell a videogame on a DVD which can only be played online if the consumer also

[54] Proposal for a Regulation on the protection of individuals with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation), COM(2012) 11 final.

[55] Cf Art 4 under (5) General Data Protection Regulation.

[56] A related practice pertains to the situation where in order for the consumer to be able to make use of the digital content he is required to consent to the processing or use of data without that processing or use being necessary for the use of the digital content. On 16 January 2013, the European Parliament's Committee on Civil Liberties, Justice and Home Affairs adopted a draft-Report on the proposal for a General Data Protection Regulation. Amendment 107 in that draft-Report suggests to include a new Art 7(4b) in the Regulation banning such practices.

concludes an access contract with the producer of the game. However, in particular when the consumer is not informed of this restriction before the conclusion of the contract, such a provision may inflict on a consumer more (financial) obligations than he may have expected upon the conclusion of the original digital content contract. Such terms may lead to anti-competitive tying arrangements, which traditionally have been regulated by antitrust law and the responsible competition authorities. It is, however, uncertain whether antitrust law and, more generally, competition law offer appropriate remedies in the case of bundling clauses in digital contracts. On the one hand there is still uncertainty to what extent consumers can be active parties in competition law procedures.[57] On the other hand, even though the end-goal of competition law may be the protection of end-users (including consumers) and of competitors, in the first instance competition law concerns the (functioning of) competition. And while competition authorities may decide to ban practices that they find anti-competitive, this still does not say anything about the effect of such ban on an individual consumer's contract. Similarly, while imposing such clauses on a consumer may under certain circumstances constitute an unfair commercial practice, this does not give an indication as to the validity of the contract term.[58]

This is why it is suggested to include a rule into the grey list clarifying that any not-individually negotiated term requiring the consumer to conclude an additional contract and thus taking on additional (financial) burdens is presumed to be unfair.[59] The seller may then prove that in the circumstances of the case such a term is in fact reasonable. It is certainly not inconceivable that the seller will succeed in providing such evidence—as is shown by the example above where the seller of a game has informed the consumer before the contract is concluded that the game can only be played online if the consumer concludes an additional contract with the producer of the digital content. Yet, including the term on the grey list will bring about that in case of doubt the term is not upheld—and I think that this is justified given the effects the term may have.

30.3.4 Non-Conformity

30.3.4.1 Regulation Under CESL

As already indicated in Sect. 1, Member States struggle with the classification of digital content contracts. Notwithstanding these difficulties, in practice, legal systems do not differ much in their approach as to how to determine whether or not the

[57] For a discussion, see N Helberger, *Controlling access to content. Regulating Conditional Access in Digital Broadcasting* (The Hague, Kluwer International, 2005) 188 ff.

[58] In CJEU, 15 March 2012, Case C-453/10 *Pereničová and Perenič v SOS financ spol. s r. o.)*, not yet reported, the Court made clear that this is not automatically the case and that the term must be evaluated on a case-by-case basis applying Art 3(1) Unfair Contract Terms Dir.

[59] Obviously, the practice of bundling clauses is not restricted to digital content contracts and may produce equally questionable results for other consumer contracts. Therefore, the provision on the grey list need not be restricted to such contracts either.

digital content is in accordance with the contract. In most legal systems, in practice the conformity test is applied as it has developed under Article 2 Consumer Sales Directive with regard to 'ordinary' consumer goods.[60] In this sense, it does not come as a surprise that under CESL, the conformity test laid down in Articles 99 and 100 CESL, with minor adjustments, is applied when determining whether the digital content that was supplied is in accordance with the seller's obligations under the contract.

The relevant time for establishing conformity is the moment when risk passes, Article 105(1) CESL provides. In the case of digital content supplied on a tangible medium, such as a DVD or a USB stick, risk passes when the consumer has acquired the physical possession of that tangible medium.[61] If, for instance, the DVD is scratched after the consumer has gained the physical possession of the DVD and as a result the digital content cannot be accessed anymore, this problem is for the consumer to bear, Article 105(1) CESL indicates. Similarly, where the digital content is not supplied on a tangible medium, risk passes at the time when the consumer has obtained the control of the digital content.[62] This implies in the case of downloading that the download must have been completed before risk passes; any disruptions in the transfer of the digital content therefore are the seller's problem. Moreover, as digital content, e.g. software, often needs to be installed by the consumer in accordance with installation instructions provided by the seller or producer, risk passes only when the consumer has had reasonable time for installation.[63]

Even though most provisions function properly with regard to digital content contracts, these provisions have primarily been developed with ordinary sales contracts in mind. Such contracts typically are performed in full either directly or shortly after the contract is concluded. Long-term sales contracts that require the seller to continuously or repeatedly deliver goods are not unimaginable. However, the most typical examples thereof, contracts for the supply of electricity, natural gas, and water through conduits, are excluded from the notion of 'goods' in Article 2(h) of the Regulation and therefore cannot be the object of a contract covered by CESL.[64] This could suggest that CESL may not be apt to deal with long-term contracts for the supply of digital content. Nevertheless, such contracts are not excluded from the scope of CESL, provided that the digital content may be stored, processed or accessed, and re-used by the consumer.[65] In so far as the contract would require consecutive deliveries of digital content, it stands to reason that the relevant time for establishing conformity of each individual delivery is when that delivery is made. However, where the parties have agreed that the seller is required to provide regular updates of the original digital content—e.g. updates for roadmaps for satellite navigation software such as TomTom and for virus scanners—the conformity test needs to be adjusted: in such cases, the digital content should not only conform to the

[60] Loos et al., *Analysis*, 103 ff.

[61] Cf Art 142(1) CESL.

[62] Cf Art 142(2) CESL.

[63] Cf Art 105(3) CESL.

[64] See Art 5 CESL, which indicates for which contracts CESL may be used.

[65] Cf. Art 5(b) of the Regulation. See also above, section 3.

contract at the start of the contract period but also throughout the contract period. For this situation, Article 105(4) CESL provides that the digital content must remain in accordance with the contract throughout the contract period.[66]

30.3.4.2 Does CESL Solve Consumers' Problems with Regard to Conformity Matters?

Generally, it should be noted that the conformity test appears to be flexible enough to take into account the differences between the different contracts pertaining to digital content—in much the same way as the conformity test is flexible enough to be applied to such differing goods as cars, furniture, toys and foodstuffs. In so far, the conformity test may indeed be applied to digital content contracts. The consumer bears the burden to prove that the digital content does not conform to the contract, i.e. does not meet his legitimate expectations. He normally is helped by the conformity test's sub-rules that the digital content must be fit for its normal purpose and that it must possess the qualities and performance capabilities that the buyer may expect, as also follows from Article 100(b) and (g) CESL. The sub-rules point to a standard against which the use this consumer wants to make of the object of the contract is measured. The problem for digital content is that such a standard often does not (yet) exist. With digital content the question is rather *what* the 'normal purpose' of the digital content is and *what* qualities and performance capabilities the consumer may expect.[67] The absence of a standard is caused by a number of things. Firstly, digital content is a relatively new phenomenon. Secondly, there are very different types of digital content and there is a high level of product differentiation and innovation. As a consequence, by the time a standard may have developed, it could already be outdated. An important factor in practice is the fact that the legitimate expectations of the consumer are to a large extent influenced by statements from the side of the industry. Statements by the industry representatives—whether driven by restrictions of a technical nature or by business interests—indicating that a particular use of the digital content is not or only to a limited extent possible may therefore become a self-fulfilling prophecy. In this sense, the conformity test is somewhat subject to manipulation by sellers and producers.[68]

In practice, the problem of the missing standard arises primarily with regard to accessibility, functionality and compatibility issues.[69] When the consumer cannot access the digital content or transfer it to another device, and make use thereof

[66] N Reich in H-W Micklitz and N Reich, n 12 above, part III, 74, rightly remarks that the right to an update depends on the express or implied terms of the contract and therefore may be avoided by omitting such a term in the contract. However, *if* such a term is included, Art 105(4) CESL is mandatory.

[67] Cf P Rott, 'Download of Copyright-Protected Internet Content and the Role of (Consumer) Contract Law' (2008) 31 *Journal of Consumer Policy* 450.

[68] N Reich in H-W Micklitz and N Reich, part III, 81 and 90, correctly remarks that the information requirement *de facto* may thus function as an exemption clause.

[69] Other areas of problems are digital content of bad or substandard quality; and flaws, bugs and other security and safety matters. In these cases, the non-conformity of the digital content can often

in accordance with its ordinary or specifically agreed purpose, the question arises whether this constitutes non-conformity. The inability to access the digital content may be the result of the use of technical protection measures or originate from the incompatibility of formats and standards used. Under Article 13(1) CESL, the seller is required to inform the consumer of such restrictions before the contract is concluded. Where the seller has properly informed the consumer that the digital content is incompatible with particular hardware or needs to be played on specific hardware and such statement is justified in the circumstances of the case, the consumer may not expect otherwise. If the digital content indeed does not play on other hardware than it is intended to be used on, this does not constitute non-conformity.

When the seller has neglected to inform the consumer of the relevant technical protection measures, this constitutes non-conformity as the consumer then need not expect such restrictions. With regard to the incompatibility of formats and standards used, the absence of information on the lack of interoperability of the digital content only constitutes non-conformity if the consumer demonstrates the seller was aware or should be been aware of that lack. The relevant question then is when the seller may be expected to have been aware of the lack of interoperability. The seller cannot be expected to constantly check webforums to learn whether or not there is discussion on the compatibility of the digital content he sells with specific hardware. This may be different, however, where the discussion on a webforum catches the attention of mass media, e.g. in consumer complaints programs on television.

The seller may also be expected to be aware of statements posted by other consumers on his (the seller's) own website informing other customers about the performance capabilities of the digital content or the (in)compatibility of the digital content with particular hardware. Consumers may read such postings before the digital content is purchased, and they may therefore be influenced by these statements. Where the posting is found to be unreliable by the seller, he may either delete the statement or post his own comment explaining why the posting is incorrect. Other customers may therefore rely on the correctness of the postings in case such action is not undertaken by the seller and may subsequently build their legitimate expectations of the digital content thereupon.

Article 69(3) CESL[70] may provide additional and interesting arguments in determining whether the digital content supplied is in conformity with the contract. Under this provision the seller is expected to be aware of any statements made by or on behalf of a producer or other person in earlier links of the chain of transactions leading to the contract. Such statements could then be regarded as being made by the seller unless he, at the time of conclusion of the contract, did not know and could not be expected to have known of them, or unless he has corrected the statement before the contract was concluded.[71] Clearly, if the producer of the digital content

be established with relative ease. For details, see Loos et al., 'The regulation of digital content contracts', 745 ff, and Loos et al., *Analysis*, 117 ff.

[70] Which copies Art 2(2)(d) of the Consumer Sales Dir.

[71] Furthermore, the seller may not be held to the statement if it is established that the conclusion of the contract could not have been influenced by the statement. This may be relevant where the consumer has indicated that he is only interested in making a particular use of the digital content and the third party's statement pertains to other use or other performance capabilities.

indicates on its website that the digital content is or is not compatible with specific hardware, the seller is expected to be aware thereof.

Less obvious is that the seller should also be aware of such statements on the website of the producer of the *hardware*. This is not the case where the seller does not (also) offer the hardware for sale to its customers. However, this may be different where the seller does offer both the digital content and the hardware for sale to consumers: it seems difficult to uphold in such a situation that the seller is deemed to be aware of such statements where the contract pertains to the purchase of both the digital content and the hardware but need not be aware thereof if this particular consumer has only purchased the digital content.

More difficult to answer is whether Article 69(3) CESL could be interpreted as implying that the seller should also be aware of postings by consumers on the website of the producer of the digital content: such statements are not made by the producer, but they are made public through his website. As the producer is able to remove postings and may be expected to do so where the postings are incorrect, one could argue that the fact that the statement has not been removed by the producer may be interpreted as an implied statement of the producer that the posting is in fact correct. If this view is accepted, the seller would be expected to have been aware of such statements as well. Interpreted in this broad sense, Article 69(3) CESL would bring with it that the seller would be expected to be aware of any such postings on the producer's website.

However, it seems unlikely that Article 69(3) CESL would be interpreted in such broad sense as there are also arguments that point in a different direction. One could, for instance, argue that consumer reviews are notoriously unreliable—and that consumers are aware of that—and that the reason for not-removing incorrect postings by producers is rather a consequence of their policy to allow their customers freedom of speech and that for that reason comments on the website should not be removed, even if they are considered untrue by the producer or seller. In this view, postings by other consumers may not contribute to the legitimate expectations that consumers may have of the digital content. This view, however, does reinforce the self-fulfilling prophecy that it is primarily the industry that set the legitimate expectations of their customers.

Even if the broad interpretation of Article 69(3) CESL is dismissed it seems that the notion of non-conformity is workable also for digital content, even though standards indicating what may be expected of the digital content are largely missing and probably will continue to be lacking in the near future.

30.3.5 Remedies

30.3.5.1 Regulation Under CESL

Under Articles 106 and 107 CESL it follows that where the digital content is delivered against payment of a price all remedies for non-conformity are available in the same manner as they are available for sales contracts. Moreover, the hierarchy of remedies introduced by Article 3(3) and (5) Consumer Sales Directive has not

been taken over in CESL, giving the consumer the free choice between the available remedies, which means that he is not required to first opt for repair or replacement.

Where the consumer chooses to terminate the contract, Article 172(1) CESL requires both parties to return to the other party what they have received under the contract.[72] This would seem to suggest that the consumer is to return the digital content and that he is entitled to receive back the price paid. However, the wording of Article 173(1) CESL seems to imply that in the case of a contract for the supply of digital content, the obligation to return the digital content is replaced by an obligation to pay back its monetary value. The idea behind this provision undoubtedly is that the consumer should not be able to retrieve the price he paid and at the same time, after having made a copy of the digital content, in fact be able to use the digital content after termination for free. However, as it is worded, Article 173 CESL in fact makes termination impossible, even if it is safeguarded that the consumer could not continue to make use of the digital content.

In this respect, the Amendments 229–231 adopted by the European Parliament in its first reading of the Commission's proposal clearly improve the quality of the legislative proposal. Different from the Commission's proposal, the proposed Article 172a(1) CESL, as introduced by the Parliament, indicates that digital content may be returnable under Article 172 in three cases: (a) when the digital content was supplied on a tangible medium and had not been sealed by the seller before delivery, or when it had been sealed prior to delivery and the seal has not been broken by the consumer; (b) when it is otherwise clear that the consumer who sends back a tangible medium cannot have retained a usable copy of the digital content; and (c) when the seller can, without significant effort or expense, prevent any further use of the digital content on the part of the recipient. Examples of such measures include the use of technical protection measures blocking the digital content, and deletion of the consumer's user account where such an account is required for use of the digital content. The suggested paragraph (2) adds that where the digital content is supplied on a tangible medium which is returnable in accordance with paragraph 1 (a) and (b), the digital content is returned when he has returned that tangible medium.

In my view, these amendments are to be welcomed as they prevent an unjustified claim for payment by the seller—which would even apply in the case of non-conformity—without compromising the seller's legitimate interest that the consumer should not be able to further use the digital content for free where payment of a price in money had been agreed upon.[73] This implies that only when the requirements of the new Article 172a CESL are not met, Article 173 CESL would become applicable, requiring the consumer to pay the monetary value of the digital content instead of returning it. This seems a much more sensible approach then was originally proposed by the European Commission.[74]

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[72] It should be noted that where a consumer has exercised his right of withdrawal under Art. 40–47 CESL, the effects of termination are primarily governed by those provisions. In this paper I will not discuss whether and to what extent Art 172 ff CESL may also be applied in the case of withdrawal.

[73] See also the justification of the European Parliament for this amendment, A7-0301/2013, 109.

[74] See in a similar fashion Loos et al., 'The regulation of digital content contracts', 755 f.

However, where the digital content is not supplied in exchange for the payment of a price in money, Article 107 CESL excludes all remedies other than a claim for damages for loss or damage caused to the consumer's property, including hardware, software and data, and excluding any gain of which the consumer has been deprived of as a consequence of that damage. This provision is problematic. Obviously, a right to price reduction does not make sense, but there is no reason why the other remedies should be excluded altogether. Why shouldn't the consumer be allowed to claim the repair or replacement of the digital content even where such repair or replacement can easily be obtained from the seller? Moreover, why should the consumer be denied the right to terminate the contract? In particular where the payment has taken the form of the provision of personal data the consumer may have a legitimate interest in having his data erased by the seller—and thus preventing the seller from continuing to gather personal data and from processing and using the personal data for purposes to which the consumer had consented in exchange for the use of the digital content he now is unable to properly use.

The amendments adopted by the European Parliament in its first reading of the Commission's proposal improve the legal position of the consumer who has purchased the digital content not in exchange for a price in money but in exchange for another counter performance, such as the provision of personal data. Amendment 193 introduces a new first paragraph to Article 107 CESL allowing the consumer who has been provided with digital content in exchange for a counter performance other than the payment of a price to resort to all remedies apart from price reduction. Amendment 9, amending recital (18), makes clear that this provision is intended to apply where the consumer's counter performance consists of the provision of personal data or other utility having commercial value for the seller. This would imply that the consumer could ask for repair or replacement of the digital content, or termination of the digital content contract. The consequential Amendment 232 introduces a paragraph (3) to the new Article 172a CESL, providing that in the case of termination where the counter performance is made in the form of the provision of personal data, and that counter performance cannot be returned, the seller is required to refrain from further use of what was received, for instance by deleting the received personal data.

30.3.5.2 Does CESL Solve Consumers' Problems with Regard to Remedies?

The amendments adopted by the European Parliament certainly improve the remedial regime of CESL. Moreover, due to the absence of the hierarchy of remedies the consumer indeed has the free range of remedies available under CESL, including—as Article 111 CESL makes clear—repair and replacement.[75]

Nevertheless, some further improvements could still be contemplated. As indicated above, Amendment 232 introduces a paragraph (3) to the new Article 172a

[75] In this sense, Art 111 CESL follows and clarifies Art 3(3) Consumer Sales Dir, which in itself is somewhat ambiguous in this respect; that the choice is the consumer's, however, follows clearly from recital (10) of the preamble to the directive.

CESL, providing that in the case of termination where the counter performance is made in the form of the provision of personal data, and that counter performance cannot be returned, the seller is required to refrain from further use of what was received, for instance by deleting the received personal data. The Amendment would thus introduces a limited 'right to be forgotten' as a remedy for non-conformity, which as such is a novelty in European contract law. However, there does not seem to be a justification why this right should not also exist in cases where the consumer was required to both pay a price in money and provide personal data. In my view a similar provision should be introduced for such situations.

Further improvements are also conceivable with regard to the right to claim damages. Under Article 2(g) Regulation, 'damages' is defined as a sum of money to which a person may be entitled as compensation for loss, injury or damage. This indicates that the consumer's right to damages under Articles 106(1)(e) and 159 ff. CESL is restricted to a claim in money, disregarding any right to damages in kind. This is regrettable, in particular in the online environment. Although financial compensation is a common type of compensation for damage, the digital environment offers sellers other means to redress damage, such as free downloads, free extensions of contracts, and discounts on future purchases. Such remedies may resolve the problems consumers face more aptly than a claim for damages in money. In this sense, it is a pity that the consumer is not awarded a right to damages in kind.[76] However, a seller may of course offer such extra-legal remedies of his own motion if this may lead to an amicable settlement of the consumer's complaints. In this sense, CESL will not stifle the innovation of new remedies tailored to the needs of the digital environment.

30.4 Conclusion

In the beginning of this paper I have argued that the inclusion of digital content contracts within the scope of CESL is to be welcomed. This does not mean that 'ordinary' sales rules may be applied to digital content contracts without any adjustments being made.

In some areas, problems specific to digital content contracts have indeed led to amendments of the relevant provisions of CESL. This is true, for instance, with regard to the obligations of the seller. Typical of a sales contract is that the seller need not only deliver the goods, which must be in conformity with the contract, but is also required to transfer the ownership of the goods.[77] In the case of digital content contracts, ownership of the tangible medium on which the digital content is stored may be transferred, but the trader is typically *not* required to transfer the ownership of the digital content itself, or more specifically, of the intellectual property rights associated with the digital content. This particular trait of digital content contracts

[76] Such a right is for instance recognised explicitly in Dutch law, cf Art 6:103 Dutch Civil Code, which allows the court to award damages in kind instead of in money upon demand of the victim.

[77] In so far as the transfer of ownership is not the automatic result of the conclusion of the contract.

is well translated in Article 91 CESL, which describes the seller's main obligations, and which requires the seller to transfer the ownership of the goods, including the tangible medium on which the digital content is supplied, but not the ownership of the digital content itself. Similarly, Article 142(2) CESL takes into account that when digital content is not supplied on a tangible medium, a specific rule is needed to indicate when risk passes to the consumer. Moreover, Article 105(4) CESL introduces a specific obligation on conformity in case of a long term contract for the supply of updates to digital content, thus amending the moment against which the existence of conformity is to be measured. With regard to remedies, the amendments adopted by the European Parliament should be taken over in order to develop a properly functioning regime for digital content contracts.

In other areas, the rules of CESL are not specifically tailored to the needs of digital content contracts, but nevertheless solve problems consumers face in particular when concluding digital content contracts. A good example are the rules on incorporation of standard terms, which provide clarity on the question whether standard terms are incorporated into the contract and may be invoked against consumers in the case of click-wrap and browse-wrap agreements. Terms included in browse-wrap agreements clearly fail to meet the standard set by Article 70 CESL, whereas terms included in click-wrap agreements that are presented only when the digital content is downloaded or installed are not incorporated under Article 24(3) CESL.

In the area of unfair terms, additional rules are needed blacklisting and greylisting specific unfair terms that are commonly included in digital content contracts. In my view, terms that restrict the possibility of private copying and terms that require the consumer to conclude an additional contract with the seller or a third party should be included on Article 85 CESL's grey list. Restrictions on data protection rights, in particular terms concerning a change of the data collection's purpose without informing the consumer should rather be included in Article 84 CESL's black list. A failure to do so would require the court to evaluate on a case-by-case basis whether or not such terms would be unfair under the general unfairness test of Article 81 CESL, which would restrict the predictability of the outcome of the test and thus legal certainty considerably.

Finally, with regard to information obligations, CESL is a step in the right direction—not only for digital content contracts, but more generally for consumer contracts concluded at a distance—as through the use of the standard information notice and the instructions on withdrawal and the model form for withdrawal at least offer some guidance on the way information can or must be provided to consumers. Unfortunately, neither the European Commission nor the European Parliament have included a provision requiring the seller to provide the information to the consumer in a language the consumer masters or may be expected to master. An obligation to this extent may at best be interpreted indirectly through the obligation to provide the information 'in plain and intelligible language', but a more straight-forward rule in CESL itself seems preferable.

It may therefore be concluded that the rules of CESL lend themselves well to be applied to digital content contracts, albeit that in some areas additional adjustments need to be made. In any case, the European Parliament's amendments pertaining to remedies need to be included in the final version of CESL in order to offer parties

to a digital content contract a proper remedial scheme. However, if CESL is to be restricted to distance contracts or even to contracts concluded online, an extensive reworking of the provisions of CESL is needed.

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Chapter 31
Credit Scoring: Will Our Digital Identity Replace the Real Person?

Rainer Metz

Abstract When last summer in Germany the news spread that the most important credit agency[1] (Schufa) was cooperating with the renowned Hasso Plattner Institute, researching on social networks and their relevance for creditworthiness, there was a public uproar. The then Federal Minister for Consumer Protection, Ms. Aigner, warned that Schufa should not become the consumers' economic Big Brother. Correlating the data of a credit agency with those of social networks seemed to be quite a delicate matter. Within days the cooperation was ended. Schufa defended the cooperation by claiming that other companies were already using such data available in the internet. The German economic magazine *Handelsblatt* named a couple of foreign companies that used data from social networks like facebook or twitter to predict creditworthiness. Other companies use data from GPS services or social graphs (likes, friends, posts), the time spent on a particular web site or app or the general smartphone usage to score consumers. In Norway credit scoring also relies on taxable income and tax returns. An American start-up, headed by a former Google chief information officer, which promises to predict consumer behaviour, makes use of Big Data and utilizes 70,000 indicators. Scoring than becomes more and more a specific kind of data mining. It seems that Schufa's intention for further research is by far not the most problematic aspect of the question and that the use of internet data for consumer scoring is not limited to Germany. Apart from the United States, which has a specific legislation on scoring, there seems to be a certain lack of clarity in international consumer protection with regard to it. The proposed EU regulation on data protection[2], although intended to tackle new technological and international developments, does not deal in specific with scoring. In Germany scoring still is a very sensitive issue for consumer protection. During the Conference of the

[1] Hans Micklitz was not only the Head of the Scientific Advisiory Board of the German Federal Ministry for Consumer Protection for many years but also is a long time member of the Schufa (credit agency) Consumer Protection Committee.

[2] Proposal for a Regulation on the protection of individuals with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation), COM(2012) 11 final.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_31,

German Länder (regional) Ministers for Consumer Protection therefore there has been a demand for more legislation, more supervision and more scientific research. The German National Ministry for Consumer Protection in autumn 2013 contracted a study on the latest developments in scoring and the need for further consumer protection legislation.

31.1 Scoring

Scoring traditionally attempts to predict whether a consumer is willing and able to pay, and particularly to repay a bank credit. It is expressed in percentages or numbers, which can range from 300 to 850—with 711 being the average FICO score for Americans, and 620 the borderline between prime and subprime. As an example, in summer 2013 the author's basic score from one renowned agency was 99.65 %. From the information available in the internet such a score is interpreted as having a very low risk.[3] But one has to look for such an interpretation in the internet, since it is not normally given by the agencies themselves. In recent years, scoring has greatly increased in worldwide significance. In the US for instance, there are 11 billion enquiries into the scores of 250 million citizens annually, and that is just of one well known provider (FICO). In Germany, Schufa alone had in 2012 665 million sets of information related to 66.2 million persons in Germany, which has a population of 81.3 million, two thirds of which are above the age of 14. Almost every German adult is registered with Schufa. Schufa stores only neutral data (like the date and type of contract) or negative data (like payment defaults), but no positive data (like investments or savings) are stored. Schufa delivered its information to business companies 106.6 million times. The company is often mentioned in this article, particularly because it is by far the most important German credit agency, but also because it is the only one that provides a good deal of data related to its business, whereas other agencies are rather reluctant to be that transparent. Schufa is to a great extent owned by banks, and approx. 13 % belongs to trade companies. Their business volume in 2012 was 120 million € and the company employed 700 people.

Scoring services attempt to reduce the (credit) risk of a contract by calculating the probability of default using numerous parameters—for instance the consumer's age, address, and number of outstanding credit obligations. The forecast is supposed to be formulated upon mathematical and statistical processes, which ascertain the consumer's "creditworthiness", encompassing both the ability and the intention to pay. Sometimes agencies develop a score even when they do not have any data at all apart from the name and address of the consumer. Since different agencies use different methods, the score for the same consumer can vary from agency to agency. The consequences of a disadvantageous score run from higher interest rates

[3] The credit score found online varies as follows: >97.5 % very low risk, 95–97.5 % low to comprehensible risk, 90–95 % satisfactory to increased risk, 80–90 % substantially increased to high risk, 50–80 % very high risk, <50 % critical risk.

on credit to the complete refusal of any kind of contracts. It can also require various payment modalities, especially the more costly ones, for mail-order trade, or the refusal of a contract, for example a tenancy agreement. In the US, scoring is also taken into account by employers or while establishing an insurance contract. In the US the use of credit history for employment purposes gained enormously—from 19% in 1996 to 42% in 2006. For consumers, therefore, scoring is not purely, as Schufa promises, capable of "enabling trust and credit" but can also have considerable economic or social effects.

In Germany, before scoring was actually introduced, the rate of credit problems, like payment defaults, was very low, between 2 and 3%. After its introduction and development that percentage remained more or less unchanged. Credit scoring seemed to have had no real practical effect—a result that maybe due to the lack of available data. A test done in 2010 by the German consumer organization Stiftung Warentest[4] revealed that data of agencies was often wrong and incomplete. Only 11 out of 89 tested persons have complete and correct data. Although the credit score never relies just on single data alone, such a poor and inaccurate pool of data seems problematic.

31.2 New Developments

Traditionally scoring in Germany was done only by a very limited number of credit agencies. Nowadays in Germany there are dozens of new companies, sometimes subsidiaries of telecom companies, of commercial companies, sometimes companies specialised on particular market segments, like credit scoring of tenants that offer scoring. No license or registration is required. For consumers is consequentially very difficult to find information regarding who is doing their scoring and have their rights enforced. The idea of a single internet portal for all scoring agencies, which would enable consumers to enforce their rights effectively against those companies, remains undeveloped. The US do have such a portal, "Annualcreditreport.com", which includes all the most important credit agencies.

When evaluating a person, credit agencies traditionally only relied on bank data, like credit contracts, accounts, savings, investment, and various other problems or failures related to payments. Nowadays the range of criteria is almost unlimited, and all kinds of contracts and contract problems are taken into account. In absence of a birthdate, the first name is used in order to infer the probable date of birth and the consequent hypothetical age. The neighborhood in which one lives is used as a parameter in calculating the probable income and wealth. Data found in the internet, in social networks, or related to smartphone usage are used to score consumers. So not only material economic factors determine the results but also social factors are interpreted in order to establish a forecast of the consumer's alleged economic power. Most of the time, it is nothing more than an estimate.

[4] Stiftung Warentest, 'Verzerrtes Bild', (2010) *Finanztest* 12.

Originally, credit rating was a business that was confined within national borders. Today instead, more and more companies are buying businesses in other nations. The American Business leader FICO announced to have acquired the British company Adeptra, which focuses on mobile business. The German Company Arvato, for example, announced in April 2013 to have acquired a Norwegian firma, which has a strong basis in Scandinavia, in Great Britain and Ireland as well as excellent chances in Netherlands and Spain. This merger was supposed not only to improve the international situation of Arvato, but also to offer all their services throughout Europe. Scoring will no longer be restricted within national borders but will become more and more global.

Initially the scope of business was limited to credit rating for bank loans. Nowadays a wide range of services is offered, sometimes also to consumers, e.g. prevention against identity theft. Credit, mail order business, e-commerce, telecommunication, energy, insurance, job and housing markets are subject to scoring. Recently a smartphone app was introduced, which analyzes the driver's behavior in order to calculate his insurance premiums. New car insurances are offered in Germany by savings banks, which are based on scoring the drivers conduct using the car's route guidance system. There is a strong trend that sees credit scoring becomeing a relevant consumers' switch point in many economic and social areas. The trend is also directed towards a comprehensive and thorough service portfolio for business. From cloud based consumer management, business-customer relation, fraud and risk prevention, customer scoring, money collect scoring, management of payments and money collection—a wide range of services is offered. The intent is not anymore to simply provide data for decisions regarding possible commercial partnerships before signing a contract but to deliver services for the whole process, including debt collection, and to provide more and more mobile services. A real-time, multichannel dialogue is aimed at achieving a successful resolution through voice, SMS, email and mobile apps. For example, in case of delayed payments, customers will receive a reminder on their mobile phone, a so called "overdue payment reminder", with reply options such as "Pay Now", "Promise to Pay" or "Dismiss". Credit agencies will have access to a lot more consumers' data, practically to all of those associated with their business relationships. The amount and quality of data changes drastically. It is said that Mastercard in the US, on the basis of their data, is better in predicting divorces in the years to come then the couple itself. The full picture that credit agencies offer to businesses is not available via the consumer information web sites, but rather has to be found on internet sites dedicated to business. Their difference can be sometimes quite astounding.

Traditionally, credit agencies in Germany dealt only with business to business services. Nowadays Schufa and a limited number of smaller credit agencies do B2C. Schufa gained 1.6 million private customers during the last 3 years and has announced the introduction of an app that will offer services to consumers—for example, to inform them on the financial stability of construction companies

in case they plan to build a house. Some of this business is quite simple, like providing help against identity theft. But it remains somewhat unclear what this service, which costs 39.90 € a year, really entails. Schufa promises to scan the internet for eventual misuses of the consumer's name, but they do not assure their successfulness in preventing identity theft, nor imply any kinds of guarantees or liabilities. In case of identity theft, the company promises help in solving the problem, but in rather generic terms. The tips given to the consumer are not very specific and can be found elsewhere in the internet for free. Other countries, like Canada, provide such information free of charge in government publications. In the US, such information are provided free of charge by the internet portal of credit agencies. More problematic are other offers made to consumers, like the "Bonitätsauskunft"; a credit rating information for the price of 18.50 € that can be passed on from consumer to contract partners, and which promises to help finding a job or a tenancy agreement. But in difficult markets, with lot of candidates, those consumers with no or poor credit agency reports will have no chance. In my view these offers imply the risk that credit agencies will soon set the course in consumer life by way of providing better off consumer with good reports and better chances on the market and will contribute to an increasing segregation of society and social life. By way of offering such services to consumers as merely helpful, they are somewhat misleading and contributing to such a development.

Because of the wider range of businesses, the enormous quantity and quality of data and because of the deeper impact in the economic and social life of consumers, it seems doubtful whether the traditional concept of consumer protection, which is more or less limited to data protection, is still valid. A wider approach to really understand credit scoring seems instead necessary. Philip Marowski[5] connects the rapid worldwide growth of scoring to new models of liberalized financial markets and neoliberalism. Individual personal identity had to be replaced by standardized mechanisms of credit control, by categories of risks based on a stereotypical consumer; and of course without any liability for scoring providers. Or as Frank Schirrmacher,[6] the well known former editor of the *Frankfurter Allgemeine Zeitung*, said in a more philosophical way: The real empirical personal identity is without chance in a world of big data and algorithms that evaluate and provide permanent risk monitoring. All markets, producers and service providers will continuously evaluate and monitor their customers and users. Something we do not have the least cultural experience of. But all of these ideas point beyond the traditional understanding of consumer protection.

[5] P Marowski, *Never Let A Serious Crisis Go To Waste* (London, Verso, 2013).

[6] F Schirrmacher, 'Wir wollen nicht', *Frankfurter Allgemeine Sonntagszeitung*, 25/8/2013, 37.

31.3 Legislation

While the US has legislation on credit agencies since many years, for Germany this is a relatively new law. While altering the German Data Protection Act (BDSG)[7], which was approved for the first time in Germany, and in Europe, on the 29 May 2009, this law establishes specific legal provisions dealing with consumer related scoring.

The rights of the consumer were first improved by the new legislation in regard to the so-called automated decision-making. Until now only completely automated decisions were considered to be problematic. Pursuant to the new enactment in § 6a, the definition of an automated decision now encompasses whenever there has been neither an evaluation of a person's creditworthiness nor a decision as being made by a natural person. Even a somewhat formal "downstream" review made by a person lacking either the authority or enough information to evaluate correctly also counts as an automated decision. The existence of such a decision must be communicated to consumers and, upon request, the main reasons for the refusal are to be explained.

For the first time, the altered BDSG defines statutory conditions for credit scoring. Until then, every lender could maintain that it availed significant scoring methods even in the absence of data and although his procedures were somehow "clairvoyant".

Pursuant to § 28b it is now a prerequisite that the calculations will be demonstrable in terms of a scientifically recognised mathematical-statistical procedure for the determination of the probability of a particular conduct. The data protection authority overseeing such a scoring method must be able to evaluate the context (§ 38).

Further, a series of individual criteria have been statutorily excluded from scoring. Pursuant to § 3 para 9, particular types of data, like information about racial and ethnic heritage, political opinions, religious or philosophical convictions, trade union membership, health or sexual preferences are especially protected. The extent to which scoring criteria such as gender and age are consistent with the discrimination legislation is still an open question.

The home address may not be the sole criterion for scoring (§ 28b no. 3). There is a prohibition on probabilistic evaluations even where criteria other than the home address are used, but they are little valued. These measures were intended to prevent the so-called red-lining, a practice whereby particular residential areas were effectively excluded from economic life through, for example, the refusal of lenders to provide residents of such areas with certain types of credit and payment options or to provide it only at higher prices and rates. It is hard to see what the address alone can say of the resident's economic virtue or potential. By the extent of which the address is used alongside other data for the calculations, the affected parties must be notified and this must be documented. The notification requirement is less than the formal prior consent. The notification, which can also be included in the terms and conditions of a contract, creates a certain transparency for consumers, whereby

[7] (2009) *Federal Gazette* I 2355.

they can recognise who is doing the scoring and what kind of scoring is being carried out.

Pursuant to § 28a and 28b, further special pre-requisites for scoring are set out. According to § 28a, data can only be forwarded to scoring agencies under specific circumstances. Even when the contractual obligation for payment is not performed in a timely fashion, the transmission of such information must be required for the protection of legitimate business interests. This requirement is not fulfilled if the interested parties have made any objections. The forwarding of information is also possible when the parties concerned have been written to at least twice after the due date but before the transmission or, alternatively, at the time of the first overdue notice, when the consumer is warned of the prospective forwarding to a credit agency and this is not objected. The notice and the time period should also serve to avoid false data being stored. Merely failing to attend to a bill, ignorance thereof, or the prolonged absence of the affected party should no longer lead to automatic and immediate registration. The time period should also reduce incidences where merely transitory payment problems, in particular of trivial non-payments, are immediately registered—as was often the case in the past with telecommunications bills. Substantially contested demands may not be the subject of registration or transmission.

It is also not allowed to forward information derived merely from non-binding inquiries on credit conditions. Information regarding pre-contractual relationships designed to engender trust and facilitate market transparency may not be passed on to credit agencies, even with the consent of the affected party.

Pursuant to § 35 para 4(a), any indications of the existence of the so-called blocked data, the term used to refer to any contested information, may not be forwarded to third parties. Affected parties seeking to protect their rights ought not to be branded as difficult customers.

Last but not least, a so-called duty of correction was introduced. Above all, negative data ought to be rectified when the outstanding demand no longer exists—either because it has been met or for other reasons, for instance if a new payment agreement superseded the prior arrangement. This is a response to a problem frequently seen in the past, whereby data were considered out-of-date since intervening agreements had been accepted but did not show in the database. Similarly, corrections were often not given to credit agencies. Now, however, post-contractual changes are to be forwarded within a month of their adoption (§ 28a para 3). This clearly facilitates the actuality and accuracy of the database.

The core provisions of the statutory rules revolve around disclosure and information rights vis-a-vis credit agencies and contract partners.

The party upon which the duty of disclosure is incumbent has, in cases when a score is used in respect of the starting, implementation or ending of a contractual relationship, the duty to give the affected party the following information:

- The score created or saved for the first time in the last 6 months.
- Information as to how the score was produced in an individual and comprehensible form. On the one hand, the mathematic formulae, which the firm may keep secret, need not be published but, however, the result must be sufficiently

comprehensible for affected parties so that they will be able to fully exert their rights. They must be able to notice possible mistakes in data and have the right to submit their own alternative explanations for any discrepancies. Business and trade secrets must not be revealed.

The affected party must also be given information about the meaning of his score, in particular regarding the forecasts upon which the score is based and the scale used in the evaluation. Under the FICO scoring system in the US, the following factors with the corresponding weighting are relevant: payment performance (35%), present debts (30%), length of documented credit experience (15%), number of loans awarded (10%) and the number and type of previous credits, accounts and credit cards (10%).

The duty of disclosure also exists where data used to produce a score were not retained by the credit agency itself, but rather where it was received from third parties and deleted after the scoring.

Credit agencies must, pursuant to § 34 para 4, disclose the actual credit score and scores transmitted to third parties as well as the details of third parties (name, address where data and scores were sent to).

Once a year, the affected parties may receive upon demand a free complementary written disclosure about the recorded data (§ 34 para 8). In other countries, Canada for example, consumers can get a free report as often as they choose to.

Estimates should be clearly marked as such (§ 35). It should be made clear whenever mere estimates, rather than facts, are being sent.

Provisions relating to fines should effectively enshrine these rules, for instance for the non-fulfilment of the disclosure request, also so far as it is not complete or not fulfilled in a timely fashion.

31.4 Consumer Problems

Consumers often complaint that they were denied a contract by the sole reason that their credit score was too poor. No further information was given and the staff of the company was neither able nor willing to explain what the reasons for the decision or the score result were. Quite often it is indicated that the score was not produced by the trader itself but rather created by a third company specialized in scores and therefore nothing could be done about it. Consumers do have the impression that only stored data and obscure scores are decisive but not the real person.

It seems that this is especially the case in regards to the so-called liberalized markets like telecommunication or energy. Contracts are often concluded via the internet, so the provider does not have any personal contact with the consumer or any contract history. Consumers with poor scores are excluded from better deals like lower prices because of their poor score. It seems that, like those consumers

with low incomes, older consumers and those living in areas with not such a good reputation are particularly disadvantaged when it comes to better deals. This also creates the handicap of an increased competition.

At the center of many consumers' complaints remains the lack of an explanation regarding why their score was not good enough, from both, the trader and the credit agency or that given explanation was so vague and generalized that it was eventually worthless. Transparency and details are a clear deficit. More than 80 % of consumers are not given rational information on how their score was built; that was the result of an inquiry carried out by the German TV station WDR.[8]

Another fundamental problem is that scores were anyway created although the credit agency did not have any data regarding the person involved, especially no data on credit or payment history. While with this method some companies score only about 10 % of consumers involved, other companies score almost all consumers without having any essential data. Obviously more or less pure geo-scoring becomes a reality. Some companies openly admit that the score of the consumer involved is based on numerous payment problems found in the area where he lives and that no other information on the person involved was known to the agency.

Age seems to be a problem as well. Seniors are being told that being a pensioner and being, for example, 73 years old, implies a higher risk of future insolvency.

From the perspective of consumers and their problems, it seemed at first sight that the German legislation was not very effective. A problem that was probably caused by the lack of enforcement entrusted to data protection authorities.

31.5 Case Law

The number of court decisions on scoring is rather low and only a few are published. Only one decision by the Bundesgerichtshof, the Federal Court of Justice is known. In the lower courts there appears to be a trend, by which credit agencies seem to be trying to avoid negative decisions. Whenever they have the impression, for example by questions or hints from the court, that they are going receive a negative verdict, they comply to the individual request and avoid a formal conclusion, which would set a precedent. On the other hand, consumers, are rather reluctant to go to court, because the costly court fees, the lengthy duration of the procedure and the complex legal questions involved, keep them away from courts. So the rather limited number of court decisions is not a surprise. Apart from these more objective factors there seems to be a subjective component named 'pseudo-privacy' or selected privacy. German consumers seemed to be more worried in regard to what neighbors, family or friends will directly know about them, instead of the huge masses of information related to them that are collected by state, large companies or that are available on the internet. Only a limited number of German consumers, their estimates being around 25 %, are actively trying to protect their data.

[8] WDR, *Schlechte Bonität durch Auskunfteien?* 15/4/2013, www.wdr.de

In a very early decision in 2001 by the Amtsgericht (local court) Hamburg[9] had ruled that the transfer of a score is completely illegal. The main reasons at that time were that the scoring was totally new, and lacking legal or contractual basis. This decision is nowadays outdated. Scoring and transfer of scores, if done in accordance with the legal provisions, are nowadays considered legal.

Actual court decisions deal more with questions of adequate procedures, data and their transparency.

In 2011 the Landgericht (district court) Berlin[10] decided that the data of credit agencies and credit scoring do have a great impact on consumer's life, which can be substantial for the consumer's way of living. In case negative and incorrect data are stored by a credit agency, consumers have the right to have it corrected, if necessary by preliminary action. A similar decision from the Landgericht Munich[11] in 2012 saw, in case of an incorrect scoring, the violation of consumer rights. To my knowledge only the data protection act of Austria has a clear statement, in which the burden of proof for the correctness of data falls on the company itself.

Data may only be forwarded from business companies to credit agencies in case of legitimate business interest and must be balanced against the legitimate interests of the consumer involved; that was the verdict of the Landgericht Verden in 2010.[12]

The local court of Potsdam[13] in 2008 sentenced that telecom enterprises have the right to make use of scoring before entering a contract in order to prevent customers' insolvencies. Scoring per se is not considered to be in conflict with antidiscrimination legislation. Antidiscrimination cases require from consumers more facts and details than just general claims regarding a possible scoring discrimination.

The Landgericht Oldenburg in 2009[14] sentenced that, in principle, a credit agency may be liable for damages in case of incorrect data or incorrect score. But if the low score is related to a correct data basis, like a private insolvency, the credit agency is not liable.

The Kammergericht (Higher Regional Court) Berlin[15] sentenced in 2013 that credit agencies are permitted to collect data on private insolvencies from public registers and may store it for 3 years. Credit agencies may use this information for scoring purposes.

Private insolvency procedures do cause for consumers enormous problems in regard to their scoring. Although the insolvency legislation grants a fresh start after a couple of years when the consumer is able to comply through each steps of the procedure, with the repayment orders, (formal start, probation period, formal end), the procedure is stored by credit agencies and each time it influences negatively the

[9] AG Hamburg, 27/6/2001, (2001) *Datenschutz und Datensicherheit* 621.

[10] LG Berlin, 27/4/2011, (2011) *Verbraucher und Recht* 271.

[11] LG Munich, 8/8/2012, (2013) *Zeitschrift für Datenschutz* 135.

[12] LG Verden, 13/12/2010, (2011) *Verbraucher und Recht* 191.

[13] LG Potsdam, 10/7/2008, (2008) *MultiMedia und Recht* 769.

[14] LG Oldenburg, 23/12/2009, www.juris.de.

[15] KG Berlin, 7/2/2013, (2013) *Zeitschrift für Datenschutz* 189.

score of the consumers. So for many more years than the formal insolvency period the consumer is affected negatively by scoring mechanisms.

Most of the recent cases dealt with transparency problems.

The Landgericht Wiesbaden in 2011[16] sentenced that the credit agency is obliged to provide understandable information whether the score is good, average or poor. But the credit agency is not obliged to give too many details, like the effects of a negative telecommunication score on other scores.

The Oberlandesgericht (Higher Regional Court) Nuremberg[17] in 2012 sentenced that the credit agency must give information on which factors influence the score, like the timely repayment of a credit, but is not obliged to inform how this is exactly calculated. Credit agencies must inform in a transparent and understandable manner, but are not obliged to deliver information on how they use certain data and how these are taken into account exactly.

The Landgericht Berlin[18] in 2011 granted the consumer the right to receive from credit agencies general information on how the score was produced and how to interpret the score value. Transparency includes the information on the data basis, on which elements influence the score and also give information on the basis of comparison to which the consumer is evaluated. The Bundesgerichtshof, the Federal Court of Justice (BGH, 28/01/2014, unpublished) decided recently that consumers do have the right to get information on which data is stored and influence the score. The method how the score is calculated, the so called score-formula, however, is a protected business secret and consumers are not entitled to receive further information.

Another important problem is how business can make use of the 'information' to consumers that they will inform credit agencies of non-payments even in case of disputed bills. It is my impression that a large and growing number of companies use this 'argument' to influence consumers to pay disputed bills. The legal basis is quite clear. Disputed bills or parts thereof cannot be forwarded to credit agencies.

But the consumer center of Hamburg had to appeal to Oberlandesgericht Dusseldorf[19] in 2013 to stop a telecom enterprise from writing to consumers that the company was obliged to inform credit agencies in case of even partial non-payments and that this may have negative impacts on the consumer's economic life. The court decided that a company announcing to inform credit agencies has to make clear that consumers are entitled to dispute bills and that in case of disputes the information of credit agencies is illegal. Credit agencies and scoring are not considered fair instruments of debt collection in case of disputed bills. But so far this is the only case of collective action related to scoring.

All in all just a limited number of problems were taken to courts and no clear signal is given by case law.

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[16] LG Wiesbaden, 1/12/2011, (2012) *Zeitschrift für Datenschutz* 283.

[17] OLG Nuremberg, 30/10/2012, (2012) *Zeitschrift für Datenschutz* 26.

[18] LG Berlin, 1/11/2011, (2012) *Zeitschrift für Datenschutz* 74.

[19] OLG Dusseldorf, 9/7/2013, (2013) *Monatsschrift für Deutsches Recht* 1057.

There seems to be a big gap between the everyday scoring and the German Constitution and data protection in Germany is still very much perceived as a fundamental right vis-à-vis public authorities and not private companies.

On the occasion of the public census in 1983 the German Federal Constitutional Court[20] ruled that in the context of modern data processing, the protection of the individual against unlimited collection, storage, use and disclosure of personal data is encompassed by the general personal rights of the German Constitution. This basic right—called informational self-determination—warrants in this respect the capacity of the individual to determine in principle the disclosure and use of personal data. Limitations to this informational self-determination are allowed only in case of overriding public interest or the informed agreed consensus of the individual. The German concept of data protection due to this basic constitutional element of informational self-determination goes much further than the Anglo-Saxon doctrine of privacy, which to our understanding is the right to be left alone.

Unfortunately no further consequences in regard to scoring and credit agencies have not followed until now.

31.6 Data Protection Authorities

The Federal Data Protection Agency dealt with scoring for quite some time. In the report covering the years 2007 and 2008[21] the Federal Data Protection Agency reported a specific check done on 23 telecom companies and scoring. The requirements of the Data Protection Act were not sufficiently fulfilled. Consumers who were denied a contract were passed on to the credit agency, which delivered the score, and the arguments of consumers were not taken into account. This is merely automated and not legal decision making. The consumer must have a fair chance to have her or his arguments considered. Consumers are not just mere objects of scoring. Scores obtained were stored for too long, sometimes up to 12 months. In order to avoid unnecessary storage and have an actual data basis, the maximum storage period is considered to be 1 month. Telecom companies did not sufficiently comply with their legal duty to inform consumers in regard to information requests. Companies are obliged to inform consumers on all the data stored by the company. But telecom companies rather often just asked consumers to ask credit agencies, although they had the data themselves. Transparency claims were so denied. The telecom companies agreed to comply with legal requirements in the future.

In the report covering the years 2009 and 2010,[22] the Federal Data Protection Officer in general welcomed the legal changes in the German Data Protection Act but also was skeptical whether it will really be able to secure the promised transparency and legal certainty.

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[20] Bundesverfassungsgericht, 15/12/1983, (1984) *Neue Juristische Wochenzeitschrift* 577.

[21] Bundesdatenschutzbeauftragter, *22. Tätigkeitsbericht*, 36, www.bfdi.bund.de.

[22] Bundesdatenschutzbeauftragter, *23.Tätigkeitsbericht*, 115, www.bfdi.bund.de.

The federal agency argued that in the past the regional protection agencies were unable to get sufficient information regarding how the methods of scoring were built and to obtain the data basis used for scoring. The federal agency expected § 28 BDSG to provide a better basis for more and deeper insights. Two big agencies had already provided scientific expertise on the methods they use. But it considered that further clarification is needed to prove whether certain data really have the significant influence that providers claim.

Another disputed field was that of sex and gender. The Federal Data Protection Authority considered it necessary to make sure that there are no violations of anti-discrimination legislation.

Last but not least, the Data Protection Commissioner was very skeptical in respect to geo-scoring and the use of addresses. He affirmed that only in rare cases should the mere address be used and the he was aware of the need to improve the legislation.

So far, the Federal Data Protection Agency has published no further reports. But in quite a number of interviews, the federal agency remained skeptical towards the effects of scoring, especially in regard to geo-scoring.

Regional data protection authorities were able to help individual consumers in a number of complaints but do not have the resources to really control credit agencies systematically. The answers to a formal request of the German Federal Ministry of Consumer Protection given by most of the regional data protection authorities was that they lack staff and knowledge, especially in respect to § 28 BDSG, to control the scientific basis of the scoring methods and its mathematical-statistical basis. Regional data protection authorities generally confirmed that, mostly due to their lack of staff, they were unable to enforce justice.

In general the impression is that the respective legislation lacks public enforcement. Enforcement by individual consumers is too complicated, too costly because of court fees and credit agencies can avoid significant court verdicts of higher instances by satisfying the individual complaint made.

Collective action so far was used only in a single case, but may be an alternative for better enforcement.

31.7 Alternative Dispute Resolution

Only one credit agency—Schufa—has an ombudsman, a former chief of justice of the Federal Constitutional Court. According to his annual report in 2012,[23] he received 491 consumer complaints, 293 of which were admissible and 32 of which were justified. 60 complaints dealt with scoring. Unfortunately no details are given on these cases. Generally speaking, the figure of an ombudsman implies that consumers have a high demand for improved information and that many questions were

[23] Schufa Ombudsmann (2012) *Tätigkeitsbericht* 28, www.schufa-verbraucherbeirat.de/media/obmudsmann/taetigkeitsberichte.

not sufficiently answered. Therefore all the material of Schufa will be evaluated for a better understandability.

Other credit agencies do not have an ombud-system, but this may come in near future due to the alternative dispute legislation of the EU.

Directive on Alternative Dispute Resolution 2013/11/EU[24] requires that for all kinds of contracts disputes between a consumer and a business, an alternative dispute resolution must be available. One problem is whether credit agencies do have such a contract with consumers as long as they do only provide data to business sectors. But at least in case they offer services to consumers as Schufa does, they need to have an ombud-system related to it. The efficiency of having the scoring debate dealt with indirectly by the respective industry ombud-system, i.e. telecom etc., is in my view doubtful. They will not have the expertise and I am afraid that consumers will just be directed from an institution to the next. An ombud-system for all scoring or credit agencies would be useful. In case industries do not have such a system, states are obliged to provide an ADR system for all sectors without voluntary ADR. Whether it is in the interest of consumers and credit agencies to have such a generic system dealing with such specific questions also poses doubts. Article 6 requires that the persons dealing with the problems involved have sufficient knowledge on the problems themselves.

Due to the ADR directive, such an ombud-system must be competent, neutral and independent (Art 6). To my understanding, the directive related to neutrality shows a clear preference for ombudsmen who are named by both sides, industry and consumer organization (Art 6). So it is uncertain whether a person, independently from his or her good repute, such as the ombudsperson of Schufa, being appointed only by the company itself, may be really considered to be neutral and independent in the full context of the ADR directive.

The ADR directive in Art 7 asks for transparency. ADR systems have to provide annual reports in which they have to inform on systematic or significant problems and how these problems can be avoided or solved in future (Art 7(2) and 2b).

So at least for credit agencies other than Schufa and for scoring in general the ADR directive in Germany will most likely, in due time, bring some changes.

31.8 New Federal Study on the Way

Studies already in past were a helpful tool to improve consumer rights via scoring, for example the study of the Ministry of Consumer Protection, 'Scoringsysteme zur Beurteilung der Kreditwürdigkeit—Chancen und Risiken für Verbraucher' (Scoring systems for the evaluation of creditworthiness—opportunities and risks for consumers) in 2006;[25] an investigation by the Consumer Organisation *Verbraucher-*

[24] [2013] OJ L 165/63.

[25] Unabhängiges Landeszentrum für Datenschutz Schleswig-Holstein, *Erhöhung des Datenschutzniveaus zugunsten der Verbraucher* (2006), www.bmelv.bund.de.

zentrale Bundesverband (vzbv) in 2008[26] or the Scoring-Symposium of 27 June 2006 of then Consumer Protection Minister Seehofer. Together, these important contributions not only triggered a public debate but also provided the framework for the new BDSG.

The publication of a report entitled 'Verbraucherinformation Scoring'[27] (Consumer Information on Scoring) by Minister Aigner on 18 August 2009 also showed that a change in the law was more than justified. *Inter alia*, allegedly because it was found that much of the data upon which scoring was based, proved to be either false, or because many credit agencies only had access to information freely provided by consumers themselves, or because the procedures overly relied on a consumer's address.

It is to no surprise that the Federal Ministry for Consumer Protection in 2013 again decided to undertake a new study on recent developments in scoring: 'Scoring: New Developments under the Data Protection Regime'. The general aim was to gather more information on the effects of the Data Protection Act reform and on the latest developments in scoring. The study is supposed to have an empirical and legal part and also include an international comparison. The views and experiences of consumer organisations, data protection authorities, credit agencies, business (banks, telecom and energy suppliers) and also of alternative dispute resolution bodies have been included. The study is supposed to deliver answers to 10 key questions. What were the effects of the new Data Protection Act? What kind of scoring methods use which data, and what kind of data comes from social networks, internet and mobile phones? Is it advisable to restrict the combination of the various data sources? Is more protection with regard to geo-scoring or 'social-scoring' ('friends') necessary? Are the used criteria in conflict with antidiscrimination legislation? Do data protection authorities have enough power to control scoring agencies? Are consumers empowered sufficiently with information and other rights? Do the answers of scoring agencies give consumers sufficient and understandable information? Does effective consumer protection need more collective instruments?

A wide range of interesting questions have to be answered. Expectations are enormous in regard to the results of the study and hopefully, in autumn 2013, the new elected parliament and government in Germany will, in the coming years, improve consumer protection related to scoring.

31.9 Conclusions

The traditional work of credit agencies is changing drastically. No longer do they just deliver data before contracts are concluded but the complete business consumer relation is managed. A wider variety of data and not only simple bank data are

[26] D Korczak and M Wilken, *Studie zum Scoring—Aussagekraft und Anwendung in der Kreditvergabe* (Berlin, 2008), www.vzbv.de.

[27] D Korczak and M Wilken, *Verbraucherinformationen Scoring*, 2009, www.bmelv.bund.de.

gathered and used, especially from the internet and mobile communication. It is not a simple data track of an isolated contract anymore but a rather large multi-dimensional data carpet.

Scoring will increasingly influence the consumer's economic and social life. Data protection legislation alone will not be sufficient to protect consumers. Legislation must be accompanied by effective enforcement. In order to fully understand and influence these developments more scientific studies are needed and also more and broader public and political discussions. In this respect Germany is on a good path. The German Bundespräsident, formal head of state, in his speech addressing the nation on the national holiday of 3 October 2013, also spoke upon the subject of data protection and argued that it must become as important as environmental protection already is.

Politics must be aware that Big Data is not just a mere new source of growth as assumed by free trade agreements but is associated with risks for consumers and for society as a whole.

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Chapter 32
Reflections on Hans Micklitz' Plea For a 'Movable System' (of Consumer Law)—Anything to Learn from the Experiences of Indian Consumer Law?

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Abstract The topic of the paper is based on a study done for GIZ, the German developmental agency concerning the improvement of consumer protection in India by the combined use of preventive and remedial justice which is possible under the Indian Consumer Protection Act (CPA) but not adequately implemented. The paper takes as a starting point Hans Micklitz' concept of a "movable system of consumer law", developed in the EU context whereby remedies under unfair commercial practices and unfair contract terms legislation should be applied in combination and not be separated into different "legal boxes" each following its own logic. The consequences of such an approach for rethinking Indian consumer law are presented with some reform proposals to be undertaken by the Indian legislator.

32.1 A Personal Dedication

Writing a paper in the Liber amicorum of Hans Micklitz is an honour, but at the same time a difficult challenge. An honour: this allows me to participate actively in the broad appreciation which the rich and diversified academic work of Hans Micklitz has found and which will be witnessed by the many contributions in this Liber amicorum. A challenge insofar as perhaps none of the authors have worked so closely with Hans Micklitz over time: beginning with our joint project 'Consumer Legislation in the EC Countries', published from 1979–1981 in the form of a summary in three languages (English, German, French) and national reports of

The bulk of the paper was prepared during a stay as a short term expert of the GIZ in India under the able leadership of Ms. Ruth Anna Büttner, GIZ New Delhi. It was greatly supported by the expertise of my Indian colleagues, Prof. Patil, NLSUI, Bangalore, Prof. Mittal, NLS New Delhi, Amit Gupta, LLM, NLS New Delhi. I owe thanks to all mentioned persons. Responsibility for mistakes and misunderstanding is as usual my own.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_32,

the then 9 EEC countries with a team of 9 national reporters—a specific EEC/EC/EU consumer law was only in its starting phase; the next 'big project' was the joint treatise 'Europäisches Verbraucherrecht', fourth edition 2003, complemented by an English version (with Peter Rott participating) as 'Understanding EU Consumer Law' in 2009, the second edition (with Klaus Tonner joining the party!) foreseen to be published in the beginning of 2014; in between and thereafter a number of papers in German and English—too many to be listed here, and some coming out soon. Is there anything new to add to this research cooperation? How can I surprise my longtime colleague and friend with a topic unknown to him?

The topic I choose has something to do with a project monitored by the highly respected transnational advisory work of Hans Micklitz. It has as its subject matter a review of the Indian consumer legislation recently supported by GIZ, the German development agency active in India, and where I had a chance to participate as one of these 'short-term experts'. I was assigned to a topic where Hans Micklitz would have been a much more qualified expert, namely improvement of collective remedies against Unfair Trade Practices where the EU Unfair Commercial Practices Directive 2005/29/EC (the UCPD)[1] stands out as model which has been commented on by Hans Micklitz several times. But its Art. 3(2) seemingly precludes any relevance for contract law. This strict separation between unfair trade practices law and contract law has found the critique of Hans Micklitz many times and stands in contrast to his plea for a '*movable system of consumer law*'.[2] Anything to learn from Indian law?

32.2 The CPA of 1986 as Amended in 2002: An Original and Innovative yet Deficient Consumer Protection Instrument in an Emerging Economy

32.2.1 The Importance of the UN-Guidelines on Consumer Protection of 11 April 1985

The Indian Consumer Protection Act of 1986 (in the following: CPA) must be seen as an expression of the growing importance of the consumer protection movement worldwide at the time of its adoption. According to a remark by Nayak written shortly after the adoption of the CPA, '(i)n India, consumerism is yet to become a people's movement (…) The Act is a positive step towards achieving this.' [3]

[1] Directive 2005/29/EC on Unfair Commercial Practices, [2005] OJ L 149/22.

[2] H-W Micklitz, 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?', *Gutachten A zum 69. Juristentag* (Munich, CH Beck, 2012); id, 'Do Consumers and Businesses Need a New Architecture of Consumer Law—A Thought Provoking Impulse' (2013) 32 *Yearbook of European Law* 266.

[3] RK Nayak, 'Consumer Protection Act 1986: Law and Policy in India' (1987) *Journal of Consumer Policy* 417, 423.

The most important document of the time had been the UN Guidelines for Consumer Protection which found a sympathetic assessment in a paper by our unfortunately now deceased friend David Harland.[4] The Guidelines—which had no binding legal force and were addressed to UN members—contained seven areas for further action. In the context of this study, two sets of Guidelines are of interest:

- Promotion and protection of consumers' economic interests (paras. 13–23): promotional marketing and sales practices should be guided by the principles of "fair treatment of consumers"; misleading marketing practices should be banned, information for consumers improved.[5]
- Measures enabling consumers to obtain redress (paras. 28–30): this stresses the importance of access to law, implying that access to the normal courts is not a realistic option for most consumers. 'Accordingly, Governments should establish or maintain legal and/or administrative measures to enable consumers or, where appropriate relevant organisations to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive, and accessible.'[6]

32.2.2 The Most Important Innovation of the CPA: The Establishment of a Three Tier Special Jurisdiction for Consumer Affairs in India

The main focus of the CPA was the establishment of a parallel system of resolving consumer complaints outside the regular court system. This is quite a radical move but follows clearly the 'philosophy' of the UN Guidelines. It is also the result of a widespread critique of the functioning of the judicial system in India which was said to deny access to law to 'normal', in particular poor consumers. Incremental reforms like undertaken in many other common law jurisdictions were regarded as insufficient. The CPA therefore established a completely new quasi-judicial system, consisting of three tiers:

- District Consumer Redressal Fora to handle local and regional complaints, 629 for all India
- 35 State Commissions as a sort of appeal instance against orders of the District Fora, one to be established in every State, with special jurisdiction in cases exceeding 20 'lakhs' (₹ 2.000.000 = ca. € 24.000)
- One National Commission residing in New Delhi, competent to hear appeals against orders of the States' Commissions resp. in complaints exceeding 1 'crore' (₹ 10.000.000 = ca. € 120.000)
- The Indian Supreme Court has final jurisdiction in appeals against orders of the National Commission.

[4] D Harland, 'The UN Guidelines for Consumer Protection' (1987) *Journal of Consumer Policy* 245.

[5] Ibid. 253 f.

[6] Ibid. 256.

32.2.3 Extending the Standing Provisions

Another important innovation of the CPA was the broadening of standing provisions, thus following an earlier 'revolutionary' case law of the Indian Supreme Court.[7] The starting point was rather simple and followed both Constitutional and International requirements: In many cases the individual consumer who is harmed by an unfair practice will not be able or willing to take action him/herself. Individual remedies may also be insufficient to eliminate the total harm to a larger consumer population. Following earlier precedents of the Supreme Court which were not limited to consumer matters, jurisdiction was therefore extended in Art. 12 CPA.

- Standing of 'recognized consumer associations': Sect. 12 (b) CPA; registration is necessary
- Group actions of 'numerous consumers having the same interest': Sect. 12 (c) which is broadly interpreted by the Supreme Court and allows an Indian variant of 'class action'.[8]
- Standing of central or state governments does not seem to play a great role.
- Traders and/or trade associations don't have standing, unlike Art. 11 (1) of the UCPD.

32.2.4 Deficits with Regard to Preventive Remedies

The CPA was concerned with establishing a country wide redressal system in order to overcome the malfunctioning of the existing common law instruments and jurisdictions which did not meet the social and consumer concerns of their time in India. Prevention was therefore not really part of the CPA in its original version. Remedies and procedures under Sect. 14 CPA were mostly focused on compensation and/or restitution to give the 'ordinary' Indian consumer who had been defrauded on the market back what was owed to him, or to compensate him/her for wrongs suffered by unfair marketing practices, including some modest interest payment. Of course, these remedies could indirectly have a preventive and even a deterrent effect, e.g. by cumulating compensation in the form of group actions under Sect. 12 (c) CPA, but they were limited to an 'opt-in' mechanism, unlike the US-American opt-out version of the class action. Some remedies could be used for prevention provided that adequate procedures existed, as will be shown later (32.5.5.); they could and should be extended, as will be shown in the recommendations under (32.6).

A later section of this paper will inquire in how far the CPA really attained this compensatory objective—an objective which many observers have cast into doubt. First I want to turn to the preventive function of trade practices regulation in India

[7] G Singh, 'Group Actions and the Law: A Case Study of Social Action Litigation and Consumer Protection' (1995) *Journal of Consumer Policy* 25.

[8] This important innovation of Indian consumer law is used by NLSIU/Bangalore students, after having bought the falsely advertised products, to file public interest law suits alleging UTP; see AR Patil, 'Report' (2012) V 2 *March of Consumer Law and Practice* 7.

which developed outside the CPA by the special jurisdiction of the Monopolies and Restrictive Trade Practices-Commission (MRTP-C)

32.3 The Impact of the MRTP-Commission (MRTP-C) on UTP Regulation in India

32.3.1 Establishment, Functioning and Winding-up of the MRTP-C

The MRTP-C was originally established in 1969 with a jurisdiction limited to the classical area of monopolies and restrictive trade practices. Its jurisdiction was extended in 1984 to also cover Unfair Trade Practices (UTP)—a development well documented in a recent study by Prof. Mittal et al.[9] which I will follow closely.

The 1984 amendments of the MRTP-Act were inspired by the US-Federal Trade Commission Act,[10] thus going beyond the traditional approach of competition law by including a regulation of misleading advertising and other unfair marketing practices as the central elements of an UTP. The object of the legislation was '(…) only to bring honesty and truth in the relationship between the seller and the customer'.[11] A new Sect. 36 A contained a detailed definition of UTPs which 'means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or the provision of any services, adopts any unfair method or unfair or deceptive practice, including any of the following, namely (…).'

Section 36 A than lists in great detail a number of such practices which all contain an element of deception in order to make law application and implementation easier. The blacklisted practices relate i.a.

(1) the practice of making any statement, whether orally or in writing or by visible representation which

   (i) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;
   (ii) Falsely represents that the services are of a particular standard, quality or grade;
   (iii) Falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods

[9] R Mittal, *A Report on the Experiences of the MRPC 1969, vis-à-vis enforcement of Unfair Trade Practices in India* (unpublished study, 2013).

[10] For an earlier account, see N Reich, *Staatliche Regulierung zwischen Marktversagen und Politikversagen — Erfahrungen mit der amerikanischen Federal Trade Commission und ihre Bedeutung für das Verbraucherschutzrecht* (Heidelberg, Müller, 1984); id, 'The US-American Federal Trade Commission (FTC)—A Model for Effective Consumer Protection in a Unifying European market?' in H-W Micklitz and J Keßler (eds), *Marketing Practices Regulation and Consumer Protection in the EC Member States and the US* (Baden-Baden, Nomos, 2002) 417.

[11] Mittal, *Report,* 5.

(iv) Represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have

(v) Represents that the seller or supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

(vi) Makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services

(vii) Gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that it is not based on an adequate or proper test thereof: Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

(viii) Makes to the public a representation in a form that purports to be

- A warranty or guarantee of a product or of any goods or services;
- A promise to replace, maintain or repair an article or any part thereof or repeat or continue a service until it ha s achieved a specific result,

If such purposed warranty or guarantee or promise is materially misleading or if there is a no reasonable prospect that such warranty, guarantee or promise will be carried out;

(ix) (misleading price claims)

(x) … (disparaging goods, services or trade of another person)

Explanation: For the purposes of clause (1), a statement that is—

a. Expressed on an article offered or displayed for sales, or on its wrapper or container;
b. |Expressed on anything attached to, or inserted in, o accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display; or
c. Contained in or on anything that is sold, send, delivered, transmitted or in any other manner whatsoever made available to a member of the public,

shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed or contained;

(2) (newspaper advertising)

(3) Permits—

a. The offering of gifts, prizes or other items with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;
b. The conduct of any test, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply or any product or any business interest.

(4) (non-conformity with standards to prevent risk or injury to persons)
(5) (hoarding of goods with the intention to raise costs).

The Indian Supreme Court, in several judgments held that the definition was not exhaustive and could be extended to practices not specifically blacklisted in Sect. 36 A.[12]

32.3.2 Scope of UTP Under the MRTP-Act and Commission Practice

The Mittal study gives a detailed account of the practice of the MRTP-C in applying the concept of UTP to different commercial practices in India. As an important element to extend the scope of the Act the original requirement to prove loss or damage to the consumer of goods or services was removed in 1991. This would allow preventive measures of the MRTP-C before harm to the consumer had occurred. Hence, about 30% of the complaints filed to the Commission concerned practices before a contract was concluded—a striking difference to the practice under the CPA to which we will turn later.[13]

During its lifetime—the MRTP-C was wound up in 2009—it handled 719 complaints leading to a number of orders enjoining businesses or advertisers to stop or to discontinue the incriminated UTP. This appears to be a relatively small number concerning the time span and the geographical size of its jurisdiction, but it seems that a substantial deterrent and preventive effect accompanied its jurisdiction which was highly respected by traders. The total number of cases decided by the MRTP Commission that the *Mittal*-study has included in its database and that have been analyzed are 719; however, there is an increase in the total number of cases in some categories of this analysis because of the presence of one or more elements which has necessitated in repeat counting of that particular case. For example, when one is looking at the breakup of total number of cases where different reliefs have been granted by the Commission, one has to add up all the cases in which relief has been granted. In some cases multiple reliefs have been granted by the Commission, so the figure of total cases is bound to exceed 719. This method of statistical analysis will have minimal effect on the calculated percentages and will be a more accurate portrayal of the data.

The work of the MRTP-C was also quite successful on (rare) appeal before the Supreme Court.

32.3.3 Specific Procedural Rules Under the MRTP-Act

During the time of its existence, the MRTP-C enjoyed a relatively efficient and speedy mechanism of regulating UTP, in particular misleading advertising. Not

[12] See the references to the Indian Supreme Court case law with Mittal, *Report,* 9.

[13] Mittal, *Report,* 23.

only consumers or consumer associations and groups but also traders and trade associations could file a complaint with the Commission—unlike under the CPA. The Commission could also start an investigation *suo motu*.[14]

If the Commission found that certain advertising contained an UTP, it could adopt a cease-and-desist order. If the public interest required it, it could issue a temporary injunction which included the power to grant it without giving notice to the opposite party.[15] Under Sect. 36 D (1) (c) it also could take an order for corrective advertisement—a remedy used rather seldomly.[16] Finally, Sect. 12B gave the MRTP-C power to order compensation. In cases of violation of a Commission order, a punishment for contempt could be imposed. The statistics of Mittal[17] demonstrate the following distribution of remedies for relief:

Nature of relief	Cases UTP	Percentage
Injunctive relief	47	6.46%
Compensation	174	23.90%
Order to discontinue the practice	99	13.60%
Order for republication of corrected advertisement	2	0.27%
Punishment for contempt	1	0.14%
No relief	405	55.63%
Total	728	100%

The great number of cases without any formal remedy seems to suggest a high success rate of the MRTP-C, despite the overall rather limited number of complaints and follow-up decisions.

In the opinion of Mittal, the 'success and efficiency of the MRTP system is a function of types of UTPs covered, variety of industries pursued, ease with which different stakeholders could approach the forum, time taken for disposal of disputes, satisfaction of the litigant, number of complaints in which relief was granted along with the variety of reliefs granted.'[18] This success story did not prevent the MRTP-Commission of being abolished during the 2002 reform which separated as before 1984 the regulation of restrictive practices which was transferred to a newly established Competition Commission, and the regulation of UTP which was transferred to the CPA-structure—a transfer the consequences of which I will discuss in the following section with its impact on the preventive combat against UTP.

[14] Ibid, 26.

[15] Ibid, 28, 33.

[16] Ibid, 32.

[17] Ibid, 36.

[18] Ibid, 44.

32.4 The CPA as Amended in 2002—A Hybrid Regulator of UTP

32.4.1 The Half-Hearted Transfer of Powers of the MRTP-C to the CPA Three Tier Structure

When the 2002 amendments of the trade practices regulation provided for the abolition of the MRTP-C, the Indian legislator had to decide if and—as the case may be—who would take over jurisdiction of regulating UTP. The result was a somewhat strange and for the foreign observer difficult to understand compromise:

- Restrictive practices jurisdiction was transferred to a newly created Competition Commission
- Substantive UTP jurisdiction was completely put into the hands of the CPA-structure
- The special powers of the MRTP-C were however not transferred to the CPA-institutions.

As a result, die CPA-institutions were left as the only ones to combat UTP on the Indian market, but did not get any additional powers to do so in a similar preventive spirit which were specific to the soon to be dissolved MRTP-C. This led to a somewhat 'hybrid', rather contradictory structure of the CPA:

- On the one hand, Sect. 2 (1)(r) as amended lists a number of UTP, nearly identical to the substantive provisions of the MRTP Act of 1969 as amended by Sect. 36 (A) in 1984.[19]
- On the other hand, the procedural provisions on implementation were however not taken over into the CPA, e.g. standing of traders and trade associations to take complaints before the District Fora resp. State Commissions, their investigation powers suo motu, broad jurisdiction allowing injunctive relief and temporary injunctions, enforcement of their orders via a contempt of court procedure.

The most important difference between the jurisdiction of the MRTP-C and the CPA-three tier structure lies in the fact that the first was a centralized administrative agency, subject to review only by the Supreme Court, while the CPA-institutions were regarded as quasi-judicial bodies which could not take action on their own and which were submitted to a pyramidal appeal structure culminating in a final appeal of orders of the National Commission before the Supreme Court. It is obvious that proceedings before or initiated by the MRTP-C could be handled much more efficiently and rapidly than complaints concerning UTP within the three tier structure of the CPA.

[19] R Mittal, '§ 14 India' in F Henning-Bodewig (ed), *International Handbook on Unfair Competition Law* (Munich, Beck, 2013) margin notes 21–54, 72–79.

32.4.2 The Compensation Paradigm of the CPA-Mechanism Under its UTP Jurisdiction

Even though the concepts of UTP of the former MRTP-Act and of the CPA as amended are substantially identical due to the transfer of jurisdiction in 2002, the models of enforcement are completely different. While the MRTP-Act was concerned with prevention, the CPA aims primarily at (fair and speedy?) compensation of wrongs suffered or restitution of undue payments entered into by consumers due to—not only but specifically—an UTP of a business, trader, or advertiser. This can be demonstrated by reference to the basic concept of the CPA, namely the conditions of a successful complaint: Jurisdiction of the District Fora is limited under Sect. 12 (1) in relation to 'any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided (…).' This definition does not cover the pre-contractual phase of an UTP, unlike the repealed MRTP-Act and Art. 3(1) of EU Dir. 2005/29/EC, which extends the scope of application to 'commercial practices before, during and after a commercial transaction relating to a product (including services)'. The CPA definition therefore seems not to be appropriate to combat misleading advertising before a product has been sold or a service has been provided. It was completely inadequate to take over the 'lost' MRTP-jurisdiction. The same is true with the concept of consumer under Sect. 2 (d) whereby 'consumer' means any person who

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised , or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale
(ii) (hire-purchase)

Explanation: For the purposes of sub-clause (i), 'commercial purpose does not include use by a consumer of goods bought and used by him for the purpose of earning his livelihood, by means of self-employment'.

Again, the difference to the EU concept of consumer is striking as defined in Art. 2 (a) of the UCPD whereby '"consumer" means any natural person who, in commercial practices covered by this Directive, is acting for purposes which are outside his trade, business, craft or profession.' For EU law, the purpose of the action of a person is decisive, while, for Indian law, the conclusion of a contract for consideration transforms this person into a consumer, unless the good is purchased for resale, but may be used for self-employment.

The CPA clearly has the fairness of the individual consumer transactions in mind in its regulation of UTP. It is oriented towards the protection of the individual wronged by an UTP, not towards regulating the market against UTP as was intended by the—later abolished powers—of the MRTP-C. As the Indian author Verma cor-

rectly writes: 'Unlike the earlier laws, which were punitive and preventive in nature, the provisions of the CPA are compensatory in nature.'[20]

There has been abundant case law of the CPA institutions concerning compensation respectively restitution (including discretionary interest payment and reimbursements of costs of legal proceedings) granted to consumers injured by UTP of businesses; Sect. 14 (1) (d) requires only 'negligence of the opposite party'. Most interesting have been decisions of the National Commission and rare judgments of the Supreme Court having status as precedents. Due to the great bulk of cases, it is impossible to go into details. Most surprisingly to the lawyer trained in traditional categories of civil law application based on such concepts as contract, tort, fault, joint and several liability, restitution etc., the mechanism of the CPA operates outside these concepts, if a link to the injury of the consumer to an UTP can be shown to exist. This is at odds with Art. 3(2) of the above mentioned EU Directive 2005/29 which states explicitly:

> This Directive is without prejudice to contract law and, in particular, to the rules on the validity, formation and effect of a contract.

Such broad jurisdiction, denying a clear demarcation line between unfair practices on the market as such and specific consumer harm caused by these practices, avoids on the one hand the legal technicalities to which compensation of consumers is subjected and frequently limited. The Consumer Fora enjoy a broad discretion in defining an UTP and in granting remedies to the injured consumer without the need to go into a detailed legal analysis under Sect. 14 CPA. The CPA in its 2002 version has established a parallel regime of consumer law, not only with regard to procedures but also to substance. This resorting to equitable consumer justice 'beyond the books' is to some extent however 'compensated' by the length of proceedings, especially when the orders of the District Fora are taken to appeal (32.5.2.). What is even more surprising is the appearance of lawyers in most of the consumer complaints, if the anecdotal evidence given to me is correct.

A more traditional approach has been taken with regard to defective goods under Sect. 2 (1) (f) and deficient services under Sect. 2 (1) (g) combined with the remedies under Sect. 14 (1) (a), (b) (c), (e) CPA; special remedies are foreseen for hazardous products under Sect. 14 (1) (g-h) but will not be discussed here.

32.4.3 The Main Objective of Litigation Under the CPA: Just Compensation

The enormous balk of case law of the Indian consumer redressal institutions cannot be adequately analysed in the context of this short paper which is concerned mostly with prevention, not so much compensation. But in order to understand the 'spirit'

[20] DPS Verma, 'Developments in Consumer Protection in India' (2002) *Journal of Consumer Policy* 107, 111.

and objective of the CPA system, is it useful to look at two areas where a striking difference to EU traditions can be found:

- The submission of medical malpractice cases under the CPA regime.
- The existence of a compensatory mechanism favouring individual (or group of) consumers injured by an UTP.

32.4.4 A Short Look at Medical Malpractice Cases Under the CPA Provisions on Deficient Services

Medical malpractice cases, due to a broad definition of the 'consumer' by the Indian Supreme Court,[21] have been litigated by the Consumer Fora under the heading of 'deficient (medical) services'. The following orders of the National Commission reported in a recent collection[22] and also published in law journals are worth mentioning to give the non-Indian reader an impression on the complexity and originality of litigation under the CPA.

- In the case *MC Katare V/s Bombay Hospital*,[23] the litigation concerned a young woman who loses her life due to medical negligence by doctors. Anesthesia is incorrectly administered during ankle operation. Doctors were held liable by National Commission. ₹ 5 lakhs (about € 6,000) compensation were awarded. The plaintiffs demanded ₹ 25 lakhs as compensation:, arguing that the young woman, of 30 years at the time of death would contribute to the family income at ₹ 2,500 per month, and could be expected to live for 70 years. The sum of ₹ 5 lakhs, awarded after a period of 15 years (!) does not amount to an adequate compensation. The UTP giving raise to the complaint is not clear.
- The litigation *Ashok Kumar Upadhyay V/s D.N. Mishra*[24] concerned the death of child due to medical negligence. A 16 year old boy dies due to incorrect treatment by doctors. A strain of anti malaria injection was wrongfully administered causing death of child. The compensation awarded was ₹ 11 lakhs (about € 13,000) after a litigation of 13 years. The compensation demanded was ₹ 128 lakhs, based on completion of education and earnings in working life between 24 years and 80 years. The Commission argued that, since the family was well to do with a permanent source of government income, did not depend on the son for their survival; hence the compensation amount was recomputed.

[21] For a recent analysis see P Deepak and AJ Malik, 'Interpretation of Medical Negligence under the CPA' in AR Patil (ed), *25 Years of Consumer Protection Act—Challenges and the New Way Forward* (Bangalore, NLSIU, 2012) 201.

[22] National Consumer Disputes Redressal Commission, *Landmark Judgments on Consumer Protection Law* (New Delhi, Universal Law Publishing Company, 2011).

[23] *MC Katare v Bombay Hospital,* ibid, 287.

[24] *Ashok Kumar Upadhyay v D.N. Mishra,* ibid, 275.

- In case *Ms Dhanwati Kaur V/s Dr SK Jhunjhunwala*,[25] the gall bladder of the patient was removed through surgery without consent. Compensation claimed was ₹ 15 lakhs; the compensation awarded only ₹ 2 lakhs (€ 2,500), given that the lady was left indisposed and could not attend to household responsibilities for a period of 9 months.

32.4.5 Compensation Linked to UTP

- Medical malpractice cases may also be litigated under the UTP jurisdiction which avoids difficult questions of negligence and doctor's duties of care and information. A good example is case *Ajay Gautman v Amritsa Eye Clinc and 6/6 Laser Ctr*[26] concerning a misleading advertisement by a doctor that his patients would get rid of spectacles by undergoing laser surgery. The doctor was found guilty of adopting an unfair trade practice. He was directed to pay a lump sum compensation of ₹ 100,000 (about € 1,200) and to withdraw the advertisement in media. He had to give an undertaking before the NC that he will not publish any such advertisement in the future.
- The Supreme Court judgment of 5 April 2013 in case *Bhanwar Kanwar v. Gupta et al*.[27] concerned the deficient treatment of febrile convulsions during fever at the age of 6 month of the son of the complainant with the help of advertised Ayurdevic medicine which were passed off as being Allopathic medicines. The National Commission found that the doctor was not registered to practice and prescribe modern Allopathic medicine. He was therefore 'guilty of unfair trade practice and adopted unfair method and deceptive practice by making false statement orally as well as in writing.' Against the order of the National Commission of 29 January 2009 the Supreme Court awarded an enhanced compensation for the injury suffered by the child and his father of ₹ 15 lakhs. The incident and treatment relate to the period of 1994 to 1997.
- Another series of UTP complaints standing out for their frequency and impact on consumer's future chances in the labour market concern claims on university access or job placement success if a certain educational training program is contracted; the Patil-study mentions 11 of them.[28] The best known precedent is the Supreme Court judgment of 13 February 2009 in case *Buddhist Mission Dental et al v Bhupesh Kruana Camp et al*.[29] which concerned a misleading claim of a dental college concerning admission and studies of qualified candidates for a relatively high fee. The advertisement did not mention that the college was not

[25] *Ms Dhanwati Kaur v Dr SK Jhunjhunwala,* ibid, 327.

[26] 2010 (2) CPR 22 (NC of 26/2/2010).

[27] Civil Appeal No 8660 of 2009, not yet reported.

[28] AR Patil, *To study and analyse the cases in the field of misleading and unfair advertising to explore gaps of the present system of enforcement, first draft report to GIZ* (October 2013) 5 ff.

[29] (2009) 4 *Supreme Court Cases* 484.

recognised by the Dental Council of India and had no University link. Students had already started enrolling and following classes only to find out later that their courses and certificates did not qualify for a professional career. After a protracted litigation against a judgment of the National Commission of 29/9/2000 upon appeal of the college the Supreme Court awarded ₹ 1 lakh (€ 1,200) additional compensation to each of the complaining students and another ₹ 1 lakh for costs of litigation—a rather trifle sum without any deterrent effect. It seems that 12 students profited from the judgment.

- The Patil study and the earlier documentation of Singh[30] mention a great number of cases concerning compensation due to UTP of the automobile, residential homes, financial services, travel and similar industries not subject to any detailed analysis here. What is striking to the observer is the little—or even absent—analysis devoted to causation questions linking the UTP to the specific injury of the consumers. Additionally, liability seems to be rather strict, requiring only negligence on the part of the trader or advertiser without the possibility of limiting the liability via exemption clauses. The competent Consumer Fora and Commissions seem to enjoy an almost unlimited discretion concerning sanctions of UTP vis-à-vis individual consumers, including the amount of compensation to be awarded to the consumer. This makes an analysis under comparative law aspects almost impossible

32.5 Two Main Problems of the Redressal System: Insufficient Compensation—Excessive Length of Proceedings

32.5.1 The Dearth of Compensation

The following overview has been made by my Indian collaborator, Mr. Gupta concerning in particular the rather discretionary and frequently unsatisfactory allocation of compensation:[31]

[30] A Singh, *Law of Consumer Protection in India,* 4th ed (Lucknow, Eastern Book, 2005) 154 ff.

[31] After analyzing the cases, it can be summarized that the each forum/commission is awarding damages according to their hierarchy (like Supreme Court is awarding 1 lakh) and the particular facts of a case. If the consequence of the misleading advertisement is grave the compensation is also in the nature of exemplary, but if not the forum is awarding nominal damages. It's all depends upon the subjective satisfaction of the presiding officer of the forum/commission. There is no straitjacket formula on which we can say the damages should be awarded, though consequential result of the misleading advertisement may be a guiding factor but it is not the only way to award damages in a case. The position of the aggrieved consumer, the position of the respondent, the overall effect of a misleading advertisement on society at large are also to be taken into account.

S.no.	Title	Damages + interest + mental agony in ₹	Time
1	Big Bazaar vs Government of Gujarat (National Commission = NC) *Citation*—Revision Petition No. 1674 of 2007	195,000 + 9 % PA + 10,000	Approx. 18 months
2	Tesol India, Chandigarh V. Sh. Govind Singh Patwal (Chandigarh State Commission)	No info. about the damages but awarded exemplary cost of 5,000/- to complainant	
3	Bhupesh Khurana vs Vishwa Buddha Parishad 2000 CTJ 801 (CP)	Refund of college fees + 12 % PA + 20,000 + 10,000 as cost	
4	Brilliant Classes vs B.M. Gupta (NC) *Citation*—Revision Petition No 281 of 2007	Fees + 2,500 in compensation	
5	Indian Institute of Professional Studies v Smt Rekha Sharma(NC) *Citation*—Revision Petition No 2864 of 2011	Fees + 10,000 (mental agony) + 2,000 (litigation) + 25,000 (lost 1 year)	
6	C.M.S. Computer Institute v/s Shri Gaurva Sharma Appeal No FA-884/2006 (State Commission)	Fees + 5,000 as compensation	
7	Smt. Divya Sood vs Ms. Gurdeep Kaur Bhuhi *Citation*—I (2007) Consumer Protection Judgement	Fees refund + 25,000/- as compensation by District forum which was confirmed by State commission but the NC observed that the compensation amount is very low	
8	Ajay Gautam Vs Amritsar Eye Clinic & Ors (NC) Review Appl. No.79 of 2010 & Review Appl No. 209 of 2011	Compensation of 100,000 at 12 % pa	

32.5.2 The (Abominable) Length of Proceedings

A more frequent critique of the redressal mechanism under the CPA has been the length of proceedings.[32] Instead of streamlining compensation by rapid proceedings within the 90—150 day limit of Sect. 13 (3A) CPA, this time frame is frequently exceeded. Particular long delays happen if the case is appealed which is possible to an almost unlimited and risk-free extent under the working under Sect. 15 CPA (about 60 % of District Fora orders). This generous appeal possibility seems to be responsible for the backlog. The procedure before State Commissions takes on average about an additional 2 extra years, this being due to the fact that the State Commissions are remarkably understaffed by comprising only a President (a former

[32] Report of the Working Group on Consumer Protection, Gov. of India, Dpt. of Consumer Affairs, Twelfth Plan 2012–2017, 28 referring to a total of 394,583 pending at various levels, some of them more than 10 years.

High Court judge) and two members (without substitutes!) being competent for all appeals in one state against District Fora orders. State Commissions are, unlike courts, not divided into benches allowing a more effective and speedy handling of cases. There is an incentive for parties to go for appeal, in particular for the losing side (mostly businesses) in order to avoid the order of the District Forum becoming final and being able to be implemented.

'Justice delayed is justice denied'—a saying which is certainly true in the Indian context. Other, more technical problems are also invoked, like the understaffing of the District Fora or of the State Commissions, the unwillingness of state authorities to speedily replace vacant positions, the missing of adequate technical equipment. Several proposals have been voiced in the Indian context to improve the working of the CPA mechanisms—a discussion which will however not be taken up here.

32.5.3 The Overall Critique of the Compensation Mechanism of the CPA by Patil

Prof. Patil, one of the most prominent Indian consumer law experts, has summarized the critique against the compensatory mechanism of the CPA—including its deficient socio-legal embeddedness—as follows, after having studied a bulk of cases:[33]

1. The provisions of consumer protection Act 1986 are not efficient and vigilant.
2. The enforcement machinery is not strong as there is need for not only civil redressal but criminal provisions to be incorporated to make it more efficient.
3. ….
4. When there is higher grievance then there should be provisions for damages, compensation and penalization.
5. The consumer's problems are created in the market place and range from fraud and deception to outright rejection of their just protest and right to information about goods. Whatever the remedies which are available in India for the protection of the consumers in the marketplace they are by no means sufficient and the consumers find themselves helpless due to ineffective legal machinery for redressal of grievances.
6. Very few consumers were fully aware about the rights, responsibilities and the Consumer Protection Act. Hence, it is necessary to educate them on their rights and responsibilities as consumers, to make them vigilant, rational and aware buyers.
7. Educate consumers to develop an understanding about their responsibilities as consumers. Consumers should organize together to develop the strength and influence to promote and protect their own interest. Government should make and implement rules of punishment more harsh so that manufacturers and shopkeepers think twice before adopting fraudulent practices.

[33] Patil, To study and analyse, 40.

8. Redress procedures should be made more logical, easy enough to be understood by a large number of consumers. Further procedures shall so designed as to have easy handling and quick disposal of cases.
9. The active involvement and participation from all quarters i.e. the central and state governments, the educational institutions, the NGO's, the print and electronic media and the adoption and observance of a voluntary code of conduct by the trade and industry and the citizen's charter by the service providers is necessary to see that the consumers get their due.

This contribution will however not go into the details of the Indian discussion, except referring to the obvious deficiencies of the well-intended Indian consumer redressal system, namely the lack of adequate compensation to wronged consumers and the length of proceedings, especially when going on appeal. This makes an effective preventive system ever more necessary to which I will turn now under the existing CPA mechanism.

32.5.4 The Near-to-Absence of Preventive Justice Under the CPA

As was already mentioned, the CPA is mostly concerned with individual (or perhaps group) redressal schemes, not so much with preventive justice. This has not been substantially changed after the 2002 amendments where the jurisdiction of the MRTP-C was to some extent transferred to the CPA institutions, without however giving them the same powers. In particular, the narrow concept of UTP was not changed which always required a prior transaction and did not apply in case of a complaint before a sale or a service contract is concluded. This excludes jurisdiction particularly against misleading advertising directed at a large public, as mentioned before. The same is true with the corresponding concept of 'consumer' which is linked to a transaction against consideration, not to the objective of the action (business or private).

32.5.5 Some Examples Supporting Preventive Justice in CPA

On the one hand, however, there are still some 'hidden' elements in the CPA provisions which could be used for preventive justice. This is true with regard to available remedies which may have a deterrent effect on wrongdoers in the consumer and advertising markets. There are no statistics available on the (infrequent?) use of these remedies. The following examples contain only anecdotal evidence:

Section 14 CPA: District Forum may issue 'an order to the opposite party directing him to (do) one or more of the following things, namely (…):

- Under lit. (f) this also includes an order "to discontinue the unfair trade practice or the restrictive trade practice or not to repeat them".

- This allows for corrective advertising, Sect. 14 (lit hc). In the case of *Dr. Navdeep Singh Khaira et al v Sheela Gupta et al*,[34] the National Commission ordered 'withdrawal of any such advertisement (on wrongful laser treatment of an eye defect) (…) and to desist doing so in future'.
- Exemplary damages in case of repeated or serious infringements are possible under the Sect. 14 (lit. d) CPA and in some cases awarded by the State or National Commissions, see *Bonn Nutrients vs Jagpa Singh Dara*.[35] The damages may be put into a government (welfare) fund and therefore not help consumers. However, the amount awarded by the National Commission does not seem to have any deterrent effect. The compensation awarded by the District Forum in this case was ₹ 5,000 (€ 60) and enhanced by the State Commission to an exemplary award of ₹ 50,000. (about € 600), plus ₹ 3,000 for costs of the complaint.
- A highly publicized case involving the award of punitive damages before the National Commission *Society of Catalysts v StarPlus TV et al*[36] concerned the promise of prizes to be offered to the participants of a lottery on a public TV programme which in fact were financed by the very participants, allowing a substantial profit to the advertiser without this being disclosed to the consumer.[37] The scheme was regarded as a (grossly) UTP; the defendant was condemned to 'punitive damages' of 1 crore (€ 120,000), a remarkably high sum for Indian circumstances, even though only covering 14 % of the profit from the scheme; the complaining consumer association did not get anything except a trifle 50.000 Rp. (about € 600) for its costs. This sum of 1 crore was to be paid into the 'Consumer Welfare Fund'. At the end of the order, the NC said that it 'highly appreciate(d) the efforts made by complainant, the Voluntary Consumer Association.' This is a remarkable example of a public interest litigation within the narrow framework of the CPA. Whether the order which became final may have a substantial preventive effect on the use of prizes for marketing purposes remains to be seen.
- Another way to speed up proceedings which is particularly important for the success of preventive justice would be the use of interim orders under Sect. 13 (3B) CPA as amended in 2002: These orders seem also to be available for interlocutory injunctions to stop UTP including misleading advertising before having caused damage to consumers, but there seems to be little use so far by District Fora.

[34] 2010 (2) CPR 29 (NC).

[35] 2005 (2) CPR 111 (NC).

[36] 2008 (4) CPR 313 (NC).

[37] For a similar scheme in the EU see CJEU, judgment of 18/10/2012, case C-428/11 *Purely Creative,* not yet reported: It is an unfair commercial practices under Dir 2005/29/EC of informing the consumer that he has won a prize and obliging him, in order to receive that prize, to incur a cost of whatever kind profiting the advertiser.

32.5.6 Limits to Preventive Justice Under CPA

On the other hand, the proceedings before the consumer redressal institutions, in particular the District Fora, do not seem to be tailored to preventive justice. They do not have the expertise to handle claims against misleading advertising. They lack investigative powers. The exclusion of trade associations from standing—unlike the MRTP-Act—necessarily eliminates a number of potential complainants who have a substantial interest and expertise how to successfully combat UTP. Injunctive relief, particularly temporary injunctions seem to be available in theory but not used in practice.

The State Commissions would be in a better position to handle preventive justice than the District Fora whose basic mission is to help the 'Indian consumer in need'. However, as I was told, the State Commissions are remarkably understaffed by comprising only a President (a former High Court judge) and two members (without substitutes!) being competent to hear all appeals in one state against District Fora orders. State Commissions are, unlike courts, not divided into benches allowing a more effective and speedy handling of cases. They cannot take action against misleading advertising *suo motu*, unlike the old MRTP-C. Vacancies of Presidents and (the two) member of the Commissions are filled with great delay and frequently subject to political squabbles.

32.6 How to Bring Preventive Justice Against UTP Again into the Indian Legal Order—Some Personal Suggestions and Recommendations

As a preliminary result of this study undertaken, the following changes of law and practice of the CPA would be necessary as a minimum to improve preventive justice on the Indian consumer market, thereby indirectly profiting consumers themselves. This should be possible without radically changing the entire institutional patterns and arrangements of the CPA:

1. In order to improve the protection of the collective interest of Indian consumers, there is a need for a paradigm extension in Indian consumer law and practice under the CPA. Such extension would imply action under the CPA from compensation only to both compensation and prevention. This conforms to a citation by a prominent Indian author Singh:[38] '(the) purpose (of the CPA) (…) is to outlaw practices which are deceptive and otherwise unfair to consumers'.
2. This paradigm extension implies both legislative and institutional changes, but in no way radical modifications of the existing structure and practice under the CPA. This paper will list only some of them, without being in any way exhaustive. The recommendations are purely personal.

[38] Singh, *Consumer Protection Law,* 158.

3. As a first requirement, preventive jurisdiction against UTP, in particular misleading advertising should lie exclusively with the State Commissions, eventually the National Commission, not with District Fora. It is suggested that a second bench be installed in the—at present overburdened and understaffed—State Commissions which would handle preventive actions with a view to developing expertise and efficiency—similar to the existing (5) benches at the National Commission.[39] Such centralisation and concentration of proceedings would accelerate the complaint handling which in the end would be monitored by the possibility of an appeal to the Supreme Court of India.
4. As a second important reform to be enacted by the Indian legislator, there is a need to modify existing legal restrictions to improve prevention, in particular by broadening the jurisdiction under Sect. 12 to cover practices also before any commercial transaction with a consumer has taken place, similar to Sect. 36A MRTP Act of 1984,[40] Art. 3(1) Directive 2005/29. The concept of consumer needs to be widened to include cases where there has been no express transaction for consideration, but its preparation.
5. The remedial mechanism should be improved with a view to attain rapid cessation orders against obvious UTP, including interlocutory/interim injunctions to be sought by 'recognised consumer associations' under Sect. 12 (b), consumer groups under Sect. 12 (c) and/or governments under Sect. 12 (d) CPA. Individual consumers should not have standing.
6. Whether trade associations should have standing like under EU law and the former MRTP-Act must be decided by the legislator. This author is convinced that a broadening of standing to include also business actors would increase the preventive effect of the CPA, but be strictly limited to preventive, not to compensatory jurisdiction.
7. In order to allow a speedy out of court settlement of a case concerning an UTP, an informal pre-trial 'warning procedure' would be helpful as used in many EU countries. It could be initiated by consumer organizations, consumer groups and governments having standing under Sect. 12 CPA, eventually also by trade associations. If the trader/advertiser complies, he would sign an undertaking to abstain from continuing the UTP, sanctioned by a conditional penalty in case of breach.
8. It is suggested that the already existing remedies under Sect. 11 (2) CPA, including accelerated procedures for orders with 'interim effect', could be activated to allow for rapid injunctive relief.
9. Orders by State Commissions or the National Commission enjoining a specific UTP should be accompanied by a conditional penalty payment in case of breach. If the order has been appealed, the penalty payment would only be preliminary and has to be revoked in case of a successful appeal by trader.
10. Under existing law, neither the State Commissions nor the National Commission have investigative powers, unlike the former MRTP-Commission. In

[39] Report of the Working group, 21.

[40] Mittal, *A Report on the Experiences of the MRPC 1969,* 45.

the opinion of this author, this principle should not be abandoned because of the judicial character of the Commissions. It would therefore be part of the substantiation requirements of an action for an injunction by the plaintiffs as mentioned under paras. 5 and 6, to submit the necessary documentation to the Commission to justify a claim. If consumer associations do not have the means to provide the necessary documentation, this must be done by the state plaintiff under Sect. 12 (d) CPA. The defendant advertiser could obviously rebut the claim by appropriate counter-evidence. The Commission could use its own expertise and knowledge of the deceptiveness of an adverting, or, as the case may be, consult an independent expert to assess the claims[41]. It could however not take action *proprio motu*.

11. The existing remedy of corrective advertising should be used more frequently by State Commissions and the National Commission in advertising cases. Serious violations may be sanctioned by exemplary, as is already done today, however exceptionally.
12. Punitive damages which were introduced by the 2002 amendments[42] need to be utilized more frequently in the public interest against UTP seriously impairing the consumer interest.[43]
13. The Undersigned does not take a stand on recommending or not the establishment of a Consumer Protection Agency to deliver preventive justice similar to the defunct MRTP-C, which has been recommended by the GFA-study[44] and more cautiously proposed as Option 1 of the CUTS-study[45]. The Government working group has discussed the establishment of a 'National Trade Practices Regulatory Authority', but has not taken any recommendation on this controversial issue.[46]
14. The proposed 'paradigm extension' of the CPA should not undermine the traditional consumer protection role of its institutional structure, in particular by the jurisdiction of the District Fora for compensation and/or restitution which should remain untouched, but be supplemented by elements of a better preventive control in order to avoid consumer harm before a contract is entered into. Some legislative changes as indicated above will be necessary for this objective. On the other hand, the existing CPA already contains elements to protect the collective consumer interest, in particular in its provisions on standing (to be

[41] See AR Patil, 'Consumer Protection Amendment Bill 2011– An Analysis' in AR Patil (ed), *25 Years of Consumer Protection Act—Challenges and the New Way Forward* (Bangalore, NLSIU, 2012) 115.

[42] Singh, *Consumer Protection Law,* 196.

[43] Report of the Working group, 20.

[44] GFA/GIZ Study by Chaturvedi and Thorun on 'Recommendation for a National Consumer Protection Agency' (unpublished, 2012).

[45] CUTS Report on 'Study and analyse the situation in India regarding unfair trade practices and limitations of enforcement' (unpublished, 2013) 66; option 2 proposed 'strengthening the institutions under the CPA' and comes close to the recommendations voiced in this paper.

[46] Report of the Working group, 23.

extended to trade associations), compensation (exemplary and/or punitive) with deterrent effect), and remedies for injunctive relief.

15. The recommendations of this study can be regarded only as a 'second best' compared to a solution based on a public authority like the former MRTP-Commission. Under the CPA, the redressal institutions do not have investigative powers, nor can they initiate proceedings *proprio motu*. The injunctive remedies do not seen to be sufficient—even if improved in the CPA as suggested—in the absence of public enforcement.

32.7 Conclusion—The Necessity of a Joint Reading of Prevention and Compensation Against UTP in a "Movable System of Consumer Law"

How far does the Indian system of regulating UTP conform to Hans Micklitz ideas of a 'movable system'? It may be useful to take a look at another paper by Hans Micklitz where he criticizes the so-called 'Kästchendenken' ('thinking in legal boxes') in unfair commercial practices regulation.[47] Under such a (wrong!) premise, trade regulation and prohibition of unfair contract terms are two completely separate areas which have nothing to do with each other. This narrow view—popular especially in German legal thinking—has found some confirmation in the above mentioned Art. 3(2) UCPD, even though critique had already been voiced by authors from other jurisdictions[48].

Hans Micklitz' broader view was to some extent supported by a recent litigation before the ECJ in *Pereničová and Perenič*.[49] Advocate General Trstenjak, in her opinion of 21 November 2011, wrote;

> (…) An overall examination of the legal acts adopted to protect the consumer reveals many links between them, which must similarly be taken into account in the interpretation. The acts of European Union law in the area of consumer protection law must therefore be seen as part of a single, overall set of rules which complement each other (para. 86).

The Court in its judgment of 15 March 2012 has taken up this broader approach toward a joint understanding and interpretation of the UCPD and UTD:

> In those circumstances, (…) a finding that a commercial practice is unfair is one element among others on which the competent court may base its assessment of the unfairness of contractual terms under Art. 4(1) of Directive 93/13 (para. 43).

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[47] H-W Micklitz and N Reich, 'AGB-Recht und UWG—(endlich) eine Ende des Kästchendenkens nach Perecinova und Invitel?' (2012) *Europäisches Wirtschafts- und Steuerrecht* 257; it should be admitted that the relevant parts of this paper orignated from the pen of Hans!

[48] See for example S Orlando, 'The Use of Unfair Contractual Terms as an Unfair Commercial Practice' (2011) *European Review of Contract Law* 25.

[49] Judgment of 15 March 2012, case C-453/10 *Jana Pereničová and Vladislav Perenič v SOS financ spol. s r. o.,* not yet reported.

Such 'joint reading' of instruments of trade practices and mandatory contract law insists on their common consumer protective objective and should be making its way into EU and implementing Member State law. As this paper on India hopefully shows, this integrated understanding between UTP and individual remedies has some tradition there which is useful to be considered also by the EU lawyer. The problem of modern Indian consumer law seems to be concerned with the reverse problem as in the EU discussion taken up by Hans Micklitz: the predominant focus on individual compensation against UTP has seemingly left behind the need for preventive justice. Indian law still has to develop efficient remedies before UTP appear on the market place and harm consumers. Individual and collective remedies, compensation and prevention have to be seen as two sides of the coin of an efficient consumer protection practice as being directed toward both, without artificially putting them into 'different legal boxes'. Indian and EU law share the same orientation but suffer from one-sided deficits relating either to prevention or compensation, if my observations on the relevant state of each law is correct. The 'movable system' as proposed by Hans Micklitz should be able to overcome these deficits.

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Chapter 33
The Low-Income Consumer in European Private Law

Peter Rott

Abstract The configuration of consumer law obviously depends on the underlying consumer image. Apparently, there is a strong desire to define 'the consumer' in a uniform manner, in order to design doctrinal solutions that suit to pay regard to his or her particularities. This article instead suggests that consumers are different, and that differences do not only stem from experience or mental capacities but that poverty is a criterion that needs to be considered when designing consumer law. It argues that, in contrast to traditional national legal orders, EU private law has made first steps towards special rules for low-income, or poor, consumers that will force national legislators and courts to abstain from overly rigid uniformity in the consumer image that they base their legislation and case law on.

33.1 Introduction

One of the many areas where European private law and traditional private laws clash is consumer law, and one of the basic questions of consumer law is, of course, what consumers are like and what kind of protection they therefore need. This area has undergone quite some development in the last 30 years, and *Hans Micklitz*, to whom this essay is dedicated, has discussed consumer images and regulatory techniques flowing from them in numerous contributions.[1] The focus of that debate has always been on the cognitive capacities of consumers (and to what extent they matter).

In contrast, the financial capacity of citizens, or consumers, has traditionally not been considered to be of any relevance in private law relationships. A classic sentence from German legal doctrine was: 'Geld hat man zu haben' (you have to have

[1] See only H-W Micklitz, '§ 13 BGB' in F-J Säcker (ed), *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, vol. 1, 6th ed (Munich, Beck, 2012).

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_33,

money); it meant that the inability to pay did not have any influence on the contract and on the fate of the payment obligation.[2] Payment problems and poverty were public law issues and dealt with under welfare law. In civil procedural law, they mainly appeared in the form of obstacles to the execution of judgments, in the sense that the executor was and is not allowed to seize the minimum income needed to exist.[3] This is also what I had been taught at university; before I met Hans Micklitz and became his assistant at the University of Bamberg, in 1996.

In our modern societies, many households are in serious financial difficulties or over indebted; one reason for this surely being the 'credit society'. Still, the 'solution' to that problem has, for a long time, been sought in insolvency law rather than in substantive private law.[4] German courts have explicitly rejected any duty of banks to consider the financial situation of a potential customer when granting a credit. Only in the famous suretyship cases, where the Constitutional Court argued with the constitutional right of 'material' (rather than formal) freedom of contract, the financial situation of the surety—usually the wife, children or parents of the main debtor—played a role under the immorality test of German private law. Generally speaking, German academia seems to be happy with this approach. Recent efforts are even directed towards the dissolution of consumer law and its reintegration into general private law, combined with a flexible approach that would allow courts to include insights of behavioural economics in the interpretation, in particular, of general terms. In contrast, Hans Micklitz has, in his contribution to the *Deutsche Juristentag* 2012, emphasised the special (regulatory) needs of so-called 'vulnerable consumers'.[5]

Indeed, the law on vulnerable consumers is undergoing significant developments, and the EU plays an important part in these developments. For the purpose of this article, I want to distinguish two types of vulnerabilities.[6] Vulnerability may stem from lack of experience and understanding, and we meet this type of vulnerability mainly, although not only, in the context of financial services;[7] which has

[2] For fundamental critique see U Reifner, *Alternatives Wirtschaftsrecht am Beispiel der Verbraucherverschuldung: Realitätsverleugnung oder soziale Auslegung im Zivilrecht* (Neuwied, Luchterhand, 1979).

[3] §§ 850 ff. of the Civil Procedural Code (*Zivilprozessordnung*; ZPO).

[4] Very few exceptions apply, in particular, where certain barriers have been introduced to the termination of the contract in the case of late payment. These consist in additional waiting periods and thresholds but do not refer to the status of a consumer as low-income consumer. See, for example, § 498 BGB for consumer credit law. For energy law and telecommunications law see infra.

[5] See, in particular, his contribution to the Deutsche Juristentag in September 2013, published as H-W Micklitz, 'Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?', *Gutachten A zum 69. Juristentag* (Munich, CH Beck, 2012); id, 'Do Consumers and Businesses Need a New Architecture of Consumer Law—A Thought Provoking Impulse' (2013) 32 *Yearbook of European Law* 266.

[6] Other aspects of vulnerability are, for example, handicaps that have been considered broadly in travel law but also in telecommunications law; see only Reg (EC) No 1107/2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air, [2006] OJ L 204/1; Art 7 of the Telecommunications Universal Dir 2002/22/EC, [2002] OJ L 108/51.

[7] See, for example, I Domurath, 'The Case for Vulnerability as the Normative Standard in European Consumer Credit and Mortgage Law—An Inquiry into the Paradigms of Consumer Law' (2013) *Zeitschrift für Europäisches Unternehmens- und Verbraucherrecht* 124.

led to protection tools beyond information, in particular advice duties. I want to address, however, a different kind of vulnerability here that is caused by poverty, or low income, perhaps coupled with a bad credit history, which triggers problems with potential contracting partners but which may also have psychological effects that can be exploited by traders.

The prime example, where EU law requires Member States to consider the situation of low-income consumers (as a particular group of vulnerable consumers), is the law of services of general interest. In particular, low-income consumers find mention in the Electricity Market Directive 2009/72/EC,[8] the Gas Market Directive 2009/73/EC[9] and the Telecommunications Universal Service Directive 2002/22/EC[10] as amended by Directive 2009/136/EC.[11] Another area where low income can play a role is financial services law where, in particular, the principle of responsible lending has been discussed at EU level. Low-income consumers may also be even weaker parties than other consumers in the terms of the Unfair Contract Terms Directive 93/13/EEC, as interpreted by the Court of Justice of the European Union (CJEU). And finally, low-income consumers may be targeted differently from the 'average' consumers when it comes to marketing.

Obviously, the European low-income consumer cannot possibly be determined by reference to a particular income that would apply across the EU,[12] and this article will not attempt to provide for a calculation method. Instead, this article discusses why and in which way the EU addresses special problems of low-income consumers, and how this affects the traditional non-consideration of this issue in national private laws.

33.2 The Social Dimension of EU Law

Obviously, the EU law does not have the competence to regulate social law, or the levels of state welfare. EU law has, however, for a long time interfered indirectly with the social systems of the Member States, in particular through the case law of the Court of Justice (CJEU) on the four freedoms.[13] One telling example is the line of case law related to cross-border health care[14] that ultimately led to the adoption

[8] [2009] OJ L 211/55.

[9] [2009] OJ L 211/94.

[10] [2002] OJ L 108/51.

[11] [2009] OJ L 337/11.

[12] See also recital (10) of Dir 2002/22/EC, according to which 'affordability' must be determined at the national level.

[13] For a detailed account see the contribution by K Tuori, in this volume.

[14] See only the landmark cases C-120/95 *Nicolas Decker v Caisse de maladie des employés privés* [2008] ECR I-1831, and C-158/96 *Raymond Kohll v Union des caisses de maladie* [2008] ECR I-1931.

of the Patient Rights Directive 2011/24/EU.[15] Another example is the relationship between free movement of workers, the Union citizenship, the principle of non-discrimination and the obligation of the host state to pay state welfare.[16]

Equally, EU law has had an impact on the lives of low-income consumers. Here, the best example would be the liberalisation of services of general interest, such as telecommunication services, postal services, or the supply with electricity and gas.[17] That liberalisation has largely changed the conditions under which these services are supplied. The consumer is now confronted with private service providers (some still State-owned) that operate in a more or less competitive market. Public law principles, such as the principles of objectivity, equality, proportionality, neutrality or the compulsory provision of service[18] do not apply automatically anymore. Payment problems have consequences in contract law, and they may lead to the supplier refusing to contract with the consumer or to the termination of an existing contract, thus to consumers being denied access to essential services. This indirect interference with national social systems, without regulatory competence, can as such be seen as problematic.[19] Indeed, positive requirements on Member States dealing with the protection of low-income consumers may be even more problematic.

One argument in favour or such positive requirements could be found in (new) primary law. In fact, the 'framework on poverty and social exclusion' is anchored in Articles 151 and 153 TFEU under the headline of social policy. According to Article 153(2)(b), the area of social inclusion cannot be subject to binding regulation such as directives. The cooperation between the Member States on poverty and social exclusion is therefore being carried out by using the 'open method of coordination' (OMC).[20] We also find relevant aspects of social inclusion in the Charter of Fundamental Rights in the European Union. According to Article 34(3), 'in order to combat social exclusion and poverty, the Union recognises and respects the right to social and housing assistance so as to ensure a decent existence for all those who lack sufficient resources (…)'.

Social inclusion is moreover set out as a goal in Article 9 TFEU that was introduced with the Lisbon Treaty and is referred to as the 'social clause'.[21] According to this provision, the Union shall, when defining and implementing its policies and

[15] Dir 2011/24/EU on the application of patients' rights in cross-border healthcare, [2011] OJ L 88/45.

[16] See, for example, Case C-456/02 *Michel Trojani v Centre public d'aide sociale de Bruxelles (CPAS)* [2004] ECR I-7573.

[17] See P Rott and C Willett, 'Consumers and services of general interest' in G Howells, I Ramsay and T Wilhelmsson (eds), *Handbook of Research on International Consumer Law* (Cheltenham, Edward Elgar Publishing, 2010) 295.

[18] See T Wilhelmsson, 'Services of general interest and European private law' in CEF Rickett and TGW Telfer (eds), *International Perspectives on Consumers' Access to Justice* (Cambridge, Cambridge University Press, 2003) 149, 151 f.

[19] See generally the contribution by C Glinski and C Joerges in this volume.

[20] See also M Ferrera, M Matsaganis and S Sacchi, 'Open coordination against poverty: the new EU's social inclusion process' (2002) 12 *Journal of European Social Policy* 227.

[21] J-C Piris, *The Lisbon Treaty, A Legal and Political Analysis* (Cambridge, Cambridge University Press, 2010) 310.

activities, take into account requirements linked to the promotion of among other things the fight against social exclusion.

The effect of Article 9 TFEU is that social inclusion must be taken into consideration also within binding EU legislation, for example in the area of energy law. Social inclusion must also be a part of consumer law, and therefore it also featured in the Consumer Policy Strategy 2007–2013.[22]

Beyond those sources of primary law, however, taking consideration of the social consequences of otherwise liberal market policy is a political necessity. The EU legislator does not only have to comfort the needs of Member States that take a more welfarist approach[23] but also meet the suspicion and the critique of civil society of the predominant focus on free trade. And obviously the financing of support for low-income consumers, for example through free consumption or through social tariffs, may also have a competition angle to it, namely when the supplier is too generously compensated by the State for providing such benefits in its contractual relationship with the low-income consumer.[24] Thus, even before social policy and social cohesion made their appearance in EU primary law, the EU legislator has found the competence to include social aspects of liberalisation, in particular, as an annex to the liberalisation of markets and to the fostering of cross-border economic activity, as will be shown hereinafter.

33.3 Taking Stock

33.3.1 Access to Services of General Interest

Access to electricity forms part of the so-called universal service obligations that Member States have to impose on at least one electricity supplier. Universal service is defined as guaranteed access for everyone, whatever their economic, social, or geographical situation, to a service of a specified quality at an affordable price.[25] The concept aims at ensuring that consumers that are unattractive for traders do not end up without a supplier, and therefore without access to services of general interest.

Protection of low-income consumers of services of general interest goes even further and is now deeply rooted in EU law. The best example is electricity law as now regulated by Directive 2009/72/EC. Its recital (53) reads:

[22] Consumer Policy Strategy 2007–2013, COM(2007) 99 final, 8: 'Affordable access to essential services for all is both essential for a modern and flexible economy but also for social inclusion. Showing that no consumer is left behind will also help to sustain political support for measures on essential services.'

[23] In particular France, see R Sefton-Green, 'A vision of social justice in French private law: paternalism and solidarity' in H-W Micklitz (ed), *The Many Concepts of Social Justice in European Private Law* (Cheltenham, Edward Elgar Publishing, 2011) 237.

[24] See only ECJ, 6 October 2010, Case C-222/08 *Commission v Belgium*, [2010] ECR 9017.

[25] See the White Paper on Services of General Interest, COM(2004) 374 final, 8.

> Energy poverty is a growing problem in the Community. Member States which are affected and which have not yet done so should therefore develop national action plans or other appropriate frameworks to tackle energy poverty, aiming at decreasing the number of people suffering such situation. In any event, Member States should ensure the necessary energy supply for vulnerable customers. In doing so, an integrated approach, such as in the framework of social policy, could be used and measures could include social policies or energy efficiency improvements for housing. At the very least, this Directive should allow national policies in favour of vulnerable customers.

EU law has neither defined the notion of vulnerable consumers precisely, nor has EU law established specific rules for them. However, the Directive mentions possible measures to support vulnerable consumers and asks the Member States to afford specific protection to vulnerable consumers.[26] According to Article 3(7), of the Electricity Directive 2009/72/EC,

> Member States shall take appropriate measures to protect final customers, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers. In this context, each Member State shall define the concept of vulnerable customers which may refer to energy poverty and, inter alia, to the prohibition of disconnection of electricity to such customers in critical times. Member States shall ensure that rights and obligations linked to vulnerable customers are applied. In particular, they shall take measures to protect final customers in remote areas. (…)

Article 3(8) adds that

> Member States shall take appropriate measures, such as formulating national energy action plans, providing benefits in social security systems to ensure the necessary electricity supply to vulnerable customers, or providing for support for energy efficiency improvements, to address energy poverty where identified, including in the broader context of poverty. (…).

The crucial question here is: Does the Directive require Member States to include protection for low-income consumers in their *private* laws? Generally speaking, the Directive envisages two types of mechanisms, one being financial support and the other one access to electricity supply and protection from disconnection. Both are somehow linked when it comes to the threat of disconnection due to unpaid bills.

Obviously, the right to a contract, as enshrined in the concept of universal service, forms part of private law, as an exception to the principle of freedom of contract, and so do restrictions on disconnection of supply and on the termination of supply contracts in favour of low-income consumers. The requirement of affordability impacts on the freedom to fix any price below the limits of usury. Quality requirements limit the freedom to determine the content of the contract.[27]

The place in law for the protection of consumers that are vulnerable due to poverty, though, is less obvious. Unlike other Member States, Germany has kept the issues of universal service and special protection for vulnerable consumers sepa-

[26] For the variety in the Member States' implementations of those rules see P Rott, 'Liberalisation and protection of vulnerable customers in services of general interest' (2011) *Europarättslig Tidskrift* 483, 490 ff.

[27] For more details see P Rott, 'A New Social Contract Law for Public Services?—Consequences from Regulation of Services of General Economic Interest in the EC' (2005) *European Review of Contract Law* 323.

rate even after the implementation of Directive 2009/72/EC.[28] Disconnection due to non-payment is subject to certain conditions, such as a waiting period of four weeks after a warning of disconnection and a threshold of 100 € of debts,[29] but the rules in no way differentiate between (vulnerable) low-income consumers and forgetful regular customers. Instead, vulnerable consumers are supported through the general public welfare system, and it is assumed that the funds that are so made available are sufficient for regular energy consumption.[30] Thus, the idea seems to be that low-income consumers that do not pay their electricity bill can be considered to be at fault and therefore do not deserve specific protection under electricity law.

The distressing reality is that, according to the NGO *Bund der Energieverbraucher*, each year 800,000 households are temporarily disconnected from electricity or gas supply in Germany;[31] which triggers the suspicion that the protective system does not meet the standards required by the Directive. Several factors might be relevant. First, consumers are usually supplied for a monthly or bi-monthly lump sum and are only finally billed once per year. That final bill may well be significantly higher than the aggregate monthly or bi-monthly payments. A low-income consumer living on state welfare may not be able to recover the missing amount even within the waiting period as required by electricity law. Second, it may well happen that the monthly benefits are insufficient to pay all bills anyway, in particular when, for example, the landlord increases the rent, or in case of a hard winter. It may then appear more important to the consumer to pay the rent than the electricity bill.

There is also the possibility that recipients of state welfare have their electricity bill paid directly by the welfare authority. Even in that case, however, late payment may arise in that relationship. This has happened, for example, in cases where the welfare authority directly paid the rent of tenants living on state welfare. Lower instance courts[32] were of the opinion that late payment by the welfare authority justified the termination of the tenancy contract. Although the *Bundesgerichtshof* (Federal Supreme Court; BGH) has rejected that opinion and held in favour of the faultless tenant,[33] there is a serious risk of landlords terminating tenancy contracts, and of electricity suppliers disconnecting the consumer, in such situations, and that tenants living on state welfare will not have the financial means available to challenge this in court.

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[28] On the German implementation see K Lange, 'Verbraucherschutz im neuen EnWG' (2012) *Recht der Energiewirtschaft* 41.

[29] See § 19 para 2 *Stromgrundversorgungsverordnung* (Regulation concerning the general conditions for the supply with electricity of household customers; StromGVV).

[30] For more details, see P Rott, 'Services of general interest, contract law and the welfare state' in J Rutgers (ed), *European Contract Law and the Welfare State* (Groningen, Europa Law Publishers, 2011) 79, 86 ff.

[31] See Bund der Energieverbraucher, 'Brennstoff-Armut', www.energieverbraucher.de/de/Brennstoff-Armut__2397.

[32] See, for example, LG Karlsruhe, 14/7/1989, (1989) *Zeitschrift für Miet- und Raumrecht* 421; LG Mönchengladbach, 19/2/1993, (1993) *Zeitschrift für Miet- und Raumrecht* 571; AG Cologne, 3/2/1999, (2000) *Neue Zeitschrift für Miet- und Wohnungsrecht* 2000, 380.

[33] See BGH, 21/10/2009, (2009) *Neue Juristische Wochenschrift* 3781.

Similar requirements as the ones described above apply in telecommunications law,[34] and again it seems beyond doubt that every consumer is dependent on access to telecommunications services, including low-income consumers that may, for example, need to be available for job offers.

EU law does not prescribe a particular solution to these problems in private law but seems to require that the solution is embedded in the contractual relationship between consumer and supplier. Where a Member State decides to organise the support of low-income consumers mainly through (public) welfare law, it must at the very least make sure that the supplier cannot disconnect a low-income consumer before the relevant authority was consulted and gave green light.

33.3.2 Access to Bank Accounts

The payment services market has also been liberalised, and again a strong impetus came from EU law. Unlike in the area of energy or telecommunications services, however, that liberalisation does not seem to have deteriorated the situation of low-income consumers related to access to bank accounts. In fact, that situation had been bad before. The issue of poor consumers having no access to bank accounts has already been discussed in the 1990s when the German *Zentrale Kreditausschuss* (ZKA) issued a recommendation on a bank account for everybody.[35] Thus, the EU is under no pressure to complement its own potentially harmful legislation by measures to support low-income consumers. Nevertheless, the EU Commission has tabled a proposal for a Directive on bank accounts that includes provisions on 'access to payment accounts with basic features'.[36] The impetus here seems to be social inclusion,[37] although the EU Commission has again found an internal market angle to the issue of access to bank accounts, arguing that consumers without a bank account were largely excluded from the benefits of the internal market.[38] And although cross-border internet purchases may not be the first priority of low-income consumers, it is certainly true that they might save money by buying on-line.[39] At

[34] See Rott, 'Services of general interest', 83 ff.

[35] On failed attempts to enforce that recommendation see OLG Bremen, 22/12/2005, (2006) *Zeitschrift für Wirtschaftsrecht* 798; consenting DS Berresheim, 'Kontrahierungszwang der Kreditwirtschaft für Girokonten aufgrund von Selbstverpflichtungen?' (2005) *Zeitschrift für Bankrecht und Bankwirtschaft* 420, 424; critical comments by W Kohte, 'Das Girokonto für jedermann im Licht der Rechtsgeschäftslehre' in W-R Bub et al (eds), *Zivilrecht im Sozialstaat, Festschrift für Professor Peter Derleder* (Baden-Baden, Nomos, 2005) 405.

[36] Proposal for a Directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features, COM(2013) 266 final.

[37] See the Communication 'A Quality Framework for Services of General Interest', COM(2011) 900, 10: 'Access to basic payment services under fair conditions is important for financial and social inclusion and to allow consumers to benefit fully from the single market.'

[38] Ibid, at 3. For a broader perspective on economic aspects of social inclusion see Commission communication 'Towards Social investment for Growth and Cohesion', COM(2013) 83.

[39] See also W Kohte, 'Verletzliche Verbraucher' (2012) *Verbraucher und Recht* 338, 341.

the same time, consumers do not only need to pay to satisfy their economic needs but also for participation in social and cultural life; which underlines the 'social inclusion' dimension of a bank account.

The tools proposed by the Commission very much resemble those used in 'classical' legislation on universal service obligations in the area of services of general interest. According to Article 15(1) of the proposal, Member States shall ensure that at least one payment service provider in their territory offers a payment account with basic features to consumers, and it should not only be an online bank account; which makes sense as low-income consumers may not have access to internet. That basic payment account shall be provided free of charge or for a reasonable fee, Article 17(1).[40] Minimum quality standards are specified in Article 16(1).

Even though the tools are thus the same as the tools in the universal service provisions of electricity or telecommunications law, it seems clear that in the case of basic payment accounts they are exclusively directed at low-income consumers, as other lack of attractiveness, such as geographical remoteness, does not play any role in banking.

33.3.3 Access to Housing

The social relevance of access to housing is obvious, and the right to housing assistance has been included as a fundamental right into the Charter of Fundamental Rights. Housing, or tenancy law, is, however, not an issue that has been regulated by any means at EU level. Nevertheless, access to housing, or rather protection from being evicted from one's own home, has indirectly become an issue in unfair contract terms law. On its face, the case of *Mohamed Aziz*[41] mainly turned on an issue of procedural law. Under Spanish procedural law, the execution of a mortgage was separated from court proceedings in which the victim of that execution could argue substantive reasons as to, for example, the nullity of the title. The latter proceedings did not have the effect of staying the execution of the mortgage. Thus, even if the mortgage was invalid, this could well only be determined by the court after the invalid mortgage had been realised, in other words, after the owner of the property had been forced to leave the property; which is exactly what happened to Mr. Aziz. The only available protection consisted in the property owner's right to request the retention of the proceeds of the realisation of the mortgage. To make

[40] Whereby the 'reasonable fee' is a risky concept as it allows banks to argue that they have more trouble and costs with low-income consumers than with other customers so that a higher fee is 'reasonable'. See only OLG Naumburg, 31/1/2012, (2012) *Verbraucher und Recht* 370, 371, concerning the costs of a bank account that guarantees safety from execution of debts by third parties (§ 850k ZPO).

[41] Judgment of 14 March 2013, Case C-415/11 *Mohamed Aziz v Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa)*, not yet reported. For detailed analysis see H-W Micklitz, 'Unfair Contract Terms—Public Interest Litigation before European Courts—C-415/11' in E Terryn, G Straetmans and V Colaert (eds), *Landmark Cases of EU Consumer Law* (Antwerp, Intersentia, 2013) 615.

bad things worse, clause 15 of the credit agreement, concerning the determination of the amount due, stipulated not only that the lending bank had the right to bring enforcement proceedings to reclaim any debt but also, for the purposes of those proceedings, that it could immediately quantify the amount due by submitting an appropriate certificate indicating that amount. It was this clause, amongst others, the provided the CJEU with the opportunity to review the fairness or otherwise of that system; and the CJEU came to the conclusion that Member States cannot prevent the court that is competent to judge on the unfairness of a term in mortgage proceedings to stay the realisation of the mortgage until the substantive questions are answered, as otherwise the full effectiveness of the decision on the fairness of the clause could not be guaranteed; which is against the aims and objective of the Unfair Contract Terms Directive.

What has surely influenced that decision in favour of the home owner *Mohamed Aziz* is the importance of housing. According to the CJEU, its considerations concerning the necessary protection of consumers under the Unfair Terms Directive apply 'all the more strongly where, as in the main proceedings, the mortgaged property is the family home of the consumer whose rights have been infringed, since that means of consumer protection is limited to payment of damages and interest and does not make it possible to prevent the definitive and irreversible loss of that dwelling'.[42] Similarly, AG *Kokott* had argued that 'it does not constitute effective protection against unfair terms if, in connection with such terms, a consumer is defenceless in accepting the realisation of a mortgage and thus the judicial auction of his home, the associated loss of ownership and eviction, and can only make claims for damages by way of subsequent legal protection'.[43]

The relevance of housing was also underlined in another CJEU judgement on the Unfair Contract Terms Directive. In *Asbeek Brusse*, the application of that Directive to tenancy contracts was at stake. The CJEU first interpreted the wording of the Directive but then turned to the importance of its application to tenancy contracts, stating that 'the consequences of the inequality existing between the parties are aggravated by the fact that, from an economic perspective, such a contract relates to an essential need of the consumer, namely to obtain lodging, and involves sums which most frequently, for the tenant, represent one of the most significant items in his budget (…)'.[44]

In a certain way, the importance of housing is also considered in the Commission's proposal for a Mortgage Directive:[45] According to Article 8 of that proposal, credit advertisement would have to include a warning, where applicable, concerning the risk of losing the immovable property in the event of non-observance of the commitments linked to the credit agreement when the credit is secured by a mortgage or another comparable security commonly used in a Member State on

[42] Ibid, para 63.

[43] AG Kokott, 8 November 2012, Case C-415/11 *Mohamed Aziz*, para 52.

[44] Judgment of 30 May 2013, Case C-488/11 *Dirk Frederik Asbeek Brusse and Katarina de Man Garabito v Jahani BV*, not yet reported, para 32.

[45] COM(2012) 142 final.

residential immovable property or secured by a right related to residential immovable property.

The approach of the CJEU and of the European Commission can be contrasted with the case law of the German *Bundesgerichtshof* concerning the immorality or otherwise of family suretyship contracts. The relevant criterion for immorality in terms of § 138 para 1 BGB is the disproportionality between the amount guaranteed and the income and property of the guarantor. If the amount guaranteed is grossly disproportionate to the income and property of the guarantor, and there is a close relationship between the primary debtor and the guarantor, the courts recognise a rebuttable presumption of immorality. This is because, typically, such a contract would only be concluded by someone who is dominated by an emotional relationship to the debtor. Therefore, one may presume that the bank has abused this emotional relationship, which is in breach of the immorality clause.[46] In contrast, gross disproportionality is not accepted by the courts where the guarantor has property, in particular the house in which she lives, that covers the amount guaranteed.[47] The BGH argued that the situation was the same as if the guarantor had granted a mortgage for the credit of the debtor.[48] Thus, a guarantor without any other income can lose his residential home without this being 'grossly disproportionate' in the eyes of the law.

33.3.4 Access to Justice

Many Member States have barely recognised the special protective needs of low-income consumers in civil procedural law, Germany being one of them. Again, the traditional mechanism to support poor consumers is legal aid, and EU legislation requires Member States to grant legal aid to poor consumers in cross-border cases. The Court of Justice, however, went beyond this instrument and has included financial considerations in its case law on effective judicial protection under the Unfair Terms Directive.

The relevant angle here is (again) Article 7(1) of the Unfair Terms Directive, according to which 'Member States shall ensure that, in the interests of consumers and of competitors, adequate and effective means exist to prevent the continued use of unfair terms in contracts concluded with consumers by sellers or suppliers'. The first landmark judgment of the ECJ was the case of *Océano Grupo*[49] where the Court dealt with a contract term conferring jurisdiction on the courts in Barcelona (Spain), a city in which none of the consumers was domiciled but where the traders

[46] Established case-law since BGH, 22/1/1991, (1991) *Neue Juristische Wochenschrift* 923, 925.

[47] BGH, 26/4/2001, (2001) *Neue Juristische Wochenschrift* 2466, 2467.

[48] See explicitly BGH, 19/6/2002, (2002) *Zeitschrift für Bank- und Kapitalmarktrecht* 671, 672. See also G Nobbe and HP Kirchhof, 'Bürgschaften und Mithaftungsübernahmen finanziell überforderter Personen' (2001) *Zeitschrift für Bank- und Kapitalmarktrecht* 5, 9.

[49] Joined Cases C-240/98 to C-244/98 *Océano Grupo Editorial v Rocío Murciano Quintero* [2000] ECR I-4941.

had their principal place of business. The ECJ referred, amongst others, to the long way that a consumer might have to travel, and the costs related to that, as well as to lawyers' fees that may act as a deterrent. In this case, the Court developed the idea that in the area of unfair contract terms law the competent national court must have the right to determine the unfairness of a contract term of its own motion. This was the starting point to a line of judgments in which the ECJ even found a duty of the national court to do so, in particular, in *Cofidis*, *Mostaza Claro*,[50] *Pannon*[51] and *Pénzügyi*.[52] Further, the Court extended that principle to other areas of consumer law such as consumer credit law,[53] doorstep selling law[54] and most recently consumer sales law.[55] Quite obviously, this case law turns against the traditional principle of civil procedural law that the subject-matter of a case is delimited by the parties; a principle that in itself presumes that the parties have equal opportunities to defend their stance.

Whilst the line of cases that took their starting point with the case of *Océano Grupo* surely does not only apply to low-income consumers but rather underlines the importance of consumer law as such to support the weaker party to the contract, the case of *Banco Español de Credito* was clearly influenced by the fact that the consumer in question was in debt. The legal dispute turned on a credit case, in which the bank had initiated an order of court procedure. Next to outstanding credit rates, the bank sought to enforce an interest rate for delayed payment of 29 %. The referring Spanish court, the Audiencia Provincial de Barcelona, wanted to know whether it had the right, under national procedural law, to intervene when it finds that the claim is based on an unfair term in the terms of Article 3 of Directive 93/13/EEC—here: an outrageous interest rate. This question is of utmost practical importance since the vast majority of claims for payment are brought in fast-track procedures; and this applies, amongst others, to the banking sector. The major difference to the case of *Océano Grupo* and the following case line was that the defendant is normally not heard in fast-track procedures but can appeal the decision, in which case the proceedings are continued as regular controversial proceedings, in which the national court has the duty to assess the unfairness of terms of its own motion. The problem is that the vast majority of the first stage decisions are not contested by consumers so that no second stage is performed. One reason for that is obviously that a consumer who cannot pay the credit rates any longer does not have the money for legal representation either.

Indeed, this point played an important role in the Court's decision in *Banco Español de Credito*. Under Spanish civil procedural law, fast-track procedure can be

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[50] Case C-168/05 *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421.

[51] Case C-243/08 *Pannon GSM Zrt v Erzsébet Sustikné Györfi* [2009] ECR I-4713.

[52] Case C-137/08 *VB Pénzügyi Lízing Zrt. v Ferenc Schneider* [2010] ECR I-10847.

[53] See Case C-429/05 *Max Rampion, Marie-Jeanne Rampion, née Godard v Franfinance SA, K par K SAS* [2007] ECR I-8017.

[54] See Case C-227/08 *Eva Martín Martín v EDP Editores SL* [2009] ECR I-11939.

[55] See judgment of 3 October 2013, Case C-32/12 *Soledad Duarte Hueros v Autociba SA, Automóviles Citroën España SA*, not yet reported.

used for claims of up to 30,000 €, whereby the objection must be made with the assistance of a lawyer once the claim exceeds 900 €, and the consumer does not only have to find a lawyer within the appeal period but also the money to pay that lawyer. Thus, the Court concluded, that

> 'there is a significant risk that the consumers concerned will not lodge the objection required either because of the particularly short period provided for that purpose, or because they might be dissuaded from defending themselves *in view of the costs which legal proceedings would entail* in relation to the amount of the disputed debt, or because they are unaware of or do not appreciate the extent of their rights, or indeed because of the limited content of the application for the order for payment submitted by the sellers or suppliers, and thus the incomplete nature of the information available to them'.[56]

The protective approach of this decision is even clearer when one contrasts the judgment with the opinion of AG Trstenjak[57] who proposed to prioritise the speediness of the fast track procedure over the effectiveness of consumer protection at that stage. Her main reason was that the consumer could easily take the conflict to the second stage, the adversarial part, where then the court does have to consider the unfairness of a term of its own motion. Importantly, at this point of her argument she referred to the consumer image of the reasonably well-informed and reasonably observant and circumspect consumer that we find in many other areas of EU consumer law but that may be less helpful where the consumer simply cannot afford to act in accordance with his or her insights.

33.3.5 Prevention of Poverty or Insolvency

Living on a low income not only makes consumers unattractive to sellers or suppliers, therefore restricting access to goods and services but it also increases the likelihood of consumer insolvency if bad decisions are made. Such bad decisions may, in particular, relate to financial services. The EU therefore generally pursues a policy that aims at financial education and at the prevention of consumer insolvency.[58] Both aims can again be seen as a politically necessary complement to the market-oriented approach in financial services law in general, and in credit law in particular.

At the same time, the EU legislator has, until now, not been able to regulate consumer insolvency and debt relief procedures as such. This policy is, however, reflected in contract law as well as in unfair commercial practices law.

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[56] Judgment of 14 June 2012, Case C-618/10 *Banco Español de Crédito SA v Joaquín Calderón Camino*, not yet reported, para 54. Emphasis by the author.

[57] AG Trstenjak, 14 February 2012, Case C-618/10 *Banco Español de Crédito*, paras 48 ff.

[58] See, for example, Council Resolution on consumer credit and indebtedness, [2001] OJ C 364/1; Commission's Communication on financial literacy, COM(2007) 808 final. See also recital (28) of the proposal for a Payment Account Dir: 'In order to minimise the risk for consumers to become financially excluded, Member States should improve financial education, including at school, and combat over-indebtedness'.

33.3.5.1 Contract Law

Recognising the risk of credit for low-income consumers, the EU legislator has, cautiously, begun to introduce the principle of responsible lending in credit legislation. The starting point was the proposal of 2002[59] for what became the Consumer Credit Directive 2008/48/EC. According to Article 9 of that proposal, the creditor should be assumed to have previously assessed, by any means at his disposal, whether the consumer can reasonably be expected to discharge their obligations under the credit agreement;[60] and under Article 6(3) the creditor should have advised the consumer accordingly. With this proposal, the Commission aimed at avoiding the consumer's over indebtedness by avoiding unreasonable credit contracts in the first place. Although Article 8 of Directive 2008/48/EC only contains a significantly watered down version of this in the form of a duty to assess the consumer's creditworthiness, the legislative history shows that this duty is meant to protect the individual consumer in his or her relationship with the creditor. Thus, Article 8 forms part of European private law, and its aims and objectives are not satisfied by implementation at the national level (such as the German implementation) that denies private law protection from over indebtedness to consumers at risk.[61]

This becomes even clearer when one looks at the most recent developments. In the meantime, the Commission tries to go even further by disallowing credits to consumers who cannot afford them. This is particularly striking when one compares the proposal for a Mortgage Credit Directive to Article 8 of the Consumer Credit Directive. Article 14 of the proposed Mortgage Credit Directive contains the same duty to perform a creditworthiness assessment. However, the creditor would have to refuse credit if the assessment of the consumer's creditworthiness results in a negative prospect for his ability to repay the credit over the lifetime of the credit agreement.

Even stricter are the rules of the proposed Payment Account Directive that directly aim at low-income consumers. According to its Article 16(4), Member States shall ensure that the consumer is not offered any overdraft facilities in conjunction with the payment account with basic features.

33.3.5.2 Unfair Commercial Practices Law

Since it has long been recognised that, in particular, advertising has a strong effect on consumers by channelling his or her decisions towards a certain product or trader, it is only consequent to consider the vulnerability of the low-income consumer already at the stage of unfair commercial practices law.

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[59] COM(2002) 443 final, [2002] OJ C 331E/200.

[60] For details see P Rott, 'Mitverantwortung des Kreditgebers bei der Kreditaufnahme—Warum eigentlich nicht?' (2003) *Zeitschrift für Bank- und Kapitalmarktrecht* 851.

[61] For details see P Rott, E Terryn and C Twigg-Flesner, 'Kreditwürdigkeitsprüfung: Verbraucherschutzverhinderung durch Zuweisung zum Öffentlichen Recht?' (2011) *Verbraucher und Recht* 163.

Tying is a practice that takes advantage of needy consumers by making a service dependent on the purchase of another, unnecessary, service. The EU legislator has understood the special vulnerability of low-income consumers facing those practices and introduced a prohibition of tying basic telecommunications products with further services as early as in 2002. According to Article 10(1) of the Universal Service Directive 2002/22/EC, Member States ensure that universal service providers establish terms and conditions in such a way that the subscriber is not obliged to pay for facilities or services which are not necessary or required for the service requested. A prohibition of tying including information of the consumer of that prohibition also features in the proposed Payment Account Directive.[62] Member States have also reacted to such specific vulnerabilities. Tying of banking services is prohibited under French law unless the services concerned can also be purchased individually or cannot be separated.[63] In Italy, it is not allowed to tie compulsory car insurance liability to other insurance services.[64] Whilst the EU legislator has not taken these practices up yet, it does allow their consideration at national level, at least as far as financial services are concerned. Article 3(9) of the Unfair Commercial Practices Directive 2005/29/EC exempts financial services from the maximum harmonisation approach of that Directive, and the EU Commission has decided not to make an attempt to change this now.[65]

The other side of the coin is that the limited access to certain goods or services that are usually unaffordable may induce consumers to make imprudent decision when being offered to them surprisingly. Again, at national level, special incentives to low-income consumers have been considered by means of the prohibition of certain advertisement. For example, under French law, it is prohibited to categorise monthly repayments as 'rental payments' or referring, for the calculation of instalments, to social security benefits which are not guaranteed throughout the duration of the contract.[66] The prohibited practices obviously target those consumers who live on state welfare.

Article 5(3) of Directive 2005/29/EC deals with vulnerabilities but does not cover vulnerability due to poverty. One could, however, think about low-income consumers as a special group in the terms of Article 5(2) of that Directive. According to Article 5(2), the benchmark for the assessment of unfairness is the average consumer. Where a commercial practice is directed to a particular group of consumers, the average member of that group is relevant. Arguably, as the just mentioned French example shows, traders do specifically tailor advertisements towards low-income consumers, in particular in the area of financial services. Another example would be advertisement for credit without creditworthiness assessment ('ohne Schufa'). Thus, the typical vulnerability of an average low-income consumer could, and should, be considered under Article 5(2) of Directive 2005/29/EC.

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[62] See Arts 15(6) and 19(2) of the proposal.

[63] Art L 312-1-2(1) of the French Monetary and Financial Code.

[64] Art 170 of the Italian Private Insurance Code.

[65] See the Communication on the application of the Unfair Commercial Practices Directive, COM(2013) 138 final, 6.

[66] Art L 312(6) Code de la consommation.

33.3.6 Summing Up

The examples show that the EU legislator does not shy away from including social policy, or social inclusion, considerations into private law instruments that (predominantly) pursue internal market aims. The reasons for this may be manifold, and they may partly lie in the limited competence of the EU in the area of social policy. However, EU law certainly reflects the fact that it is private actors (traders) whose actions in private law relationships with low-income consumers may have huge impact on those consumers' lives, and the recognition that consequently social protection must be afforded within that private law relationship; thus, by private law rules. The EU legislator is developing coherent protective instruments in areas that it considers 'of general interest' in the sense of 'necessary in order to allow citizens to fully enjoy their fundamental rights'[67] or in the sense of social inclusion; dealing with access, affordability, continuity and quality standards. As the example of payment accounts shows, it thereby progresses beyond the classical services of the network industries. EU law has also begun to acknowledge the special vulnerability of low-income consumer towards marketing practices by which traders try to exploit access problems or unsatisfied desires.

The Court of Justice has used suitable cases such as *Mohamed Aziz* and *Banco Español de Credito* to include social considerations in the interpretation of general terms such as 'unfairness'. Article 5(2) of Directive 2005/29/EC would seem to offer similar possibilities in unfair commercial practices law. Finally, the EU is progressing into the area of poverty prevention through private law mechanisms such as responsible lending. The Member States have to follow suit, and they cannot simply uphold traditional ideas of a 'neutral' private law that ignores the poverty of one contracting partner. The low-income consumer has become a special figure in European and Europeanised private law; a figure, however, that needs further research as to its particularities beyond mere lack of funds. I have no doubts that Hans Micklitz will continue to contribute to that research and debate.

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[67] See the White Paper on Services of General Interest, COM(2004) 374 final, 4.

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Chapter 34
From the Kennedy Message to Full Harmonising Consumer Law Directives: A Retrospect

Klaus Tonner

Abstract This contribution looks to the past of consumer law. There are two reasons for doing so: the personal one is that this author accompanied Hans Micklitz during the first years of his career in Hamburg, Bremen and Berlin, when we established in 1986, together with Udo Reifner, the law journal *Verbraucher und Recht*, and the academic one is that an answer to the question in which direction a development might go is easier to be found when you know where it comes from.

So this contribution draws an arc between the US consumer policy of the Kennedy era and its spread over to Western Europe—that is to say to the states of Western Europe, not to the then EEC—and the completion of the first generation of consumer (contract) Directives with the Sales of Consumer Goods Directive in 1999 and to the full harmonisation approach of the second generation of Directives. At the beginning, Member States were active, whereas the EEC only adopted programmes which were not implemented; at the end of this period, the question is what will be the next steps after targeted full harmonisation. In retrospect it becomes clear that the relation between national and European influence in consumer law cannot be fixed to a certain stage but is subject of a process of continuing changes.

Hans Micklitz is, as the author of this contribution, a contemporary witness of the decades described herein, and he contributed substantially not only to academic discussions, but also to the process of political decision-making. Younger readers may find access to the historical background of today's consumer law.

34.1 Introduction

In 1980 and 1981, a series of books were published dealing with the consumer law of the nine Member States at that time. The series was mandated by the Commission of the European Economic Community; the purpose was to deliver a comprehensive comparative law study as the basis for building a European consumer law. The editors of the series and the authors of the volumes about comparative law and German

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*, Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_34,

law were an already well known Professor, Norbert Reich, and a young academic scholar, Hans Micklitz.[1]

None of the consumer law Directives had been adopted in those days; the landscape of European consumer law was like a desert, except for a not implemented programme from 1975. The series of books dealt with national law and helped to start the project of European consumer law. So the development of European consumer law and also the academic career of Hans Micklitz started with the same couple of books in the early 1980s.

Many of the contributions of this Festschrift will look forward to the future of consumer law as well as other areas of law. This contribution, however, does the opposite: It looks back. There are two reasons for doing so: the personal one is that this author accompanied Hans Micklitz during the first years of his career in Hamburg, Bremen and Berlin, when we established in 1986, together with Udo Reifner, the law journal *Verbraucher und Recht*, and the academic one is that an answer to the question in which direction a development might go is easier to be found when you know where it comes from.

So this contribution draws an arc between the US consumer policy of the Kennedy era and its spread over to Western Europe—that is to say to the states of Western Europe, not to the then EEC—and the completion of the first generation of consumer (contract) Directives with the Sales of Consumer Goods Directive in 1999[2] and to the full harmonisation approach of the second generation of Directives. At the beginning, Member States were active, whereas the EEC only adopted programmes which were not implemented; at the end of this period, the question is what will be the next steps after targeted full harmonisation. In retrospect it becomes clear that the relation between national and European influence in consumer law cannot be fixed to a certain stage but is subject of a process of continuing changes.

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34.2 Consumer Policy as Expression of Welfare Policy in the 1960s and 1970s

34.2.1 Starting Point: The Kennedy Message

The origin of modern consumer policy in western states is a shift from a liberal—in some states ordo-liberal economic approach to a Keynesian orientation of the

[1] See N Reich and H-W Micklitz, *Consumer Legislation in Germany* (Wokingham, Van Nostrand Reinhold, 1980); id, *Consumer Legislation in the EC Countries: A comparative Analysis* (Wokingham, Van Nostrand Reinhold, 1981).

[2] Dir 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees, [1999] OJ L 171/12.

economic policy of states. The confidence in the capability of the state to regulate social problems was nearly unlimited. It was the general opinion, that liberal markets led to 'market failure', and that the state has to intervene to make markets functioning. The state was regarded as being responsible to provide for social goods which were not delivered by the market. Prevention for the risks of daily life was regarded as an area of responsibility of the state. State meant the national state; the perspective was not a global one and was restricted to industrialized countries.

It is not surprising that consumer policy became part of such an orientation of economic policy. The market does not fulfil its promises with regard to prices and quality of consumer goods and services, and the state was considered responsible in providing redress for its citizens. It is also not surprising that the starting point for consumer policy was in the US as the most advanced economy. There is no need to characterize this development in detail, but we may recall the famous Kennedy message, which is regarded as the symbolic beginning of western style consumer policy. It begins with the famous words 'consumers, by definition, include us all.' The four rights, which today are part of Art 169 TFEU are

- the right to safety—to be protected against the marketing of goods which are hazardous to health or life;
- the right to be informed—to be protected against fraudulent, deceitful, or grossly misleading information, advertising, labelling or other practices, and to be given the facts the consumer needs to make an informed choice;
- the right to choose—to be assured wherever possible, access to a variety of products and services at competitive prices, and in those industries where competition is not workable and Government regulation is substituted, an assurance of satisfactory quality and services of fair prices;
- the right to be heard—to be assured that consumer interests will receive full and sympathetic consideration in the formulation of Government policy, and fair and expeditious treatment in its administrative tribunals'.[3]

34.2.2 Transfer to National Policy

As already mentioned, the ideas of US consumer policy were not transferred to the European level, but to the Member States—and it took a decade from the Kennedy message to declarations of consumer policy in Europe. To take, as an example, Germany as the home country of this author, two reports were adopted by the government in 1971[4] and 1975.[5] They differ from the Kennedy message and from the following EEC programme, as they focus on the market position of the consumer, safety, environmental protection, public services, and consumer organizations. In particular, the idea of strengthening the position of the consumer, be it individual, be it collective, is

[3] JF Kennedy, 'Special Message to the Congress on Protecting the Consumer Interest' (1962), www.presidency.ucsb.edu/ws/?pid=9108.

[4] Bundestags-Drucksache (Federal Gazette; BT-DrS) VI/2724.

[5] BT-DrS 7/4181.

of interest. There may be even drawn a line from these early documents to the recent coalition agreement of the new German government, which came into office in December 2013, which underpins the role of consumers and their organisations as market monitors ('Marktwächter').[6] It is not the weak consumer who must be protected in an individual case, but the consumer must be strengthened by giving him or her substantive rights—individual rights and the right of acting collectively.

34.2.3 Transfer to European Policy

The declarations of the EEC in the 1970s and the 1980s are closer to the US model than the German reports. There was a first programme in 1975.[7] On a Paris summit, the heads of states and governments had decided in 1972 to act in the field of consumer policy; after the summit the first programme was drafted by the Commission and adopted by the Council. Two follow-up programmes were adopted by the Council in 1981[8] and 1986.[9]

According to the first programme 'consumer rights may be summed up by a statement of five basic rights:

- the right to protection of health and safety;
- the right to protection of economic interests;
- the right of redress;
- the right to information and education;
- the right of representation (the right to be heard).'[10]

There was some debate as to whether the EEC had any competence to act in those days, as the provision on consumer policy was only introduced by the Maastricht Treaty in 1992. The programme refers to the broad wording of then Art 2 EEC Treaty (now Art 3 [3] TEU).

34.2.4 Transfer to the Global Level

The idea of consumer protection also reached the global level. In 1985, the General Assembly of the United Nations adopted Guidelines for Consumer Protection.[11] As

[6] CDU and SPD, 'Deutschlands Zukunft gestalten, Koalitionsvertrag zwischen CDU, CSU und SPD, 18. Legislaturperiode' (2013) 124 ff.

[7] Preliminary programme of the European Economic Community for a consumer protection and information policy, [1975] OJ C 92.

[8] Second programme for a consumer protection and information policy, [1981] OJ C 133.

[9] Council Resolution of 23/6/1986, [1986] OJ C 167/1.

[10] Preliminary programme for a consumer protection and information policy.

[11] United Nations General Assembly, Consumer Protection, Resolution No 39/248 of 9 April 1985; on which see D Harland 'The United Nation Guidelines for consumer protection' (1987) 10 *Journal of Consumer Policy* 245.

UN soft law, these guidelines cannot represent the interests of industrialized countries only, and in fact, the guidelines are not only western style consumer protection. They include the basic rights according to the Kennedy message and the 1975 EEC programme and refer to the information model,[12] but also take into account the needs of consumers in developing countries.[13] The Guidelines use the term of 'essential goods and services', which should be available also in rural areas and for that part of the population that lives in poverty. Special attention is given to food, clean water, and pharmaceuticals.

In the 1990s, the Guidelines were 'greened'. Provisions following a relevant section of the Rio Declaration from 1992 were added to the Guidelines.[14]

34.3 Competition Between EEC and Member States

34.3.1 European Level

The EEC programme of 1975 included not only general principles, but also a comprehensive number of actions, which should have been taken at European level. Among these were the harmonization of the conditions of consumer credit, measures against false or misleading advertising, against unfair commercial practices, which include unfair terms, door-to-door sales, unsolicited goods, the harmonization of product liability and improving the quality of services. In other words, this was the programme for the Directives adopted between 1985 and 1999, which we call the first generation of consumer protection directives. But no piece of legislation was passed in the years to follow immediately after 1975. Why?

The reason is at least twofold: first, there is a formal reason. According to the EEC Treaty, before the entry into force of the Single European Act in 1987, the Council had to adopt proposals of the Commission unanimously. The legal basis for such directives was Art 100 of the original Rome Treaty dealing with harmonization of law. The internal market provision was only passed as an amendment of the Treaty in 1987.

But in our view, not legal, but political reasons were the main cause for the Council not to pass consumer protection directives. Consumer protection was a playing field of the Member States; they had only discovered this topic a short time earlier; and they did not want to hand it over to another law-maker. Simply speaking, the time was not ripe for European consumer protection in the 1970s.

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[12] 'Access to adequate information to enable … [consumers] to make informed choices (…)', no 3 (c) of the Guidelines.

[13] See AH Benjamin 'Consumer protection in less developed countries—the Latin American experience' (1996) 4 *Consumer Law Journal* 47.

[14] See K Tonner, 'Towards a sustainable consumer contract law' (2012) 10 *Zeitschrift für Europäisches Umwelt- und Planungsrecht* 56.

34.3.2 Member States

The Member States saw in the 1970s a lively development of consumer protection by legal instruments. They were discussed as measures of national policy, consumer markets were, or at least seemed to be, national markets and nobody took care whether such legislation had a cross border impact. Member states were the first on the playing ground.[15]

We will give some examples from Member States' legislation, which later influenced European legislation, and begin with standard terms regulation in Germany. This country had—and has—a rich jurisdiction in this field, which was transposed to a formal act in 1976, the AGB-Gesetz (Act on standard contract terms). This act was based on a general clause which gave courts the opportunity to continue their case law even after the adoption of the AGB-Gesetz. Further, it includes a right of consumer associations to take action against unfair standard terms. Both proved to be a success story. Meanwhile, the general clause became part of the Civil Code, the BGB, whereas the provisions on the right to take action were transferred to the Unterlassungsklagengesetz (Injunction Claims Act).[16]

Other examples, where German rules were 'on the national market' a long time before the adoption of European legal instruments were the right to withdraw from a consumer credit contract (in Germany since the Consumer Credit Act 1990,[17] at EU level only since Directive 2008/48/EC), or the travel law sections in the Civil Code since 1979, whereas the Package Travel Directive was adopted only in 1990. Also Belgium[18] and France[19] adopted legislation protecting the travelling consumer a long time before the Package Travel Directive.

In the 1970s, France developed a set of withdrawal rights, which were far more comprehensive and earlier[20] than the relevant rules of the original Doorstep Sales Directive.[21] The same is true with regard to the Distance Selling Directive.[22] A UK example is the monitoring of Codes of Conduct by the Office of Fair Trading. Other examples from other Member States could be added; not at last they are reported in the series of books edited by Norbert Reich and Hans Micklitz, mentioned in the introduction of this contribution.

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[15] Consumer law books were published on national, not European law. A first book on European consumer law was L Krämer, *EEC Consumer Law* (Louvain-la-Neuve, Centre de Droit de la Consommation, 1986), which in its structure followed the Reich and Micklitz series.

[16] This act was a transposition of Dir 98/27/EC.

[17] The Verbraucherkreditgesetz (Consumer Credit Act) was the transposition of the original Consumer Credit Dir, 87/102/EEC. Whereas the Directive did not provide for a withdrawal right, the German act of 1990 did so—making use of the minimum harmonisation principle.

[18] Act of 30/3/1973.

[19] Loi no 75-627.

[20] Loi no 72-1137.

[21] Dir 85/377/EEC, now part of the Consumer Rights Dir (Dir 2011/83/EC).

[22] Loi no 88-21; Dir 97/7/EC, now part of the Consumer Rights Dir (Dir 2011/83/EC).

We can summarize that the consumer protection laws of the Member States were no traditional laws, but only recently adopted, when the EEC entered the scene not only with programmes, but with legislation in the second half of the 1980s.

34.4 Shift to the European Level in the 1980s and 1990s

34.4.1 Single European Act

It could have been foreseen that the 'victory' of the Member States in the 1970s to play the fundamental role in consumer law, was not final. The 1980s and 1990s saw the shift from Member States to the European level with regard to the responsibility in consumer law. Again, the reasons were twofold.

A formal reason was provisions of the Treaty. The internal market project of the Delors Commission arose. It was linked with the first amendment[23] of the original Rome Treaty, the Single European Act. The core provision of this Treaty was the internal market rule of Art 100a EEC Treaty (since the Amsterdam Treaty Art 95 EC, today Art 114 TFEU). According to this rule, majority voting for purposes of establishing the internal market was sufficient. The unanimity rule of Art 100 EEC Treaty was maintained, but could be circumvented, if a proposal of a legal instrument was of relevance for the functioning of the internal market. If it could be pointed out in the recitals of a legal instrument that the instrument would contribute to the functioning of the internal market, the mechanism of majority voting in the Council according to Art 100a EEC Treaty could—and can—be employed.

It was not surprising that this new possibility was used also in the field of consumer protection. The Directives of the 1980s were based on the old mechanism of Art 100 EEC, that is to say unanimity. The proposals of these Directives were published already in 1976[24] respectively in 1977[25] and 1979.[26] It was due to the complicated process, according to Art 100 EEC Treaty, that they were not adopted earlier. All the other ones, beginning with the Product Liability Directive,[27] were based on Art 100a EEC. Even after the provision on consumer policy in the Maastricht Treaty came into force, this practice was not changed, but the Commission maintained Art 100a respectively Art 95 EC as basis for its proposals. The possibilities of Art 129a EEC Treaty, since the Amsterdam Treaty Art 153 EC, now Art 169 TFEU, to serve as basis for the legal instruments were never tested.[28]

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[23] Except the accession treaties with new Member States.

[24] [1976] OJ C 241/6: Product Liability Dir 85/374/EEC.

[25] [1977] OJ C 22/6: Doorstep Sales Dir 85/577/EEC.

[26] [1979] OJ C 80/6: Consumer Credit Dir 87/102/EEC.

[27] Dir 85/374/EEC; see also H-W Micklitz, in N Reich, H-W Micklitz, P Rott and K Tonner, *EU Consumer Law,* 2nd ed (Cambridge, Intersentia, 2014) ch 6.

[28] With one exemption, Dir 98/6/EC on consumer protection in the indication of the prices of product offered to consumers.

This raises the question, whether consumer policy became really a part of internal market policy, or whether it was only tricky to make use of Art 100a EEC to pass legal instruments of consumer policy, either to circumvent Art 100 EEC or to disguise that there was—before Maastricht—no authorization in the Treaty for consumer protection measures. Consumer policy was described as by-product in relation to internal market policy.

The consumer protection policy of the Member States in the 1970s and the programmes of the Commission from 1975 and 1981 were not the same as the consumer policy under the internal market rule. The legal instruments of the 1970s were designed as part of social policy to protect the weaker party to the contract. They were part of a welfare state. In the second half of the 1970s faith in to successfully balance market failure got lost. 'State failure after market failure' was one formula. Neo- liberal theories came up and dominated the economic policy of the states. This was not without influence on consumer policy. Consumer protection policy changed to consumer policy; 'protection' was denounced as 'paternalistic'. The confident consumer entered the scene.[29] So it is not by chance that the internal market rule was used to establish consumer policy.

34.4.2 The Role of the ECJ

The possibility of the Commission and Council establishing a European consumer policy was substantially supported by the European Court of Justice (now Court of Justice of the European Union). Through case law the Court struck down provisions of the Member States which contradict the free movement of goods (then Art. 30 EEC Treaty). The European legislator could establish new law on the European level on the, so to speak, cleared grounds. It is not necessary to explain here the *Cassis de Dijon* doctrine of the ECJ again,[30] as this is well known, but I will expose that this doctrine did not only enable the European legislator to establish new rules on the cleared grounds but even forced it to do so.

The ECJ introduced a three steps test. The national provision at stake must impede the free movement of goods. This is understood in a wide sense according to the *Dassonville* formula,[31] and therefore many national provisions are considered by the ECJ, in other words the autonomy of Member States to pass their own (consumer protection) acts is restricted by the requirements of the free movements of goods. At the second step, Member States may object that the national law may protect their 'general interests'. It is the ECJ which defines what a general interest is and, according to the Court, consumer protection is, since *Cassis*, one of the general interests that are accepted by the ECJ. That is to say that Member States are free to establish their own systems of consumer protection, including legal instruments, as long as they can argue that the legal act at stake protects consumers, even if it inter-

[29] For critique see T Wilhelmsson, 'The abuse of the "confident consumer" as justification for EC consumer law' (2004) 27 *Journal of Consumer Policy* 317.

[30] Case 120/78 *Rewe-Central AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

[31] Case 8/74 *Procureur du Roi v Benoît and Gustave Dassonville* [1974] ECR 837.

feres with the free movement of goods. But whether the provision at stake is really a consumer protection measure is under control of the ECJ. This is the third step, the proportionality test. So Member States are free to adopt their own consumer protection rules, but only if they can give evidence before the ECJ, that they are really consumer protection rules (and not only hidden protectionist instruments), and that they meet the standard of proportionality.[32]

The consequent approach taken by the Commission was that *Cassis* could be used as a 'weapon' not only against alleged consumer protection but in fact protectionist national legal instruments. As the line between an alleged and non-proportionate legal act and a really consumer protecting act cannot be drawn without difficulties, Member States could no longer establish legal concepts of consumer protection on their own without taking into account the European aspect of the matter. On the other hand, the Commission had to take into consideration that Member States are allowed in principle to adopt their own legal instruments, especially if there is no regulation of the specific general interest at European level. This was the basis of the re-establishing of a system of consumer protection at European level. It was combined with the minimum standard principle, which grants Member States their autonomy for their own rules—as long as they are proportionate. A national rule, which goes beyond a minimum standard provision of a Directive, is not necessarily in all cases considered to be non-proportionate, but is in danger of being so.[33] So even in the days of the minimum standard principle, Member States were not absolutely free with rules which went further.

34.4.3 The First Generation of Consumer Protection Directives

The minimum standard policy was, of course, not only a result of the ECJ case law, but mainly a political decision for more cooperation with the Member States—and it was finally successful. All the Directives, which were already part of the programmes of 1975 and 1981, were adopted one by one in the 1980s and 1990s. The core of consumer law at European level was consumer contract law. Seven Directives dealt with contract law, beginning with the Doorstep Sales Directive in 1985 and ending with the Sales of Consumer Goods Directive in 1999. They were accompanied by the Product Liability Directive, two Directives dealing with unfair commercial practices (first the Directive on Misleading Advertising[34] and then the Unfair Commercial Practices Directive[35]) and Directives for the enforcement of consumer law.[36]

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[32] One of the many examples is the purity of German beer rule, which protected German breweries against competition from abroad, case 178/84 *Commission v Germany* [1987] ECR 1227.

[33] Case C-205/07 *Gysbrechts and Santurel Inter BVBA* [2008] ECR I-9947. See also N Reich, 'The ECJ and the autonomy of Member States—Some critical remarks on the use and methodology of the proportionality principle in the internal market case law of the ECJ' in H Altmeppen et al (eds), *Festschrift für Günther H. Roth zum 70. Geburtstag* (Munich, CH Beck, 2011) 615.

[34] Dir 84/450/EEC.

[35] Dir 2005/29/EC.

[36] Especially the Dir on injunctions for the protection of consumers' interest, originally Dir 98/27/EC, now Dir 2009/22/EC.

At the beginning, the Directives did not affect core matters of contract law. They picked up new business practices, those which were unfair or were caused by new technological developments, especially the internet. It was a development from the margin to the core.[37] The Doorstep Sales Directive and the Timeshare Directive[38] were two examples, in which the consumer is protected against unfair business practices by means of contract law, whereas the Distance Selling Directive is an example for the consumer's getting acquainted with the internet.[39] In the eyes of the Commission, the internet plays a leading role for the establishment of the internet market; so the European legislator has to guarantee by legal instruments that the consumer is not deterred from using it.

Only with the Unfair Contract Terms Directive of 1993[40] did the European legislator come closer to the core of contract law, followed by the Sales of Consumer Goods Directive of 1999, which was the last and most important step towards core matters of national contract law.[41] But the legislator circumvented, in all the Directives, a definition of contract. In the E-Commerce-Directive, e.g., it used the terms 'order' and 'confirmation' instead of 'offer' and 'acceptance'. It was left to the CESL project to go a step further. But it remains to be seen whether the CESL will ever be adopted.

The minimum harmonisation principle does not mean unification of the laws of the Member States. It is only an approximation. To disguise the difference between unification and approximation, the imprecise term of harmonisation is used. 'Approximation' makes it clearer that the goal to remove barriers for the internal market cannot be realized in this way.

On the other hand, minimum harmonisation does not allow Member States uncontrolled own policy beyond the standard. We already mentioned the limitations as identified by the ECJ, but in practice, since the middle of the 1980s, own initiatives of the Member States nearly disappeared. The governance of consumer policy was in Brussels, no longer in the Member States. In particular, it was the European legislator that picked up new developments such as the internet. Shared liability was only in theory: initiatives came from the Commission, Member States implemented them. Of course, this does not mean that there were no exceptions to this observation, for example on cold calling in Germany.[42]

It cannot be surprising that the Commission took the first opportunity to switch from minimum to full harmonisation. This happened after the completion of the seven consumer contract law Directives of the first generation by the follow-up programme of 2002.[43]

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[37] See K Tonner, 'Die Rolle des Verbraucherrechts bei der Entwicklung eines europäischen Zivilrechts' (1996) *Juristenzeitung* 533.

[38] Dir 97/47/EC, now Dir 2008/122/EC.

[39] And the E-Commerce Dir 2000/31/EC, which is no mere consumer protection Directive.

[40] Dir 93/13/EEC.

[41] On which see Micklitz in Reich et al, *EU Consumer Law,* ch. 4.

[42] Gesetz zur Bekämpfung unlauterer Telefonwerbung (Act against unfair commercial practices by telephone) of 2009.

[43] COM(2002) 208.

34.5 The First Decade of this Century

The full harmonisation option was somehow hidden in the Consumer Policy Strategy 2002–2006,[44] as other areas than contract law stood in the foreground in this period. Especially, the Unfair Commercial Practices Directive was drafted and adopted.[45] Though one piece of legislation of the time, the Directive concerning the distance marketing of consumer financial services,[46] already followed the full harmonisation approach in contract law, it was only the next Consumer Policy Strategy[47] and in particular the proposal of a Consumer Rights Directive,[48] which led to a comprehensive discussion. The idea of full harmonisation was rejected by academic writers[49] and also by Member States.[50] The proposal of the Consumer Rights Directive failed, only a much reduced part of the original proposal was adopted by Parliament and Council.[51]

Again, a compromise was at hand. As the minimum standard of the 1980s was a compromise between acting fully in the field of consumer protection or not at all, this time 'targeted harmonisation' was the compromise.[52] This meant that Member States remained free to adopt legislation in sectors where there is no relevant provision in a European legal instrument, but must not alter provisions of the European legislator. For example, a national legislator is free to apply the provisions of the transposition act of the Unfair Commercial Practices Directive also to business to business relations, which are not covered by the Directive, but a national legislator must not change a period set out in the Directive, e.g. a withdrawal period.

It seems that the targeted full harmonisation principle might work, though it is sometimes difficult to draw the line as to what the implementing national legislator is allowed to do and what not. The Consumer Policy Strategy 2007–2013 was implemented in that sense, that is to say that meanwhile a new Consumer Credit

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[44] Ibid.

[45] See G Howells, H-W Micklitz and T Wilhelmsson, *European Fair Trading Law* (Aldershot, Ashgate, 2006).

[46] Dir 2002/65/EC.

[47] COM(2007) 99.

[48] COM(2008) 614; on which see G Howells and R Schulze, 'Overview of the proposed consumer rights Directive' in G Howells and R Schulze (eds), *Modernising and Harmonising Consumer Contract Law* (Munich, Sellier, 2009) 3.

[49] See H-W Micklitz and N Reich, 'Crónica de una muerte anunciada: The Commission proposal for a Directive on Consumer Right' (2009) 46 *CML Rev* 471; P Rott and E Terryn, 'The proposal for a Directive on consumer rights: no single set of rules' (2009) *Zeitschrift für Europäisches Privatrecht* 456; K Tonner and M Tamm, 'Der Vorschlag einer Richtlinie über Rechte der Verbraucher und seine Auswirkungen auf das nationale Verbraucherrecht' (2009) *Juristenzeitung* 277.

[50] See the then Minister of Justice B Zypries, 'Der Vorschlag für eine Richtlinie über Verbraucherrechte' (2009) *Zeitschrift für Europäisches Privatrecht* 225.

[51] Dir 2011/83/EC.

[52] See H-W Micklitz, 'The targeted full harmonisation approach: looking behind the curtain' in Howells and Schulze (eds), *Modernising and Harmonising Consumer Contract Law,* 47.

Directive[53] and a new Timesharing Directive[54] follow the new approach. The new Consumer Rights Directive is also a targeted full harmonisation Directive. The question is still open for the Package Travel Directive, where a proposal does not give a clear answer and shows the uncertainty of the Commission.[55] Whereas the Consumer Rights Directive includes a provision with clearly stated that this Directive is a targeted full harmonisation Directive, the proposal of a new Package Travel Directive is silent in that respect. There is also no answer as to what the Commission intends to do with unfair contract terms and sales of consumer goods after the failure of the original proposal of the Consumer Rights Directive.

The question remains what targeted harmonisation means in a series of steps in the development of consumer policy from autonomy of the Member States and not implemented programmes of the EEC to a shared responsibility, where the EEC *de facto* took the lead, but left some autonomy to the Member States. Targeted full harmonisation is not unification of the laws of the Member States. It still leaves room for national solutions, and in particular, the interdependencies between the law, which transposes directives, and autonomous parts of national law prevent consumer law in Member States being identical. In consumer law cases it is still necessary to determine the applicable *national* legal order according to the rules of the Rome I Regulation,[56] even after the transposition of the targeted full harmonising Directives of the second generation. Thus, targeted full harmonisation is only a next step, not a final solution. The relation between European and national influence must be continuously adjusted based on the insight that there is a development to more and more centralisation on the European level. But this process must be respect the characteristics of Member States and must not be too rash.[57]

34.6 Beginning of a Systematic Structure of European Consumer Contract Law?

There is another observation, when comparing the first and the second generation of consumer protection Directives. The first Directives were an archipelago, as it was called,[58] not connected among each other. They were adopted not as part of a systematic approach, but as 'stand-alone' pieces of legislation, though nearly all the Directives were already part of the first programme of 1975. The lack of a systematic approach had an advantage for the Member States as they could maintain their

[53] Dir 2008/48/EC.

[54] Dir 2008/122/EC.

[55] COM(2013) 512.

[56] Reg (EC) 593/2008.

[57] See T Wilhelmsson, 'Introduction: Harmonization and national cultures' in T Wilhelmssson et al (eds), *Private law and the many cultures of Europe* (Alphen an den Rijn, Kluwer, 2007) 3.

[58] See J Basedow, 'Das BGB im künftigen europäischen Privatrecht: Der hybride Kodex' (2000) 200 *Archiv für die civilistische Praxis* 445.

own systems and integrate the transpositions into their national systems. Especially the Dutch and German approach to integrate the Directives into their national civil codes, could be realized only because of a missing system on a European level—and because of the minimum standard which makes such integration easier.

But the 'stand-alone' approach also has disadvantages. A borderline between the directives of the first generation did not exist. They could overlap. There are two famous decisions of the ECJ, in which the judges declared the provisions about the right to withdraw of the Doorstep Sales Directive applicable in a timesharing case[59] and in a consumer credit case.[60] In both cases the court declared the unlimited right to withdraw in case of missing information about the right to withdraw applicable, though the original Timesharing Directive[61] and the original Consumer Credit Directive were silent on that right—a result, which is consumer friendly, but was probably not the intention of the legislator.

The possible overlapping of directives was eliminated by the directives of the second generation. In the Consumer Policy Strategy 2007–2013 the Commission introduced the differentiation between horizontal and vertical directives, trying to assemble four directives in one horizontal Directive: the Consumer Rights Directive, and three vertical directives (consumer credit, timesharing and package travel), that is to say, directives which affect only one economic sector. The system is still incomplete, as European consumer contract law does not only consist of these seven directives. It is for the first time that a system appears, even if only in an embryonic stage.

The basic idea is that the Consumer Rights Directive covers all business to consumer transactions which are not regulated by a special vertical directive. As at the moment, only three directives are identified as vertical directives, this means, that the Consumer Rights Directive has more than a residual character. The Consumer Rights Directive includes a long list of exemptions, which has to be criticized partly,[62] but not insofar, as cases are excluded which are subject to other directives. Each of the new directives includes a provision not only about their scope, but also about distinguishing them from other directives. Each of the directives stands on its own feet and does not refer to other directives. In particular, the Consumer Rights Directive is not the general part of consumer contract law. That is to say that one has to apply only one directive in a given case—exactly the opposite of the *Travel Vac* and *Heininger* decisions of the ECJ.

The stand alone principle requires a careful drafting of directives to ensure their coherence. For example, the withdrawal period has to be the same in all Directives which provide for such a right. Information duties in different directives must express the same general principles of consumer law. Those principles which have to underlie all directives have to be identified.

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[59] Case C-423/97 *Travel Vac SL v Manuel José Antelm Sanchis* [1999] ECR I-2195.

[60] Case C-481/99 *Georg Heininger and Helga Heininger v Bayerische Hypo- und Vereinsbank* [2001] ECR I-9945.

[61] Dir 94/47/EC.

[62] See S Weatherill, 'The Consumer Rights Directive: How and why a request for "coherence" has (largely) failed' (2012) 49 *CML Rev* 1279.

34.7 Conclusion

The development of consumer law started with consumer protection law as part of a welfare state policy and went on with the concept of the confident consumer who had to play his or her role in the process of establishing the internal market. According to Micklitz there was a further step, the efficient consumer[63]—and today? Today the vulnerable consumer has entered the scene: recent consumer law distinguishes between the responsible and the informed consumer, who needs enforceable rights, and the vulnerable consumer who needs special protection. It seems that a new concept has appeared: the consumer is not always weak, and s/he is not always well informed. Both types of consumer exist, and both need consumer law in a differentiated way. So the main streams of the past, the weak consumer and the informed consumer, may be connected together in the future. But it should be stressed that even the 'informed' consumer acts in asymmetric markets, so that mandatory (contract) law as special consumer law is indispensable.

The core of the consumer protection law of the Member States in the 1970s was mandatory contract law; it was shifted to the European level in two steps, first by minimum standard, then by targeted full harmonisation Directives. Now, for the first time, a somehow systematic approach to European consumer contract law appears. But the development is not at its end. Private law mechanism must be combined with public law, new types of contracts especially those dealing with services of general interest[64] need regulation, to mention only two of the many keywords.

It was Hans Micklitz in his Gutachten für den 69. Deutschen Juristentag,[65] who asked for a movable system (bewegliches System) 'that allows for connecting substantive rights and remedies to the different concepts of consumers, vulnerable, confident and responsible.' Let us work on that.

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[63] See Micklitz, 'The targeted full harmonisation approach'.

[64] On which see P Rott, 'Consumers and services of general interest: Is EC consumer law the future?' (2009) 30 *Journal of Consumer Policy* 49.

[65] H-W Micklitz, *Brauchen Konsumenten und Unternehmen eine neue Architektur des Verbraucherrechts?*—Gutachten A zum 69. Deutschen Juristentag (Munich, CH Beck, 2012). In English Do Consumers and Business Need a New Architecture of Consumer Law? (2013) 32 *Yearbook of European Law* 266.

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Chapter 35
Contra Emptor Interpretation-Protecting Service Providers from EU Law

Christopher Willett

Abstract UK courts and legislators display a tendency to interpret EU consumer protection rules in a manner that prioritises regulation of business processes over direct regulation of the substantive consequences of these processes. The result is that consumers are afforded a lower level of consumer protection than may have been intended and, indeed, we might say that service providers are protected from consumers. I label this 'contra emptor' interpretation: an approach to interpretation of law that protects the stronger party. This stands in contrast to the 'contra proferentem' interpretation principle which is traditionally applied to documents to protect the weaker, rather than the stronger, party.

35.1 Introduction

35.1.1 Hans Micklitz

I am honoured and delighted to play a part in this tribute to Hans Micklitz, who has been a friend and academic inspiration to me for almost 25 years. Hans has made a remarkable contribution to scholarship, especially in consumer law, contract law and EU law. He just never seems to stop giving, when it comes to innovative thinking and original critiques, constantly inspiring the rest of us to think about old and new rules and regimes in fresh ways. I have lost count of the times I have read work by Hans or listened to him giving a conference presentation and begun by thinking: 'what are you on about?', only for this to give way to: 'ah, now I see, that is a very interesting and new way of looking at things-I wish I could have ideas like that!'. Whether or not Hans agrees with my arguments here, I hope he will view them as a worthwhile attempt to see things in a slightly different way.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_35,

35.1.2 The Argument

UK courts and legislators display a tendency to interpret EU consumer protection rules in a manner that prioritises regulation of business processes over direct regulation of the substantive consequences of these processes. The result is that consumers are afforded a lower level of consumer protection than may have been intended and, indeed, we might say that *service* providers are protected from consumers. I label this 'contra emptor' interpretation: an approach to interpretation of law that protects the stronger party. This stands in contrast to the 'contra proferentem' interpretation principle which is traditionally applied to documents to protect the weaker, rather than the stronger, party.

35.2 The Ethics of EU Consumer Law and the Role of Protection

35.2.1 Market Ethics

One can perhaps infer quite readily from the above summary that the focus here is on areas in which EU consumer law might be said to set a *higher* level of protection than pre-existing national law: national institutions then choosing to read these EU rules in a way that reduces their protective effects. Now, before proceeding further, I should make it 'crystal clear'[1] that I recognise that EU consumer law is certainly not always more protective than national law. EU law sometimes, perhaps very often, reduces or removes national standards of protection. Scholars such as Hans and others have regularly highlighted the tensions that often exist between EU concepts and goals such as free movement, developing the single market, the efficient and the (presumed to be) well informed and circumspect consumer, on the one hand; and traditional national concepts of consumer protection and social justice on the other hand.[2] Sometimes, it is these overarching EU market-orientated values that lie behind traditional national protection rules being characterised as barriers to trade and struck down on this basis;[3] or that lead to rules of positive harmonisation

[1] 'Transparent', to use the parlance of our times and of a lot of 'process-orientated' consumer policy, see S Weatherill, *EU Consumer Law and Policy* (Cheltenham, Elgar, 2005) Chap. 4.

[2] See, eg, H-W Micklitz, 'Jack is out of the Box—the Efficient Consumer Shopper' (2009) *Juridiska föreningens tidskrift* 417; H-W Micklitz (ed), *The Many Concepts of Social Justice in European Private Law* (Cheltenham, Elgar, 2011).

[3] See Weatherill, *EU Consumer Law and Policy*, ch 2; although there is often perfectly legitimate debate as to whether some of the national rules were really needed for protection or, rather were simply protecting national producers from competition, see S Weatherill, 'Who is the "Average Consumer"' in U Bernitz and S Weatherill (eds), *The Regulation of Unfair Commercial Practices under EC Directive 2005/29* (Oxford, Hart, 2007) 115.

not being as protective as some traditional national rules.[4] Sometimes, there are other reasons that positive harmonisation ends up reducing national standards of protection, e.g. compromises between different doctrinal, conceptual and protection traditions existing at national level; political compromises; or just poor drafting of legislative texts.

Of course, therefore, it continues to be vital to provide critical analyses of the role of EU law in reducing necessary and legitimate levels of national consumer protection.[5] At the same time, if we are to maintain a balanced understanding of the (oft-referred to) 'multi-layered' nature of European private law, and if we are to maximise the protective potential of EU law, attention must be paid to those areas where EU law may offer greater protective potential than traditional national law rules. This is especially important if this potential is not being realised and is actually being positively obstructed at national level.

35.2.2 Protective Ethics and Tools

EU consumer law is not without protective philosophies and tools. It may be market orientated in that it starts from the position of trying to reduce barriers to trade and develop a single market. Inter alia, this involves the Treaty provisions on completion of the single market being the legal basis for most of the 'positive' EU consumer law that comes in the form of Directives.[6] It also involves consumers being cast in the role of active, efficient and confident cross border shoppers who are, or can be helped to be, reasonably well informed and circumspect, such that they will play an important role in developing the single market.[7]

Yet, protective philosophies are also present. Achievement of a 'high level of consumer protection' is an ancillary, supporting goal in positive EU law.[8] This 'high level of protection' is specified as a fundamental 'solidarity' right in article 38 of the Charter of Fundamental Rights (CFR). Also (whether or not one buys the notion

[4] E.g. where practices can no longer be banned outright by member states because the Unfair Commercial Practice Directive (2005/29/EC) insists (through full harmonisation) that they be allowed insofar as they are not on the blacklist of banned practices or are not demonstrated to affect the transactional (market) decision making of the (possibly unrealistically market attuned) 'reasonably well informed and reasonably circumspect consumer' in a manner that is contrary to professional diligence (joined cases C-261/07 and C-299/07 *VTB-VAB v Total Belguim* and *Galatea BVBA v Sanoma Magazines Belgium NV* [2009] ECR I-2949).

[5] And to use research to highlight those cases where there is a special need for national law to be allowed to act in tandem with EU law to maintain necessary levels of protection-eg on why it is vital to continue to exempt financial services and immoveable property from the full harmonisation provisions of the UCPD, see Civic Consulting, *Study on the application of the Unfair Commercial Practices Directive to financial services and immovable property* (2012), http://ec.europa.eu/justice/consumer-marketing/document.

[6] Art 114 TFEU; Weatherill, *EU Consumer Law and Policy*, Chap. 3.

[7] Micklitz, 'Jack is out of the Box'.

[8] Art 169 TFEU; Weatherill, *EU Consumer Law and Policy*, Chap. 3.

that consumers think much about what legal protection is available when contemplating shopping across borders) the fact remains that the rules are often stated to be intended to make consumers more confident to shop across borders.[9] This being the case, it is reasonable to assume that, where there is doubt as to their meaning, such rules should be understood in reasonably protective ways-as consumers will surely be less confident if they are provided with a low level of protection.

In addition, the Court of Justice of the European Union (CJEU) might be said to be showing increasing signs of applying a relatively protective ethic to the way it interprets key Directives. So the *Leitner* case famously interpreted the reference to 'compensation' in art 5 of the Package Travel Directive (PTD) to include non-material damage, such as distress and loss of enjoyment.[10] Then take the obligation in the Sale of Consumer Goods Directive (SCGD) to carry out 'free of charge' repair or replacement of goods that do not conform to the contract.[11] This might be understood only to mean that the repair or replacement itself should be free of charge. However, the CJEU has held that the obligation on the supplier to bear repair and replacement costs means that the supplier is not entitled to require any sum from the consumer to reflect prior use of the replaced goods, i.e. use before the defect emerged and repair or replacement was requested.[12] Of course, this is also a valid reading, but it is the more protective one, which seeks to protect consumers from being charged indirectly for cure.

In relation to the Unfair Terms Directive (UTD),[13] the Court has emphasised the need for precise and clear means of national implementation; and the obligation on national courts to review fairness 'ex officio'. Importantly, the CJEU has said that these interpretations are necessary in order to *recognise the weaker position of consumers and to provide proper protection*.[14] When it comes to the general clauses on unfairness under the UTD and the Unfair Commercial Practices Directive (UCPD), the CJEU has often, in giving 'interpretations', simply repeated the basic language of the test.[15] However, now there is also authority to the effect that the *interpretive* role of the CJEU extends to providing national court*s*:

> all the elements (…) which could be useful to decide the case before them (…). Among the elements which it can provide (…) the Court could (…) indicate the criteria allowing it to distinguish between the various possibilities in individual sets of facts.[16]

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[9] Weatherill, *EU Consumer Law and Policy,* 77 f.

[10] Case C-168/00 *Simone Leitner v TUI Deutschland* [2002] ECR I-2631.

[11] Art 3(3) Dir 1999/44/EC.

[12] Case C-404/06 *Quelle AG v Bundesverband der Verbraucherzentralen und Verbraucherverbände* [2008] ECR I-2685.

[13] Dir 93/13/EEC.

[14] Case C-144/99 *Commission v The Netherlands* [2001] ECR I-3541 and joined cases C-240 to C-244/98 *Oceano Grupo Editorial SA v Murciano Quintero* [2000] ECR I-4941.

[15] See case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v Hofstetter* [2004] ECR I-3403; *VTB-VAB v Total Belgium;* case C-540/08 *Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co KG v Österreich Zeitungsverlag GmbH* [2010] ECR I-10909.

[16] Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociacion de Usarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-4785, para 70; and see case C-358/08 *Aventis Pasteur*

The suggestion here does seem to be of a broader interpretive role in relation to general clauses. This could be of enormous significance given the huge range of transactions that are covered by the UTD and UCPD general clauses and the 'cradle to grave' coverage that (taken together) they provide within any given relationship.[17] Provision of interpretive guidance on these general clauses might involve a degree of 'unpacking', for instance, as to how to measure fairness in substance and whether or not formal transparency is routinely to be viewed as a 'defence' for traders where terms and practices might otherwise be viewed as unfair. There has to be a reasonable likelihood that such guidance would be inspired by a relatively protective ethic. This would reflect the 'high level of protection' and 'solidarity' policies in, respectively, the Treaty and the CFR. It would also be consistent with the abovementioned protective approach taken by the CJEU under the PTD, SCGD, UTD and UCPD. Indeed, we may now be seeing some evidence of a reasonably protective ethic being applied in interpreting the unfair terms general clause. In both the *Invitel* and *Aziz* cases, it was emphasised that fairness of contract terms should be assessed at least partly by reference to contract law default rules. [18] This might suggest quite a protective way of measuring fairness in substance, given that default rules have been set by law as a way of balancing the interests of the parties.[19] Also, the *Aziz* case in particular, seems to go further in taking a protective approach to unpacking how fairness in substance should be analysed. The term in question in *Aziz* was an 'acceleration clause', allowing the bank to call in the totality of the loan after a single failure to meet a due payment of principal or interest. The CJEU held that the national court must, in particular, assess whether the Bank's right to do this is conditional upon the non-compliance by the consumer with an *essential* obligation of the contract and whether such non-compliance is *sufficiently serious* in the light of the term and amount of the loan.[20] In short, we see an interpretation that focuses on preventing businesses from punishing consumers for non-serious breaches of non-essential provisions.

In the *Aziz* case the CJEU also said that, in order to determine whether any significant imbalance arises 'contrary to the requirement of good faith', it must be assessed whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.[21] The point here is that the Court appears to be

SA v *O'Byrne* [2009] ECR I-11305, a reference under the Product Liability Directive, where quite a significant degree of interpretive guidance was provided.

[17] The UTD covers most forms of contract and all terms except those positively excluded, while the UCPD covers most practices at the pre-contractual, performance and enforcement stage of most 'commercial transactions', see C Willett, 'Fairness and Consumer Decision Making' (2010) 33 *Journal of Consumer Policy* 247.

[18] Judgment of 26 April 2012, case C-472/10 *Memzeti Fogyasztovedelmi Hatosag v Invitel Tavkozlesi Zrt*, not yet reported) and judgment of 11 March 2013, case C-415/11 *Mohamed Aziz v Caixa d'Estalvis de Catalunya, Tarragona I Manresa* (Catalunyacaixa), not yet reported.

[19] C Willett, *Fairness in Consumer Contracts* (Aldershot, Ashgate, 2007) 47–9.

[20] Case C-415/11 *Mohamed Aziz*.

[21] Ibid.

associating good faith and fairness with what, *in substance*, consumers would agree to if they were in a position to bargain to protect their own interests. Good faith, in other words, is not associated with *procedural* fairness. Good faith is not about making terms (which might be substantively unfair) transparent to consumers. This suggests that, for the CJEU, procedural fairness, in the form of transparency, does not legitimise unfairness in substance.

35.2.3 National Interpretation Choices

We see from the above discussion that we can find important protective ethics within EU consumer law. In the case of the UK, the EU acquis has also brought specific concepts that provide the potential for protection that did not exist before. Very important examples here are the fairness concepts in the UTD and UCPD, which cover terms and practices that were not covered by pre-existing UK law (e.g. control of terms imposing obligations and liabilities on consumers, control of misleading omissions and various forms of high pressure selling).[22]

It is the approach of the UK in these sorts of areas that is of concern here. It is in relation to these areas (where EU law brings scope for greater protection) that UK courts and legislators often interpret the EU rules in a manner that prioritises regulation of business processes over provision of substantive protection. By this I mean, for instance, that, where there is doubt, transparency (procedural fairness) may be taken to be sufficient: e.g. as a means of determining what charges are excluded by art 4 (2) UTD from the general fairness assessment, or as a means of satisfying the general fairness assessment. Also, performance standards (eg the provision on incorrect installation in art 2 (5) of the SCGD) may be understood to focus on trader processes: to require proof of fault in relation to the trader's input, rather than requiring there to be a satisfactory substantive outcome. In other words, the trend is to 'contra emptor' interpretation of EU consumer law rules (interpretation against the interests of the consumer buyer). The sections to follow will show how such contra emptor interpretation has been a feature in the past and how we see it being consolidated in current reforms of UK consumer contract law. The main beneficiaries of this contra emptor interpretation seem to be *service* providers, the agenda appearing to be to maximise their freedom to achieve their self-interested goals in relations with consumers and to minimise their responsibilities to consumers.

[22] C Willett, 'General Clauses and Competing Ethics of European Consumer Law in the UK' (2012) *Cambridge Law Journal* 412, 416–9; and M Koutsias and C Willett, 'The Unfair Commercial Practices Directive in the UK' (2012) 5 *Erasmus Law Review* 237.

35.3 The Price Exclusion in the Courts

35.3.1 Art 4 (2)

As is well known, art 4 (2) UTD permits member states to provide that, insofar as a term is plain and intelligible, there will be no assessment of fairness relating to '….the adequacy of the price or remuneration as against the services or goods supplied in exchange.'[23]

So, if there is transparency (in the form of plain language), member states may provide for there to be no review of the substantive fairness of the 'price' under the unfairness test. The obvious intention here is to allow member states to preserve a degree of freedom of contract in relation to the price. When it comes to such a central part of the contract, trader freedom may be preserved: member states may permit traders to charge what they wish, so long as the trader is required to present the terms in plain language, i.e. to practice a minimum degree of transparency, a form of procedural fairness. The corollary would be that consumers should act in a self-reliant manner. They should take advantage of this price transparency by comparing prices, 'shopping around' for the best deal: they should make an 'informed choice' on this core element of the contract.

It is obvious, then, that the inclusion of art 4 (2) is about opting for an ethic of self-interest and self-reliance (or informed freedom of choice), over an ethic of protection.[24] But, what is the intended *extent* of this freedom of contract, procedural fairness approach? Art 4 (2) is rather open-textured: leaving open precisely what *is* the 'price or remuneration'. The preamble to the UTD explains that what is excluded is the 'quality/price ratio'.[43] But this does little more than repeat the basic idea that there can be no assessment as to whether the price is too high, given the quality of the goods or services received. It does not actually tell us how to work out *which* of the many types of charges potentially made under a contract actually count as the price.

35.3.2 The Bank Charges Litigation Through the UK Courts

The UK chose to implement the art 4 (2) price exclusion[25] and the question as to how to interpret it reached the Supreme Court (SC) in the well-known *Abbey National* case. At issue in the case were terms providing for large bank charges to be made in a variety of circumstances, including, for example, where consumers exceeded agreed overdraft facilities.[26] Under the terms, exceeding the overdraft fa-

[23] Art 4(2) UTD.

[24] See H Collins, 'Good Faith in European Contract Law' (1994) 14 *OJLS* 229, 238.

[25] Unfair Terms in Consumer Contracts Regulations (UTCCR) 1999 (SI 2083), reg 6(2)(b).

[26] *OFT* v *Abbey National and others* [2009] UKSC 6; S Whittaker, 'Unfair Contract Terms, Unfair Prices and Bank Charges' (2011) 74 *MLR* 106 and C Willett, 'General Clauses and Competing

cilities was not defined as a default or breach of contract by the consumer. Rather, it was defined formally as an option exercised by the consumer. Following this logic through, the obligation to pay the relevant charge was not defined as compensation for a loss suffered by the bank. Rather, it was defined as a charge for the bank's *service*, i.e. the 'service' of allowing the payment to be made from the account.

For the Office of Fair Trading (OFT) and the Court of Appeal (CA), the 'price' only covered charges that the typical consumer would view as 'essential' to the bargain; or, to express this otherwise, what such a typical consumer would reasonably expect to pay in the normal due performance of the contract. Given that consumers do not normally actually plan to take an unauthorised overdraft in the normal course of things, the OFT and CA concluded that the charges in question were not 'price' terms'.[27] This seems to be an understanding of the 'price' concept that is underpinned by a reasonably protective ethic. From a protective point of view, the key is whether consumers are really likely to focus on the charges, such that the charges have a significant influence on consumer decision making, and consequently have a realistic chance of being subject to competitive market discipline. Such competitive discipline may mean that the charges are made fairer in substance (so that application of the unfairness test does not matter so much). From a protective point of view, transparency, in the form of the plain and intelligible language requirement, will not be enough to make it likely that consumers will focus on, and base their decisions on, these charges. It till not be enough to produce the desired competitive discipline. This is based on the common sense instinct (supported by behavioural science research) that (transparency notwithstanding) consumers will only tend to focus on charges that they will definitely or probably need to pay.[28] In other words, from a protective point of view, although the plain language requirement is of course necessary[29] 'price' itself needs to be understood by reference to the *substantive nature* of the charge: is it one that consumers will definitely or probably need to pay and which will therefore form the basis of consumer decision making and be likely to be subject to competitive discipline? The OFT and CA expressed this in terms of whether the charge was 'essential' to the bargain.

The SC, however, refused to distinguish between what consumers would see as essential and non-essential charges; considering such an approach to be too complex and even to compromise the European law principle of 'legal certainty'.[30]

Ethics of European Consumer Law in the UK'.

[27] *Abbey National plc and Others* v *OFT* [2009] EWCA Civ 116.

[28] Due to behavioural biases: e.g. the natural inclination to focus on the immediate advantages and costs of the transaction; the limited time in which a choice will be made; and the limited ability to assess the future likelihood of circumstances arising in which contingent charges will need to be paid (e.g. the risk of needing to choose to exceed an authorised overdraft or doing so inadvertently). Generally, see G Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32 *Journal of Law and Society* 349; I Ramsay, *Consumer Law and Policy* (Oxford, Hart, 2007) 71–85.

[29] Whatever a term provides for in substance, consumers cannot focus on it, and choose based on it, if they cannot understand it.

[30] *OFT* v *Abbey National and others*, Lord Mance at [112] and [115].

For the SC, identifying the 'price' was 'a matter of objective interpretation by the court'.[31] The SC accepted that, applying such an approach, charges flowing from consumer *default* were not the 'price'.[32] Beyond this, however, the Supreme Court appeared, effectively, to allow the technical provisions of the contract to determine what should be called the price. Basically, if the terms (as they did in *Abbey*) say that the charge is payable for services, then it seem that they are 'price' terms (even if the charge, e.g. for exceeding an agreed overdraft as in *Abbey*, looks suspiciously like a default charge that has been dressed up formally as a primary payment obligation for services the consumer 'chooses' to take up![33]). In other words, the SC refused to make the sort of distinction drawn by the OFT/Court of Appeal, which broadly only treats as price terms those charges that, by their substantive nature, are genuinely essential to how the bargain would be perceived by consumers and which are therefore more likely to be subject to market discipline.

35.3.3 The Choice of Ethics and (Judicial) Contra Emptor Interpretation

In short, then, the SC chose to interpret art 4 (2) in a manner contrary to consumer protection needs. There are protective and non-protective interpretations of art 4 (2)-the strength of the more protective interpretation being emphasised further in the following section-yet the SC chose the non-protective interpretation. This arguably adapts and subverts the traditional concept of contra proferentem interpretation. This doctrine (given legislative expression by art 5 of the UTD itself) holds that where there is doubt as to the meaning of provisions in a document, these issues should be interpreted against the interests of the author of the document, in favour of the interests of the (usually weaker) party against whom the document is used. Here there is a *legislative* provision with at least some consumer protection goals[34] and we find that the interpretation doubts are resolved in favour of the stronger parties-the financial service providers-and against the interests of consumers: 'contra emptor' interpretation.[35]

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[31] Ibid, [116].

[32] Ibid, [102].

[33] Something of a 'wolf in sheep's clothing', to coin a phrase.

[34] UTD, Preamble, recitals 9, 5 and 6, expressing, respectively, the goals of the UTD to protect consumers from 'one-sided' terms (including those not sufficiently subject to competitive discipline to be controlled by the market?) and to generate consumer confidence.

[35] See Willett, 'General Clauses and Competing Ethics of European Consumer Law in the UK', for discussion of the reasons for this, including an underlying ethic of self-interest/self-reliance, deriving from common law individualistic traditions and a perceived need to protect banks' income streams during the financial crisis.

35.4 Legislative Reform of the Price Exclusion in the UK

35.4.1 Overview

This section analyses the approach to art 4 (2) taken by the English and Scottish Law Commissions and the Consumer Rights Bill (CRB). It is shown that the above SC approach is followed, subject to requiring greater transparency; that this remains a non-protective-'contra emptor'-interpretation; and that this cannot be justified by the 'improving certainty and accessibility' policy underlying the CRB-as there is a protective interpretation of art 4 (2) which is just as stable and certain as the non-protective approach chosen. It is therefore hard to resist the conclusion that the interpretive choice made is one based on a non-protective ethic, one intended to protect and promote interests of service providers (for whom these charges are a major income stream).

35.4.2 The Consumer Rights Bill, the Law Commissions and the Proposals[36]

The CRB seeks to clarify, consolidate and modernise key aspects of business to consumer (B2C) contract law. More broadly, the intention is make the regime more accessible, so as to better facilitate informal dispute resolution and enhance competition.[37] The Bill contains all the key rules on conformity of goods, services and digital content (DC);[38] as well as the rules on unfair contract terms, including those implementing the UTD.[39] It reforms and clarifies many of these rules, separating them out from rules applicable to business to business (B2B) contracts.[40] The new

[36] See C Willett, 'Rights to Cure and More Accessible Consumer Law' and 'The Consumer Rights Bill: Transparency, Accessibility and (Limited) Substantive Protection', unpublished research papers.

[37] CRB, ref BIS/13/925; http://discuss.bis.gov.uk/consumerrightsbill; https://www.gov.uk/government/publications/draft-consumer-rights-bill, BIS, *Enhancing Consumer Confidence by Clarifying Consumer Law* (London, HMSO, 2012) 15–18. The more squarely protectionist goal of preventing consumer detriment is also often mentioned (e.g. paras 5.54, 5.131, 5.137, 6.7, 6.44, 7.9 and 7.32), although it is not given the same prominence as the accessibility goal.

[38] e.g. terms and rights related to quality, fitness, description, pre-contact information in supply goods and DC contracts; rejection, repair, replacement and price reduction rights when the aforementioned terms and rights are not respected; terms as to reasonable care, pre-contact information, time and price in services contracts, and repeat performance and price reduction remedial rights for breach of such terms.

[39] The UTD implementing regime (the Unfair Terms in Consumer Contracts Regulations (UTCCR) (SI 2083) 1999) will be merged with the B2C provisions from Unfair Contract Terms Act (UCTA) 1977.

[40] Currently, for instance, the statutory implied terms and remedies for defective goods and services in B2C and B2B contracts are spread across the Sale of Goods Act (SGA) 1979, Sale of Goods (Implied Terms) Act (SOGIT) 1973 and Supply of Goods and Services Act (SGSA) 1982; while

unfair terms regime is based mainly on work by the Law Commissions, the most recent of this work giving particular attention to the art 4 (2) issue in the aftermath of the bank charges litigation that was discussed above.[41]

As we know, art 4 (2) only excludes an assessment of fairness in relation to the *adequacy of the price as against the goods or services supplied in exchange.* The Law Commissions accepted that this does not exclude application of the unfairness test to price terms per se. All that is excluded by art 4 (2) is an assessment as to whether the price is too high for the goods or service received in exchange.[42] So, the test can still be applied, for instance, to provisions determining the time or mode of payment. In addition, the CRB makes amendments to the 'grey list', to emphasise that the fairness test applies not only to terms allowing for the price to be varied; but also to terms fixing the price after conclusion of the contract;[43] and to terms imposing charges when consumers terminate the contract.[44]

However, both the Law Commissions and the CRB appear to follow the 'contra emptor' interpretation of the SC, when it comes to the main question, i.e. the question as to what counts as the 'price' for the purposes of exclusion from the *adequacy* assessment under the test of unfairness. The general thrust of the Law Commissions' analysis is that charges that are non-essential in substance, should (following the SC) continue to be treated as price terms, albeit that such terms should only be excluded from the fairness/adequacy assessment where they are both 'transparent' and 'prominent'.[45] [46] The CRB seems to follow this analysis. It repeats the current

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statutory unfair terms rules for both B2C and B2B are in UCTA, and UTCCR is an overlapping regime solely applicable to B2C contracts.

[41] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts* (Law Commissions, 292/199, 2005); English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: a new approach? Issues Paper* (Law Commissions, 2012); and English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills* (Law Commissions, 2013).

[42] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, ibid, 24–6; this following the decision on this point in Case C-484/08 *Ausbanc*.

[43] CRB, ref BIS/13/925, Schedule 2, Part 1, para 14.

[44] Ibid, para 5.

[45] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, 3.109. This therefore adds to the plain and intelligible language requirement in art UTD 4 (2). The transparency and prominence requirements are in CRB, s 67 (2); transparency is defined in the CRB as involving plain and intelligible language and legibility (s 67 (3)); and prominence requires that the term has been brought to the consumer's attention in such a way that an average consumer would be aware of it (s 67 (4)).

[46] NB also that, while the Law Commissions accept that default charges are not price terms, the Law Commissions say that it is preferable to leave it to the courts to decide on the facts of a case whether a term (such as in the *Abbey* case, for instance?) which depicts the charge as being for a service, is really a default charge (English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills,* 5.64–8). The courts should be able to recognise some disguised default provisions, e.g., where the charge pretends to be for services, but there are no services provided in exchange. But, beyond this, we already know from *Abbey* that, where some case can be made that services are supplied in exchange,

test and adds the transparency and prominence condition.[47] (One has to assume that the intention, following the approach of the SC and the Law Commissions, is that essential *and* non-essential charges may be treated as price terms, so long as they are presented formally as charges for goods or services provided in exchange. If the intention was for only essential terms to be counted as the price, then this would surely have been indicated expressly in the legislation).

The Law Commissions did accept that art 4 (2) *could* be read only to cover some charges, e.g. those that are central or essential to the contract;[48] that courts in other member states, such as Germany, have interpreted art 4 (2) in more protective ways;[49] and that the CJEU could insist on some such more protective approach.[50] It is striking, then, that the Law Commissions do not really offer substantial arguments as to why a more protective approach, based on the substantive nature of the charges, should not be adopted in the UK.[51]

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the SC seems disinclined to treat contingent charges as disguised default charges, appearing to give great latitude to businesses to 'draft their way into' the Art 4(2) exclusion from the fairness test (see the discussion above). Perhaps, though, there is scope for charges for contingencies to be treated as disguised default charges where the event triggering the charge (e.g. exceeding an airline baggage allowance or forgetting to check-in on-line) might be said to be even more likely to arise through inadvertence than, for example, exceeding agreed overdraft facilities. The suggestion might be that very few consumers are likely to make a positive choice to pay high baggage and check-in charges, so that argument might be that the event leading to being required to pay these charges looks even more like a breach (and even less like a positive choice to take up a service) than when a consumer exceeds an agreed overdraft facility. But then, just as some consumers may actually positively calculate that access to extra funds in an emergency is worth paying a high price for, some may make a very conscious choice to pay high fees to avoid the hassle of weighing baggage or checking in on line. So, it is questionable how plausible it is to distinguish between contingent charges in this manner.

[47] S 67.

[48] See the discussion of both interpretations in English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, Chap. 3.

[49] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, 2.10 and English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: a new approach? Issues Paper,* 7.61: citing the German cases, BGH, 30/11/1993, (1994) *Neue Juristische Wochenschrift* 318; BGH, 19/10/1999, (2000) *Neue Juristische Wochenschrift* 651; BGH, 13/2/2001, (2001) *Neue Juristische Wochenschrift* 1419; and BGH, 8/3/2005, (2005) *Neue Juristische Wochenschrift* 1645, 1647.

[50] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*.

[51] There is a fairly strong sense running through the Law Commissions' work that the reasoning of the SC should be treated with very considerable respect.

35.4.3 The Choice of Ethics and (Legislative) Contra Emptor Interpretation

Essentially, the view of the Law Commissions and the government seems to be that the addition of the transparency and prominence conditions achieves the same effect as an approach that distinguishes between charges based on their substantive nature. The notion is that the transparency and prominence conditions enable consumers to focus on even non-essential terms and to make decisions and choices based on them, the effect of this being to generate competitive discipline. This is an argument that seems grounded in an ethic of (very strong) consumer self-reliance rather than an ethic of protection. It assumes consumers to be capable of making very complex assessments. Suppose there is a non-essential (but very large) charge for something that is contingent, i.e. dependent on what may or may not happen in the future.[52] Even if such a charge is transparent and prominent, the first requirement is for consumers to assess the likelihood that the contingent events triggering the charge will occur. They must then search out what other businesses provide for in similar circumstances. We shall see shortly that it may be far from simple to work out exactly what the various providers charge. This is because it is not clear, eg, whether the prominence requirement demands that charges must be explained in literature other than the formal terms and conditions, or only set out in a prominent place in these formal terms. Also, where charges are not fixed at a specific amount, it does not appear that 'transparency' requires that the means of calculating the final charge must be explained.

However, even if consumers are able to identify everything that they must pay (and what they might need to pay, depending on contingencies), a comparison between different traders is potentially a very difficult and complex task. This is particularly the case because, in addition to the different core and subsidiary charges that will be payable,[53] the various traders in any given market may use a variety of contingent charges. Not only might these be fixed at different levels, but they may deal with different sorts of contingencies (different businesses having different

[52] e.g. high charges for exceeding an overdraft limit in the future (*Abbey* case) or for exceeding an airline's baggage limit or forgetting to check in online (e.g. well known Ryanair terms); forgetting to re-fuel a hired car, leading to imposition of a fee for re-fuelling that is far in excess of the aggregate cost of the fuel and the labour and time involved; high charges for withdrawing money over the counter at a bank, rather than from an ATM-see the German case, BGH, 30/11/1993, (1994) *Neue Juristische Wochenschrift* 318. There may also be charges that are contingent on matters involving third party choices: e.g. whether-in the context of a contract for an estate agent to rent out and manage a consumer's property-a third party will later wish to buy the consumer's property, thereby triggering a payment to the estate agent who set up and managed the tenancy, but played no part in facilitating any later sale. See *OFT v Foxtons* Ltd [2009] EWHC 1681 (Ch), where the High Court found such terms not to be price terms covered by the Art 4(2) exemption, but given that they were expressed as primary payment obligations, one must assume they *would now* be viewed as covered by Art 4(2) following the SC decision in Abbey and the affirmation of this approach by the Law Commissions and the CRB.

[53] e.g. arrangement fees for mortgages, commission fees for financial service advisers, finding fees when using an agent to find tenants etc.

business models in terms of how to raise revenue through such contingent charges). So, it really could take quite a gargantuan exercise of self-reliant endeavour for even the 'reasonably well informed and reasonably circumspect consumer' to make comparisons that will enrich choice and contribute to applying competitive discipline to the contingent charges in question.

This UK policy preference for an ethic of consumer self-reliance is closely associated with an ethic of business self-interest. The calculation appears to be that, while there may be a risk that the transparency/consumer self-reliance strategy will not necessarily result in market control over non-essential charges, especially those that are contingent in nature, it is preferable to take *this* risk than to risk direct legal control over such charges. It appears to be considered to be the priority to protect businesses from this, lest it should lead to too much of a reduction in the income stream gained from these charges.

So, once again we find a 'contra emptor' approach to interpreting art 4 (2). This time it is the legislator who takes this approach, in the context of deciding how to respond to the previous litigation: in deciding what path to set for the future.

35.4.4 The Alternative Interpretations and the Pursuit of Certainty

Legal certainty is an important principle generally in guiding the behaviour of those affected by legal rules. In particular, legal certainty is a general principle of EU law. Indeed, we saw above that the SC took the view that seeking to distinguish between essential and non-essential terms for the purpose of art 4 (2) would potentially undermine this principle of EU law. The Law Commissions were concerned to remove the uncertainty considered to exist as to the scope of art 4 (2).[54] We also saw above that the CRB seeks, inter alia, to clarify B2C contract law, to make the regime more accessible. Obviously certainty has a key role to play in such a policy goal. Laws that are uncertain in scope are more difficult to use, especially where (as is the case) the idea is for these rules to be made more use of in informal dispute resolution, without resort to lawyers and courts. Patently, if it is hard for lawyers and courts to interpret any given rule, it is even harder for ordinary consumers and businesses and for the relatively non-expert advisers, mediators and adjudicators who will be involved in alternative dispute resolution.[55]

Yet, the non-protective interpretation of art 4 (2) chosen by the UKSC and the UK legislator does not appear to provide any more legal certainty than would an approach under which 'price' is understood by reference to the *substantive nature* of the charge. First, as the Law Commissions recognised, the SC approach might well

[54] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, Chap. 2.

[55] Willett, 'Rights to Cure and More Accessible Consumer Law' and 'The Consumer Rights Bill'.

be overturned by the CJEU.[56] So far the Court has indicated that defining 'price' is a matter for national courts;[57] and it is certainly clear that deciding whether particular charges are the 'price' remains squarely a matter for national courts. However, the measured shift towards providing a degree of *interpretive* guidance has been noted above.[58] At least one reference as to the meaning of art 4 (2) is pending.[59] If the Court chooses to 'unpack' the price concept, there must be at least a chance that it would not agree with the UK approach. It could well interpret the provision in the light of some of the protective values that have already been argued to underlie EU consumer legislative and judicial policy.

Second, there are ways of designing a more protective model that would provide greater certainty than the UK model. Perhaps, the 'essential/non-essential term' distinction is a rather vague one, especially for common lawyers who are not as familiar as civil lawyers with this sort of distinction.[60] But a reasonable degree of certainty could surely be achieved by drawing on help from civil law experiences.

Also, a protective interpretation need not be based, as such, on a distinction between essential and non-essential terms. It could be provided that a charge is not the price if the obligation to pay it is 'contingent', i.e. if this obligation does not arise automatically when the contract is first made,[61] but, rather, the obligation to pay it is dependent on what may or may not happen in the future-on some future action, omission or inadvertence by the consumer, by the business or by third parties.[62] Another more positive way of expressing this is to provide that charges are the price only where they are payable in the due and normal performance of the contract, although perhaps it would be clearest if this was explained or qualified by reference to the contingency issue. So, it could be provided that it is only charges payable in the due, normal performance of the contract that count as the price, this not including contingent charges of the type described above.

This sort of formulation seems to recognise the difficulty consumers will have in assessing the risks posed by contingent charges, especially when so many other

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[56] English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*.

[57] Case C-484/08 *Ausbanc*.

[58] Ibid.

[59] Case C-571/11 *SC Volksbank România SA v Câmpan*. The Romanian court has sought guidance on whether either the concept of 'main subject matter' or 'price' in Art 4(2) can be interpreted as including a 'risk commission' in a mortgage contract, calculated at 0.22% of the total credit balance and payable monthly.

[60] A De Moor, 'Common and Civil Law Conceptions of Contract and a European Law of Contract: The Case of the Directive on Unfair Terms in Consumer Contracts' (1995) 3 *European Review of Private Law* 257, 268.

[61] Of course, it is the timing of the *obligation* to pay that matters, not the time of payment-so long as the obligation arises automatically when the contract is made, this is a non-contingent charge, even if the time for fulfilling the obligation (the time to pay) is at some later point.

[62] See the new Australian test, which only excludes the 'upfront' price, but not contingent charges (Australian Consumer Law 2010, s 26 (1) (b) and Commonwealth of Australia, Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010, para 229).

contingent and non-contingent charges may be used. It would result in a number of terms that cause significant consumer detriment being subject to the fairness test.[63]

The 'contingent/non-contingent' distinction seems to provide a perfectly stable and reasonably certain test. It should normally be very clear which obligations to pay charges are contingent on some future action, omission etc; and which are not contingent in this way, but arise automatically when the contract is first made. By contrast the 'transparency/prominence' model has serious uncertainty problems. 'Transparency' means that the term must be plain, intelligible and legible. This, in itself, seems more difficult to agree on than whether a charge is contingent. There are divergent views, for instance, about grammar, linguistic style and about the clarity and sense of many of the new words and expressions that are entering the English language increasingly quickly. There is also a problem in applying the transparency requirement to those contingent charges that are not fixed, but which are to be calculated according to some formula, e.g. prevailing interest rates or trader costs. The problem is that it is not made clear whether, in such a case, 'transparency' requires that the means for calculating the final charge must be explained.[64]

'What about the 'prominence' requirement'? A term is prominent if it is 'brought to the consumer's attention in such a way that an average consumer would be aware of the term'. Again, there is much scope for debate as to what this requires in different cases. Does it merely require charges to be set out in a prominent place in the formal terms and conditions or must they always or sometimes be explained in other literature, such as advertising or later communications between the trader and the consumer? Do the charges sometimes need to be explained verbally, whether in phone or face to face encounters? How prominent is 'prominent', whether in a written or verbal explanation or in standard terms? Do more substantively onerous or unusual charges need to be more prominent than other charges?[65] How will prominence be judged where there are a number of charges, e.g. in phone contracts where there are multiple call charges for various forms of home and international calls?[66]

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[63] See the examples at note 52 above. If there was a concern to exclude from the fairness assessment certain contingent charges thought to be more routine, which consumers might be expected to take into account (phone charges for non-routine use, e.g. international calls or those applying once the 'minutes limit' has been exceeded?), then research could identify these and they could be expressly excluded.

[64] This gap may not be filled by other provisions. The Consumer Rights Dir (CRD) requires that consumers are provided with the method of calculation of the 'price' (Art 5(2)(c) Dir 2011/83/EU) but what if 'price' under the CRD does not include contingent charges? The Consumer Credit Dir requires that consumers are provided with information on the total charge for credit and on default interest or charges, and with 'warnings' as to the consequences of default (Art 5(1)(c), (l) and (m) Dir 2008/48/EC), but what if charges are not classified by the contract as being based on 'default', but are characterised simply as being payments for services provided (which, in *Abbey*, prevented the term being a default term)?.

[65] The Law Commissions recommended this (English and Scottish Law Commissions, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills*, ch 2, 4.46), but it is not provided for in the CRB provision (s 67 (4)).

[66] See Law Commissions, ibid, 4.35–40 on the difficulties of applying the prominence test.

35.4.5 Protecting the Business Model of Service Providers-Both Under Art 4 (2) and Under the Good Faith Concept

We have just seen that there are protective approaches to art 4 (2) which provide more certainty than the transparency/prominence model. Given this, it appears that the (contra emptor) choice of the latter model is intended to protect and promote the interests of service providers. Subsidiary and contingent charges are an increasingly significant component of the business model of service providers. The very large income gained by banks from unauthorised overdraft charges was discussed in the Abbey case, it even being suggested by the SC that the size of this income was, in itself, a reason for judging them to be important terms (and therefore price terms).[67] The use of high charges for excess baggage and airport check-in is very well known.[68] There is no space here to go through the many other examples, but it is clear that such charges play major role in the service economy.

As we have seen, these charges may escape significant competitive discipline due to their nature. Equally, the transparency/prominence model focuses on procedural legal control. Businesses need only develop processes to present the charges in a formally transparent manner and they escape substantive regulation under the test of fairness.

There is another (unfair terms related) example of the focus on process over substance, and this can be mentioned briefly. Even in relation to terms that are subject to the test of fairness, there has always been significant uncertainty as to whether the 'good faith' element of the test can be satisfied if a term is sufficiently transparent, i.e. whether transparency can legitimise substantive unfairness. The SC has never been prepared to say explicitly that this is not necessarily so;[69] and the CRB fails to take the opportunity to clarify this either.[70] This could leave open the way to provide further protection for service providers, e.g. in relation to terms that are clearly covered by the fairness test, but that raise significant revenue (default charges, termination charges, price variation clauses, full payment in advance clauses etc): these

[67] *Abbey National*, Lord Phillips at [58], on the £ 30 million that these charges then made for the banks annually.

[68] See note 52 above. It was reported in May 2012 that Ryanair made £ 715 million in annual profits form 'ancillary' revenue, this including all subsidiary charges such as upfront ones for insurance, priority boarding etc, as well as contingent charges for excess baggage, airport check-in etc: http://www.dailymail.co.uk/news/article-2147490/Ryanairs-rip-charges-help-boost-profits-record-400MILLION-despite-higher-fuel-costs.html.

[69] C Willett, 'The Functions of Transparency in Regulating Contract Terms: UK and Australian Approaches' (2011) 60 *International and Comparative Law Quarterly* 355, 363–7.

[70] The test in the CRB (s 65 (4)) is (following the UTCCR, reg 5 (1)) a 'copy-out' of the UTD Art 3(1) test, with no associated provision or guidance indicating that the good faith requirement is not necessarily satisfied by transparency. Under the new Australian law, it is indicated in guidance that transparency, while relevant, does not necessarily legitimise unfairness in substance (Australian Competition and Consumer Commission, *A Guide to the Unfair Contract Terms Law* (2010) 12; and see C Willett, 'Transparency and Fairness in Australian and UK Regulation of Standard Terms' (2014) *University of Western Australia Law Review* forthcoming.

potentially being held to satisfy the good faith requirement (and therefore not be unfair), so long as they are presented in a formally transparent way, notwithstanding that they may be substantively unfair.

35.5 Process Over Substance Again: Installation Services

35.5.1 Introduction

Above, we have seen a tendency in the UK to interpret EU law in ways that restrict protection by focussing on business process over substantive control: by using transparency as a defence, a 'get out of jail' pass, whether through an interpretation of art 4 (2) which focuses on transparency and prevents an assessment of substantive fairness; or, potentially, under the fairness test, by using transparency as a defence when there is substantive unfairness.

This prioritisation of process over substantive outcomes can also be achieved by interpreting positive performance standards in ways that focus on trader processes: on fault, rather than on outcome. This allows traders to escape responsibility, so long as their procedures cannot be demonstrated to have been carried out negligently. So, inter alia, quality management processes can operate as a defence, even although the consumer has not received the outcome expected and paid for. A good example of this is the UK implementation of art 2 (5) of the SCGD.

35.5.2 Art 2 (5)-Fault (Process) or Strict (Substantive Outcome) Liability?

Art 2 (5) provides, *inter alia*, that:

> Any lack of conformity resulting from incorrect installation of the consumer goods shall be deemed equivalent to lack of conformity of the goods if installation forms part of the contract of sale of the goods and the goods were installed by the seller or under his responsibility.

We can see that Article 2 (5) refers to a lack of conformity (ie in the goods) 'resulting' from the process of installation (the service element). But what is 'incorrect' installation? Has there been 'incorrect' installation in any case in which the goods are defective (non-conformant) after installation? This would be a 'strict liability' standard, such a standard being one that prioritises substantive outcomes over business processes-if the substantive outcome of the installation service is that the goods do not conform, the installer is liable, whether or not there was negligence in

the process leading to this outcome. This approach seems to have been assumed to be correct by several commentators.[71]

However, there is another way that Article 2(5) could conceivably be read. It could be said that there is only 'incorrect' installation if it can be established that the trader was negligent in carrying out the process of installation. The fact that the installed goods are defective (that there is a defective substantive outcome) may suggest that there has been negligence in the process leading to this outcome, but such negligence must, in itself, be established or the supplier will not be liable. A negligence standard, focussing on the processes (the input) of suppliers, is a standard that is concerned with whether suppliers have followed *standard business practice* in carrying out the installation; and how much it would *cost* for the supplier to have done more, e.g. to carry out more rigorous checks or tests.[72] If standard business practice is followed, if it would have been too costly to do more, then, notwithstanding that the final outcome is defective, there is often no liability under a negligence standard.

There is no definition of 'incorrect installation' in the Directive. However, there are several factors that would suggest that a strict, substantive outcome based, standard is intended. First of all, such an interpretation would accord with the broader approach to conformity in the Directive. The other aspects of the conformity standard in the Directive (ie the quality, fitness etc standards applicable to straight sale of goods cases) are clearly strict liability/substantive outcome based.[73] The focus of each of these criteria is the state of the goods received-the substantive outcome-not whether there was negligence in relation to the processes or input of the supplier. If Article 2(5) was intended to introduce such an element then surely this would have been expressly provided for.

Further support for viewing art 2 (5) as setting a substantive outcome based standard can be found in the background to the Directive. In the 1995 Proposal, the Commission, when discussing the extension of the conformity concept to cases of installation, observed that: '… as regards the installation of goods linked to a sale, this extension is unproblematic and even necessary since in practice it is difficult to distinguish between the two and because it is necessary to protect the consumer consistently.'[74]

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[71] G Howells and C Twigg–Flesner, 'Much Ado About Nothing? The Implementation of Directive 1999/44?EC into English Law' in MJ Schermaier (ed), *Verbraucherkauf in Europa—Altes Gewährleistungsrecht und die Umsetzung der Richtlinie 1999/44/EG* (Munich, Sellier, 2003) 314; C Willett, M Morgan–Taylor and A Naidoo, 'The Sale and Supply of Goods to Consumers Regulations' (2004) *Journal of Business Law* 94, 104–6; and P Atiyah, J Adams and H MacQueen, *The Sale of Goods*, 11th ed (Harlow, Pearson/Longman, 2005) 529.

[72] *Bolam v Friern Hospital Management Committee* [1957] 2 All ER 118 and *Latimer v AEC Ltd* [1953] 2 All ER 449.

[73] See Willett, Morgan–Taylor and Naidoo, 'The Sale and Supply of Goods to Consumers Regulations', 105.

[74] See Proposal for a Directive on the sale of consumer goods and associated guarantees, COM(95) 520 final.

So, the Commission believed that there was so little difference between straight sale and a sale combined with an installation obligation, that a similar approach could be justified. More importantly, the Commission evidently believed that the art 2 (5) installation rule would mean that the consumer would be treated 'consistently'. This must surely mean that the Commission believed that the standard being introduced in relation to installation was (in common with the rule on straightforward sales) a strict (substantive outcome based) standard.[75]

35.5.3 UK Implementation of Art 2 (5)-Another Example of Contra Emptor (and Pro-Provider) Interpretation

Despite the strong likelihood that art 2 (5) sets a strict (substantive outcome based) standard, the UK chose to interpret it as requiring proof of fault, i.e. to be a standard focussing on the *processes* of service providers, rather than on the substantive outcome received by consumers. It was initially provided, and will be repeated in the new legislation, that in contracts where suppliers agree to supply and install goods, the goods are to be treated as not being in conformity with the contract where, inter alia, *the installation has not been carried out with reasonable care and skill*.[76] This reflects the general approach to services in UK law.[77]

It might be suggested that it makes little practical difference whether there is a strict substantive (outcome based) standard or a fault (process based) standard. If goods are satisfactory and fit for their purpose prior to installation and defective after installation it may often be reasonably easy to establish that the party responsible for installing them must have been negligent. This is a common assertion and one that may have influenced the UK government in deciding that there was no need to adopt an outcome standard.[78] It is true that where the installation is a simple, routine

[75] For further arguments in favour of a strict substantive outcome based standard (based on the goals of the SCGD and the approach in other Member States) see D Oughton and C Willett, 'Liability for Incorrect Installation and Other Services Associated with Consumer Goods' (2006) *Yearbook of Consumer Law* 1, 8–11.

[76] Supply of Goods and Services Act (SGSA), 1982, ss 11S and 13 and CRB, ss 14 (1) and 51 (1). There is also a new form of non-conformity under the CRB, where the installation is in breach of obligations that may be created by pre-contractual information provided by the supplier (ss 14 (1) and 52).

[77] SGSA, s 13, CRB, s 51. NB that the strict, goods, standards in SGSA, Part 1 apply to goods which were defective *before* installation. The goods standards in the SGSA and the Sale of Goods Act 1979 could possibly also apply in such a way as to make suppliers strictly liable for goods that were initially fine, but that are rendered defective by the installation process; the argument being that goods may need to meet the strict goods standards at the point when the goods are in a 'deliverable state', i.e. possibly only when installation is complete (see Oughton and Willett, 'Liability for Incorrect Installation and Other Services Associated with Consumer Goods'). But the position is far from clear and is confused further by the fault standard explicitly provided for in the case of installation.

[78] BIS, *Enhancing Consumer Confidence by Clarifying Consumer Law*, 6.133.

task over which the installer has a lot of control, then if the goods end up damaged, it would be relatively easy to persuade a court that there must have been a lack of reasonable care. However, this misses the point that effective consumer law rules should be able to be used effectively to bring about easy *out of court* dispute resolution, whether simply by negotiation between the parties, through in-house processes or through some form of independent mediation or other ADR.[79] Especially where there is no independent party involved, the business may routinely argue that it has not been negligent, leaving the contrary to be established by the consumer, who will not benefit from the inferences of negligence that may routinely be drawn by a judge.

These problems will potentially be much worse (and may also apply in court proceedings) where installers have less complete control over the process, e.g. where installation requires machinery or involves reliance on instructions provided by a third party such as the manufacturer.[80] Here, the supplier may argue that some such factor is the cause of the outcome not being as it should have been: e.g. the kitchen units damaged after installation (perhaps) due to defective machinery used in the installation process, or incorrect manufacturer instructions, or malfunction in computer software that is used to calculate spatial dimensions. Here the focus under a fault standard is on the *business processes* of the supplier: whether the supplier has followed *standard business practice* in terms of checks, tests etc on the relevant machinery, instructions or computer software; and how much it would *cost* for the supplier to have carried out even more rigorous checks or tests. He may be able to use a 'quality management' argument, producing a rigorous 'paper trail' showing that all generally accepted procedures were followed to prevent such problems arising. This could be supported by the argument that it would have been unreasonably costly to adopt a more rigorous system. It will take time and money for this paper trail to be examined and argued over; especially where rather technical issues are involved. Consumers may often just give up.

In short, the focus on process will often help service providers to escape liability for defective substantive outcomes: in out of court negotiations and even in court proceedings.[81] This appears to be an unnecessary level of protection for service providers. An outcome based standard for installation services does not seem to unduly burden service providers. This is especially true given that the SCGD does not require a damages remedy to be available, so there need be no risk of exposure to liability for large consequential losses. The only required remedies are repair or replacement, followed by price reduction or rescission.[82] Even if someone who has sold and installed goods has not been negligent, it does not seem to be too much of an imposition to expect such a person to cure a defect resulting from installation, or to provide a price reduction or take back the goods.

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[79] And these are core goals of the CRB-BIS, ibid, 15–18.

[80] It was accepted by the government that in the case of more technical services, it may be hard for consumers to know whether reasonable care and skill has been exercised (BIS, ibid, 6.113).

[81] See OFT statistics on the very high numbers of complaints in areas such as home improvement and car repairs where sale and installation will often be involved (cited at BIS, ibid, 6.44–5).

[82] Art 3 SCGD.

In fact the approach to art 2 (5), especially in the context of the current reform, arguably highlights a much more general government policy to protect service providers from responsibility for defective substantive outcomes. An outcome based standard (of satisfactory quality) for services related to property and digital content[83] was initially discussed,[84] but will probably not be introduced due to opposition from businesses.[85] Such a standard would have ensured proper implementation of art 2 (5). It would also have meant that in the case of installation *and* these other services, consumer protection would have been improved by shifting the focus away from business processes and the problems that this brings in holding suppliers to account for defective substantive outcomes. It may have been felt that if such a standard were to be introduced for installation services, it would be difficult to resist the argument that it should also be available for these other services. In these cases, as with installation, there are similar problems of proving negligence, especially where machinery, third parties, computers etc are involved. Also, as with installation, an outcome based standard is arguably perfectly workable and stable, because the property or digital content provides a tangible measure as to whether the outcome is satisfactory.[86]

35.6 Conclusion

I have sought to highlight a trend involving UK courts and legislators seeking to protect *service* providers from consumers, by interpreting EU consumer protection rules in a manner that prioritises regulation of business processes over provision of substantive protection. This can be labelled 'contra emptor' interpretation of EU law: a subversion of the protective contra proferentem interpretation principle traditionally applied to documents to protect consumers, rather than businesses. This contra emptor approach is continued under the current planned reforms of UK consumer contract law.

The challenge is to search for appropriate responses (both in the UK, and by scholars and practitioners of EU and national consumer law elsewhere if it is discovered that a similar pattern exists in other member states). This involves chal-

[83] e.g. installation, repair, storage, dry-cleaning, streaming of digital content, storage of digital content in the cloud etc.

[84] BIS, 6.125; on which see Willett, 'Cure Remedies and More Accessible Consumer Law' and 'The Consumer Rights Bill: Transparency, Accessibility and (Limited) Substantive Protection'.

[85] See BIS, *Consumer Right Bill: Table of responses to consultations* (London, BIS, 2013) 20–22 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206441/bis-13–927-consumer-rights-bill-table-of-consultation-analysis.pdf.

[86] For the various reasons that such a standard does not overburden businesses, see Willett, 'Cure Remedies and More Accessible Consumer Law' and 'The Consumer Rights Bill: Transparency, Accessibility and (Limited) Substantive Protection'; and on related, and specifically 'market function', rationales for strict liability over fault, see S Grundmann, 'The Fault Principle as the Chameleon of Contract Law: A Market Function Approach' (2009) *Michigan Law Review* 1583.

lenging the *contra emptor* interpretations in academic work and possibly in national courts and in the CJEU: by the use of strong, research based arguments that highlight the protective interpretations and those protective elements of EU consumer policy that could lend support to such protective interpretations.

Addendum A new draft of the CRB has now been issued-http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0161/14161.pdf.

This alters the section numbers given above. It does not alter the substance of the unfair terms rules discussed above. It does, however, seem to finally implement SCGD, art 2 (5) properly, as it is provided (s. 15) that where goods are supplied and installed by a trader, there is a non-conformity where the installation was carried out 'incorrectly'. This reflects the language of art 2 (5) and makes no reference to proving fault/negligence. So, if this position continues in the final Act, we can say that the contra emptor approach no longer applies to this particular provision.

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Part VI
Enforcement

Chapter 36
Towards a Rapid Claims Settlement Mechanism for Disasters?

Michael Faure and Franziska Weber

Abstract The starting point of this contribution is the necessity to speedily compensate victims of an accident, which in reality is often not the case. We look at the term accident in a broad manner, referring to disasters that affect many people rather than only one person. The main obstacles to a fast compensation may be found in lengthy mass litigation. The necessity to proceed quickly is, for instance, crucial because it can prevent further damage, for example the local industry from facing insolvencies after an oil spill. We discuss some real-life examples of such rapid claims settlement mechanisms, the Belgian compensation fund for technological incidents and the American Gulf Coast Claims Facility. Both examples show some strengths and weaknesses, which lead us to conclude that speed cautiously has to be balanced against the requirements of due process and the need to make the tortfeasor face the total costs of an accident to induce deterrence. We give some guidance as to how such a mechanism could be designed in practice.

36.1 Introduction

In his many publications Hans Micklitz has paid attention to the question how victims can receive a fair and effective compensation for their losses after an accident, but equally how this compensation can be provided within a reasonable time limit and at acceptable costs. It is one of the questions that lie at the interface of

We are grateful to Marianne Breijer (Rotterdam) for editorial review of an earlier version of this contribution.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_36,

procedural law and consumer protection, both issues on which Hans Micklitz has contributed substantially.[1]

A problem that has arisen in many situations of disasters, often leading to mass litigation, is that the liability system and the accompanying civil procedure as a mechanism to allocate liability have proven to be very costly and time consuming. Liability law has often been considered as a luxury system in the sense that it does not only (such as social security) provide a mere 'Existenzsicherung', but the 'luxury' of full compensation, both of pecuniary and non-pecuniary losses. However, in order to receive this luxury of full compensation the thresholds to be met by the victim are high and the procedures to verify whether the conditions of liability law are met can be complex and long. Especially with disasters, where the numbers of victims (and thus plaintiffs) may be large, the procedures may even be more complex and consequently more lengthy. Typically one refers in this respect to US-type litigation concerning disasters like oil pollution cases which allegedly could take many decades.[2] Not only US-type tort litigation can be lengthy and burdensome. Also in Europe litigation can take many years. For example in Belgium the explosion of a pipeline in Ghislenghien led to a lengthy criminal procedure. Since under Belgian law the civil suits cannot be handled as long as the criminal procedure has not been finalized, most of the victims only received compensation 7 years after the incident took place.

For those (and many other) reasons alternatives to the liability and insurance mechanism have been developed, like compensation funds. In some cases alternative dispute resolution (ADR) systems have been developed as an alternative to the tort system, since they would be able to award compensation more quickly than the complex tort litigation process. Traditionally law and economics scholarship has been relatively critical of alternatives for the liability and insurance system, especially when it concerned the development of compensation funds.[3] The reasons for the critical attitude of law and economics scholarship were that an automatic awarding of compensation to victims through a fund would (especially when financed through public means) jeopardize the goals and functions of tort law. If tortfeasors were no longer exposed to the social costs of their activities (by allocating the damage to them), incentives for prevention would be diluted. The same would be the case if, as is sometimes happening with fund solutions, victims would not receive full compensation, but a lump sum amount which would presumably be lower than their true costs. Also, if it was no longer verified whether the victim met all

[1] See *inter alia* H-W Micklitz, *Brauchen Konsumenten und Unternehmer eine neue Architektur des Verbraucherrechts? Gutachten A zum 69. Juristentag* (Munich, CH Beck, 2012), H-W Micklitz, 'Zukunft des Verbraucherrechts—Plädoyer für ein bewegliches System' (2012) *Neue Juristische Wochenschrift* 77; F Cafaggi and H-W Micklitz, *New Frontiers of Consumer Protection—The Interplay between Private and Public Enforcement* (Antwerp, Intersentia, 2009).

[2] Often the example of the Exxon Valdez litigation in the US is quoted. The incident happened in 1989 and litigation would only have been concluded after 2010, hence taking more than 20 years.

[3] See *inter alia* MG Faure and T Hartlief, 'Compensation Funds versus Liability and Insurance for Remedying Environmental Damage' (1996) 5 *Review of European Community and International Environmental Law* 321.

the conditions for receiving compensation (because lower thresholds for awarding compensation would apply) this could create a moral hazard on the side of victims. These insights call for caution when designing such mechanisms.[4]

The question we would like to address in this contribution to honor Hans Micklitz is whether it is possible to develop such a rapid claims management scheme that could combine the best of both worlds, i.e. provide fair and quick compensation to victims on the one hand and still expose tortfeasors to the social costs of their activities, thus providing efficient deterrence, on the other. The question arises, in other words, whether it is possible to create rapid claims mechanisms other than the traditional liability and insurance scheme, in line with an economic approach to liability law and law enforcement.

We will on the one hand describe various existing models of rapid claims management as alternatives to the tort system, but also normatively analyze under which conditions such a rapid claims management system could provide a valuable alternative to the tort system. Therefore, the remainder of this contribution is set up as follows: (1) first we will give a general sketch of compensation funds in different countries that have been created to deal with disasters—'disaster funds'—and some alternative solutions; (2) next we will look at some rapid claim settlement mechanisms more specifically; (3) attention will be paid to two examples: the specific case of the compensation mechanism for victims of technological accidents which was created in Belgium and regimes of rapid claims settlement in oil pollution cases, with a special view to the American case of Deepwater Horizon. Then a policy analysis follows, stressing the need to develop such a rapid claims mechanism for particular types of victims and damage and explaining the conditions under which such a mechanism could be effective (4). Sect. 36.5 concludes.

36.2 Disaster Funds

One alternative which (partially or entirely) bypasses liability law and civil procedure is the creation of a compensation fund. Compensation funds can have various goals and functions.[5] Usually their aim is not to replace liability law, but to provide compensation in case where there is no identifiable injurer (like in the case of natural disasters) and where hence liability law could not play any role at all.

To start with, there are some alternatives whereby no full compensation is provided to victims, but rapid disaster relief is available e.g. to support victims in the immediate aftermath of a disaster. Those payments (often by government) are generally aimed at emergency measures that government should carry out after a disaster occurs. Many countries have those systems. For example in Japan a Disaster Relief Act provides 'for government emergency measures to protect victims

[4] MG Faure and F Weber, 'Security Mechanisms for Insolvencies in the Package Travel Sector: an Economic Analysis' (2013) 36 *Journal of Consumer Policy* 425.

[5] Faure and Weber, 'Security Mechanisms for Insolvencies in the Package Travel Sector'.

of disaster and maintain social order by causing the central government to provide needed relief services on an emergency basis in cooperation with local public entities and the Red Cross, other entities, and the people of Japan'.[6] These types of relief measures after a disaster are, however, not the type of compensation needed to avoid bankruptcy e.g. of fishermen and local restaurant/hotel owners in coastal areas. The reason is that relief measures are often just aimed at providing minimal help to restore social order, for example by providing shelter to victims; the goal of immediate relief is not to provide recovery or compensation of all losses to victims.

There are some experiences with compensation funds for disasters. They usually follow an administrative procedure of claims handling whereby an administrative authority or commission verifies claims and arranges payment. Compensation is, however, in the cases where a compensation fund completely replaces liability law (like for example in Belgium[7] and Austria[8]) not necessarily speedier than liability law.

Compensation funds are also debated as a replacement of the liability system in cases where an identifiable and solvent operator would be available. The major disadvantage of such a construction would be that the operator who created the risk would no longer be confronted with the costs of the incident and hence a correct risk allocation would fail (unless the fund would later take recourse against the liable operator).[9]

To some extent a disaster fund was also created in the US with the 9/11 Victim Compensation Fund. However, there has been quite a bit of criticism on that particular fund, arguing that the authorities failed to consider the psychology of justice and compensation for harm when establishing the fund. The fund would have violated people's perceptions of procedural fairness and violated the victims' ideas of satisfaction.[10] The 9/11 Fund has therefore not been seen as a model that should be followed in the future.[11]

Some countries follow an administrative compensation system (rather than compensation via liability law). For example in Japan in response to nuclear damage Japan chose an administrative system rather than a judicial system as the primary compensation instrument. Compensation for nuclear damage in Japan is awarded according to categories of geographic areas and government orders. The standards to identify compensable losses are also set by the administrative authority. It is held

[6] See MG Faure and J Liu, 'The Tsunami of March 2011 and the Subsequent Nuclear Incident at Fukushima: Who Compensates the Victims?' (2012) 37 *William & Mary Environmental Law & Policy Review* 129, 154.

[7] See IC Durant, 'Belgium' in MG Faure and T Hartlief (eds), *Financial Compensation for Victims of Catastrophes. A Comparative Legal Approach* (Vienna, Springer, 2006) 72 f.

[8] See D Hinghofer-Szalskay and BA Koch, 'Austria' in Faure and Hartlief (eds), *Financial Compensation for Victims of Catastrophes*, 12–26.

[9] This is obviously an argument only in case of technological (man-made) disasters where there is a liable injurer that can be sued. With most natural disasters that will be much more problematic.

[10] See TR Tyler and H Thorisdottir, 'A Psychological Perspective on Compensation for Harm: Examining the 9/11 Victim Compensation Fund' (2003) 53 *DePaul Law Review* 355.

[11] So V Bruggeman, *Compensating Catastrophe Victims. A Comparative Law and Economics Approach* (The Hague, Kluwer Law International, 2010) 474.

that this approach can avoid the substantial hurdles in the tort system in awarding compensation for nuclear damage.[12] Even though the victims of the Fukushima incident followed an administrative compensation system, the compensation was (at least partially) financed by the liable operator.[13]

36.3 Examples of Rapid Claims Settlement Mechanisms

As illustrated, compensation funds for disasters can show various forms and cover different contingencies. Whereas the procedure to obtain compensation via a disaster fund is not necessarily faster than the judicial route, some examples of funds that specifically aim at providing fast compensation to victims are worth describing and analyzing.

36.3.1 Compensation for Victims of Technological Accidents in Belgium

A new Belgian Act was promulgated on 13 November 2011 concerning the compensation for victims of technological accidents.[14] Its emergence was related to the disaster of an exploding gas pipeline that happened on 30 July 2004 in Ghislenghien. As a result of this accident 24 people died and more than 130 were injured. Since in Belgium the civil procedure is linked to the criminal procedure[15] most of the victims were only compensated 7 years after the incident. This explains the need for a new act with the specific aim to accelerate victim compensation.

The Act applies to so-called technological disasters of great extent, which are defined as a technological incident involving bodily injury to at least five persons (through death or hospitalization). The Act will apply when a specific committee (referred to as a committee of wise men) declares the incident as an exceptional disaster and victims shall claim compensation within 6 months from the publication of the decision of the committee. Compensation matters are then taken care of by the Belgian motor insurance guarantee fund. The compensation has to be asked either to the Belgian motor insurance guarantee fund or to a special unit in charge of victims support which is constituted by the public prosecutor. This special unit establishes a list of potential victims and communicates this list to the motor insur-

[12] See further Faure and Liu, 'The Tsunami of March 2011', 195 f.

[13] ibid, 199 f.

[14] *Moniteur Belge*, 24 February 2012. For commentaries see C Coune, 'Wet van 13 november 2011 betreffende de vergoeding van de lichamelijke en morele schade ingevolge een technologisch ongeval' (2012) 5 *Tijdschrift voor Belgisch Handelsrecht* 5 and E Verjans, 'Nieuwe wettelijke regeling voor de vergoeding van slachtoffers van grote technologische rampen' (2012–2013) 27 *Rechtskundig Weekblad* 1076.

[15] This means that the victims cannot be compensated via civil liability as long as the criminal procedure is on-going.

ance guarantee fund. The fund in principle only compensates bodily injury and intervenes solely in addition to social security and insurance mechanisms.

It is remarkable that the Act does not specify the conditions under which the fund will compensate. Article 10 of the Act only specifies that the fund will compensate the victim or its descendants according to the rules of common law, taking into account the exceptional character of the damage.

Within 3 months after the fund has received the list of the victims the administration of the fund will formulate a motivated advice explaining whether the damage is of such a nature that it should be compensated on the basis of the statute. If the advice regarding compensation is affirmative and if the damage can be quantified, it will provide an offer of compensation. This offer is final. According to Art. 14, acceptance of the final offer by the fund through the victim will be considered as a final settlement of the case. If the victim does not agree with the decision of the fund according to Art. 10 the victim can sue the fund before the civil court.

The financing is based on a pre-payment by insurance companies. Article 16 holds that when the decision of the committee of wise men to declare the incident a technological disaster has been published, the fund will make an estimate of the damage and subsequently ask private insurers to pay to the fund on the basis of their market share. Insurers active in the area of civil liability insurance (with the exception of insurances covering liability in the field of motor vehicles) are forced to contribute to the fund on the basis of Art. 16, para. 2. The total maximum amount insurers will have to contribute is 50 million € per year.[16]

The fund is, moreover, subrogated in the rights of the victim against the liable tortfeasor and his insurer.[17] Article 17 sets out that the fund recovers the damages paid, including the interests as well as the fees and costs for managing the fund from the liable tortfeasor and its insurer. When no liable tortfeasor can be identified or when it is not possible to recover the amounts from the liable tortfeasor (because of his insolvency) the fund asks repayment from the National Disaster Fund. The amounts that can hence be recollected by the fund from either the tortfeasor (or his liability insurer) or from the National Disaster Fund will then, according to the market share, be paid back to the insurance companies that contributed in the first place.

Article 20, however, stipulates that if after a procedure it appears that there is no liable tortfeasor, the entire costs of the compensation will be paid by the National Disaster Fund. If, on the other hand, there is a liable tortfeasor, but it is impossible to obtain compensation from him (because of insolvency) the National Disaster Fund takes care of 50 % of the costs that could not be recovered. The remaining 50 % will in that case presumably remain with the insurers who contributed.

Undoubtedly, a few questions and criticisms could be formulated with respect to this Act. It is, for example, far from clear what it means that the victim will be compensated on the basis of common law.[18] Does that mean that all heads of damage that

[16] Art 16 para 5 of the Act of 13 November 2011.

[17] Art 9 para 4 of the Act of 13 November 2011.

[18] As Art 10 of the Act of 13 November 2011 stipulates: 'Conformément aux règles de droit commun, en tenant compte du caractère exceptionnel du dommage'.

the victim claims will automatically be compensated or will the fund, for example, still take into account the contributory negligence of the victim? A second point of criticism is that it is unclear why all insurers active in Belgium, also those unrelated to the incident, would have to pre-finance the compensation to the victims. From a distributional point of view this seems rather odd. The more logical solution would seem to be to ask prepayment from the identified tortfeasor or his liability insurer. Thirdly, in terms of providing correct incentives on top of this debatable solution, it is even less understandable why these insurers should risk to lose 50% of their contributions if the liable tortfeasor is insolvent. Fourthly, it is also doubtful why, when recovery is not possible from a liable tortfeasor, the National Disaster Fund would have to compensate. This disaster fund, as mentioned above, has been mainly created to compensate victims of natural disasters. In that respect it is hence strange that a fund, created to compensate damage caused by natural disasters, would now have to intervene for damage in case of a technological catastrophe. Lastly, in how far does such a solution provide potential tortfeasors (and their insurers) with the desirable incentives to avoid insolvency. In order to provide effective incentives a fund may never automatically step in but rather be a clear measure of last resort.

However, although some criticism can be formulated on the specific design of the Belgian compensation model, the solution (if one disregards a few imperfections) shows an interesting example of a model where an administrative agency provides (in principle speedy) compensation to victims and subsequently still recovers from the tortfeasors. The predominant effect of the system is a speedy victim compensation. The possibly long procedure to recover the damage from the tortfeasor, his insurer or the National Disaster Fund is carried out by the fund after compensation has already been obtained by the victims. Such a model could in principle serve (1) the goal of rapid compensation of victims and (2) the goal of a correct risk allocation to the injurer. To reach the second goal some contingencies in the design would still need to be fine-tuned. If the system worked perfectly it would mean that the victims would be compensated as if liability were applicable (which would imply the application of a contributory negligence defense) and the fund would in that particular case only prefinance compensation and later recover this from the liable injurer and his insurer (unless they are insolvent, of course). The fund is designed in addition to social security and the insurance mechanisms rather than as a substitute, which may be desirable in terms of the scope of such a mechanism.[19]

36.3.2 Claims Settlement in Oil Pollution Cases

Interestingly, in the recent Deepwater Horizon oil spill a claims settlement model has been followed which deviates from the traditional US style civil litigation. The first results seem to indicate that this fund was able to compensate a massive amount of victims and, moreover, to do this relatively rapidly and at lower costs

[19] Faure and Weber, 'Security Mechanisms for Insolvencies in the Package Travel Sector'.

than the tort system. Different mechanisms play a role in oil pollution cases. We will first set out some general facts on how oil pollution cases can be dealt with (3.2.1) and then explain the functioning of the Gulf Coast Claims Facility (GCCF) which in fact amounts to Alternative Dispute Resolution (ADR) (3.2.2).

36.3.2.1 General Compensation Mechanisms

As far as oil pollution is concerned two regimes can be distinguished that deserve separate discussion. At the international level the International Oil Pollution Compensation Funds (IOPC Funds) are of interest.[20] The international regime was set up with the 1969 International Convention on Civil Liability for Oil Pollution Damage (1969 Civil Liability Convention)[21] and the 1971 International Convention on the Establishment of an International Fund for Compensation for Oil Pollution (1971 Fund Convention).[22] With time two further instruments were added, the 1992 Civil Liability Convention (CLC) and the 1992 Fund Convention. Following major incidents with oil tankers, a third instrument, the Protocol to the 1992 Fund Convention (Supplementary Fund Protocol), was adopted in 2003. The US has not joined this regime.[23] The US to the contrary decided to enact the Oil Pollution Act (OPA) 1990 in response to the Exxon Valdez accident in 1989.[24] It is interesting to briefly address how claim settlement is arranged in on the one hand the IOPC Funds and on the other hand OPA.

1992 CLC and Fund Convention Claims management under the 1992 CLC and Fund Convention is dealt with in Art. 4.7 of the 1992 Fund Convention as follows:

> The Fund shall, at the request of a Contracting State, use its good offices as necessary to assist that State to secure promptly such personnel, material and services as are necessary to enable the State to take measures to prevent or mitigate pollution damage arising from an incident in respect of which the Fund may be called upon to pay compensation under this Convention.

Article 6 furthermore provides:

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[20] For a discussion of these regimes see H Wang, *Civil liability for marine oil pollution damage. A comparative and economic study of the international, US and Chinese compensation regimes* (Alphen a/d Rijn, Kluwer Law International, 2011) 53–97 and 212–219.

[21] The International Convention on Civil Liability for Oil Pollution Damage 1969.

[22] The International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage 1971.

[23] The reason is that those Conventions have particular characteristics, so as preemption of state law, low liability limits and channelling liability to shipowners, which were unacceptable to the US. For details see H Wang and MG Faure, 'Civil Liability and Compensation for Marine Pollution—Lessons to be Learned for Offshore Oil Spills' (2010) 8:3 *Oil, Gas, Energy Law Intelligence* 1, 3.

[24] For a summary of the US OPA regime see C de la Rue and CB Anderson, *Shipping and the Environment: Law and Practice* (London, LLP, 2009) and R Force, M Davies and JS Force, 'Deepwater Horizon: Removal Costs, Civil Damages, Crimes, Civil Penalties, and State Remedies in Oil Spill Cases' (2011) 85 *Tulane Law Review* 889.

> The time limit to bring an action for compensation is within three years from the date of the incident which caused the damage. However, in no case shall an action be brought after six years from the date of the incident which caused the damage.

Moreover, claims handling by the 1992 Fund takes place on the basis of a Claims Manual. An annual contribution is due and the finances therefore available may facilitate the payment to the victims. In this respect, the advantage of the 1992 Fund is that it always has a certain amount of funds available. So when it comes to compensation to the victims, the compensation can be done quickly (if all the conditions are complied with).

When an incident occurs the 1992 Fund co-operates closely with the shipowner's insurer, which will normally be one of the Protection and Indemnity Associations (P&I Clubs) that insure the third-party liabilities of shipowners, including liability for oil pollution damage. Since in most cases the 1992 Fund only pays compensation once the shipowner/insurer has paid up to the limit applicable to the ship involved, claims should first be submitted to the shipowner or his P&I Club.

The Claims Manual of the 1992 Fund specifies that

> The 1992 Fund and the P&I Clubs try to reach agreement with claimants and pay compensation as promptly as possible. They may make provisional payments before a final agreement can be reached if a claimant would otherwise suffer undue financial hardship. However, provisional payments are subject to special conditions and limits, particularly if the total amount of claims exceeds the total amount of compensation available under the two 1992 Conventions.[25]

However, as the Claims Manual states, the "speed with which claims are agreed and paid depends largely on how long it takes for claimants to provide the required information".[26] The Fund has developed a Claims Manual precisely to facilitate claims settlement by assisting the claimants in pursuing their claims. The Fund even has special guidelines for claimants from the fisheries, mariculture and fish processing sector on how to present their claims.[27]

Representatives from the International Group of P&I Clubs explain that the way the P&I and the Fund mechanism work is that victims have to hand in a claim and have to provide detailed documentation supporting the claim, thus providing evidence e.g. of the specific amounts of the damage.[28] That documentation will then be carefully reviewed and normally, if the documentation indeed substantiates the claim, within 6 months a payment will be made. In principle the P&I Club will immediately investigate a claim after the documentation substantiating the claim has been received. When it concerns a large incident pay-out may obviously be later, since assessments may be more complex. In those cases that exceed the CLC limit

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[25] Claims Manual, International Oil Pollution Compensation Fund 1992, December 2008 ed, 20, available at www.iopcfunds.org/uploads/tx_iopcpublications/2008_claims_manual_e.pdf.

[26] Ibid.

[27] Guidelines for Presenting Claims in the Fisheries, Mariculture and Fish Processing Sector, International Oil Pollution Compensation Fund 1992, December 2008 ed.

[28] In the interview with representatives of the International Group of P&I Clubs in London on 1/5/2013.

usually a joint claim handling office by the involved P&I Club and the Fund will be set up. Joint experts will be appointed and the entire case will be handled jointly. In principle the Club pays first up to the amount of the limit in the CLC; the Fund pays once the CLC limit has been reached.[29]

In principle, if claimants provide their claims rapidly and provide proof to substantiate the claims, claims will be rapidly assessed as far as their admissibility is concerned as well. However, it may require expert knowledge to analyze whether a claim is admissible. Since such an assessment requires specialized knowledge, the pool of experts to assess this, is relatively small.

As mentioned, the US has not joined this regime. *De facto* claims handling by P&I Clubs and the Fund (hence for marine vessel based pollution) has, for instance, in the EU not led to a serious problem. The horror stories coming from the US with long litigation (like in the case of the Exxon Valdez) are typically linked to the specific US situation (e.g. including debates concerning punitive damages).[30]

OPA Instead of joining the named conventions the US enacted the OPA. Section 2713 of OPA sets forth the procedures for claims handling after the occurrence of an incident. Following a spill, the President, acting through the Coast Guard, identifies the responsible party, which is required to advertise that it has been designated as the responsible party and to provide information about how claims can be pursued.[31] A claimant must first submit his claims for removal costs or damages to the responsible party for payment before either making a claim against the Oil Spill Liability Trust Fund (OSLTF) or filing a lawsuit under OPA against the responsible party. If the responsible party denies all liability for the claim or does not settle the claim by making payment within 90 days after the day the claim was presented or advertising was begun, whichever is later, then the claimant has an option. The

[29] Ibid.

[30] Ibid.

[31] 33 USC§ 2714. The responsible party or guarantor has 5 days to deny its designation as a responsible party, and upon its failure to do so, must advertise the designation and procedures by which claims may be presented to it within 15 days of the designation. If the responsible party does not advertise, the President is responsible, at the expense of the responsible party or the guarantor, for advertising the designation and procedures by which claims may be presented to the responsible party. The advertisement must continue for no fewer than 30 days. 33 USC§ 2714(b)(1). Sec 2714(b)(2) provides that the advertisement 'shall state that a claimant may present a claim for interim, short-term damages representing less than the full amount of damages to which the claimant ultimately may be entitled and that payment of such a claim shall not preclude recovery for damages not reflected in the paid or settled partial claim'. Under sec 2714(c), if (1) during the 5 day period both the designated responsible party and the guarantor deny the designation, (2) the source of the discharge or threat was a public vessel, or (3) the President cannot designate the source, then 'the President shall advertise or otherwise notify potential claimants of the procedures by which claims may be presented to the Fund.'
It should be noted that OPA does not impose a mandatory duty on the President to designate a responsible party, but instead, only requires the President to designate a responsible party 'where possible and appropriate'.

claimant may either file a lawsuit against the responsible party, or it may make a claim against the OSLTF. A claim may be presented directly to the Fund, without first presenting it to the responsible party, only if

(1) the President has advertised or otherwise advised claimants,
(2) a responsible party has a complete defense or has exceeded its limit of liability, entitling it to recovery pursuant to § 2708,
(3) a State seeks recovery for removal costs it has incurred, or
(4) a US claimant asserts a claim for damage for which the Fund is liable under § 2712 (a) caused by a discharge from a foreign offshore unit.[32]

If a claimant files a lawsuit, he has temporarily waived his right to make a claim against the OSLTF. If a claim is not compensated or is not compensated in full through the claimant's lawsuit, then the claimant may subsequently make a claim against the OSLTF. The presentment requirement under OPA is not a mere procedural technicality, but is a mandatory condition precedent to filing lawsuits against a responsible party. If a claimant does not comply with this requirement, his claim will be dismissed.[33]

Hence, a claimant in the US scheme has to follow various steps. Before any other action can be taken he must submit a claim for removal costs or damages to the responsible party. If this step is unsuccessful a claimant can either address the OSLTF or file a lawsuit under OPA against the responsible party. Under certain conditions the claim may be made directly to the fund. If the claimant takes the route via the court, the OSLTF works as a supplementary scheme if compensation is not (fully) granted in court. The clear aim of the OPA is to encourage settlement and avoid litigation.[34]

The OSLFT consists of two parts: an emergency fund and a principal fund. The latter is destined to compensation payments of the kind discussed. Furthermore, several federal organizations receive annual appropriations from the OSLTF to cover administrative costs and the like.

Financing of the principal fund is ensured by a number of sources:[35] a per-barrel excise tax, collected from the oil industry on petroleum produced in or imported to the United States (largest share), transfers from previously existing pollution funds (finalized), interest on the fund principal from US Treasury investments, cost recoveries and fines and civil penalties under OPA. This way a certain amount of funds is constantly available.

[32] For a detailed discussion on the claims procedure, see Force, Davies and Force, *Deepwater Horizon*, 949 ff.

[33] Force, Davies and Force, *Deepwater Horizon*, 950.

[34] S Issacharoff and DT Rave, 'The BP Oil Spill Settlement and the Paradox of Public Litigation' (2013) 13–20 *NYU Law and Economics Research Paper* 3.

[35] US Department of Homeland Security United States Coast Guard Report on Implementation of the Oil Pollution Act of 1990 (2004) 6.

Regarding the solution to the Deepwater Horizon incident in essence a settlement structure under OPA was provided after the Coast Guard identified the responsible party.

36.3.3 Claims Settlement in the Deepwater Horizon Case: The GCCF

Within weeks after the Deepwater Horizon incident, BP already began to pay compensation for claims.[36] Following the Deepwater Horizon incident, after negotiation with the Obama administration, on 16 June 2010 BP established a fund of US $ 20 billion to compensate those affected by the incident. Political pressure has undoubtedly been executed on BP by president Obama to create such a fund. If BP would have refused to create such a fund it was at risk of losing its right to drill in the Gulf of Mexico, which could potentially even have had more devastating financial consequences for BP and could potentially even have led to its bankruptcy.[37] The claims were processed through an independent claims facility, administered by Kenneth Feinberg. This facility is known as the Gulf Coast Claims Facility (GCCF). Two independent trustees, Kent Syverud and John Martin were appointed as independent trustees of the fund.[38] The idea was to create a trust for the compensation which is independent and which can manage the available money. For both, the defendant (BP) as well as for the plaintiffs (the victims), it was important that someone else than the defendant (BP) held the funds. That is why a separate facility was created.[39] It began to accept claims as of 23 August 2010. Prior to that time, BP processed and awarded claims. According to BP, the company awarded US $ 399 million in claims from 3 May till 23 August 2010 in transition to the GCCF.[40] This office was closed in June 2012 since the court took over the supervision of claims settlement.

On 23 August 2010, the GCCF issued its Protocol for Emergency Advance Payments, which established procedures for emergency advance payments by individuals and businesses for costs and damages incurred as a consequence of the incident.[41] These mainly include compensation for the loss of earnings or profits,

[36] www.bp.com/sectiongenericarticle800.do?categoryId=9048917&contentId=7082602; see also the Claims and Government Payments Public Report (31/3/2013), www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/gom_2012/STAGING/local_assets/downloads_pdfs/Public_Report_March_2013.pdf.

[37] So Dr Philipp Wassenberg, representative of Munch Re, interview on 6/5/2013.

[38] http://www.bizjournals.com/stlouis/stories/2010/10/18/focus3.html?page=all.

[39] Interview with Kent Syverud in Saint-Louis on 5/3/2013.

[40] J Ramseur, 'Liability and Compensation Issues Raised by the 2010 Gulf Oil Spill' (2011) *CRS Report for Congress,* 11/3/2011, Congressional Research Service, R41679, 15. See also BP Press Release, 23/8/2010, http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7064597.

[41] Gulf Coast Claims Facility Protocol for Emergency Advance Payments, Gulf Coast Claims Facility, section II (F), 23/8/2010.

Table 36.1 Payments

Payments	Amount paid (US$)
Individual and business claims	8,960,334,955
Government	1,419,854,638
Other	311,976,156
Total payments	10,692,165,749

removal and clean-up costs, real or personal property damage, loss of subsistence use of natural resources and physical injury or death caused by the spill.

On 22 November 2010, the GCCF issued a Protocol for Interim and Final Claims, which the GCCF subsequently revised on 8 February 2011.[42] The GCCF received claims for both interim payments designed to compensate claimants for past losses and final payments designed to compensate claimants for past and future losses.[43]

According to a study commissioned by the US Department of Justice, during its one and a half year tenure, the GCCF processed over 1 million claims and paid a total of more than US $ 6.2 billion to over 220,000 individual and business claimants. Approximately 99.8 % of the number of claims and 96.8 % of the amounts paid related to lost earnings or profits.[44]

In April 2012, BP reached definitive agreements with the Plaintiffs' Steering Committee with regard to the substantial majority of eligible private economic losses and medical claims stemming from the incident. These agreements were approved by the court in December 2012 and January 2013, although BP is still challenging a ruling by the court regarding the interpretation of certain protocols established in the economic and property damages settlement agreement.[45]

As of 31 March 2013, BP had paid approximately US $ 10.7 billion to government, individual and business claims (Table 36.1).[46]

The remainder of the 20 billion US $ that was provided to the GCCF by BP was returned to BP. BP may use it to pay government claims and to pay off other plaintiffs with whom litigation is still pending.[47]

[42] For an analysis of the function of GCCF, see Force, Davies and Force, *Deepwater Horizon*, 936 f.

[43] BDO Consulting (commissioned by the US Department of Justice), Independent Evaluation of the Gulf Coast Claims Facility: Report of Findings and Observations, 5/6/2012. The study is available at www.justice.gov/opa/documents/gccf-rpt-find-obs.pdf. This study defines the compensation process of GCCF into two phases: Phase I starts from August 2010, and Phase II starts from February 2011. The findings of the study show that the claims filed during phase II were subject to more stringent documentation requirements than those filed during phase I, whereas meanwhile it expanded the types of businesses that would be potentially eligible for compensation and granted automatic eligibility to claimants located on the Gulf shore who were involved in businesses that were particularly reliant on Gulf resources.

[44] BDO Consulting (2012) 62.

[45] www.bp.com/sectiongenericarticle800.do?categoryId=9048917&contentId=7082602.

[46] www.bp.com/sectiongenericarticle800.do?categoryId=9048911&contentId=7082592.

[47] Interview with Kenneth Feinberg, special administrator of the GCCF in Haifa on 16/6/2013.

36.3.3.1 Critical Review of the GCCF

The GCCF is a private funding to compensate victims of mass torts which cause damage over a wide range (e.g. an environmental disaster).[48] The approach adopted by the GCCF is not unique. Such an alternative claims resolution program is also used, and as mentioned very controversial, after e.g. the 11 September attack.

One advantage of such a GCCF is that it can "forestall the potentially devastating effects on families and local areas directly impacted".[49] Compared with the lengthy and costly litigation, such private funding may have the advantage of "distributing funds to affected claimants more quickly and at less cost to the claimants".[50]

An important advantage of an alternative dispute resolution of this type is that the costs of its functioning are considerably lower than the costs of the tort system and that hence much more funds were available for the victims.[51] In 16 months time 220,000 real claims were settled. During this period of 16 months 3,000 employees were working for the GCCF in 35 offices at an approximate cost of 40 million US $/month.[52] The fund could function as a confidence builder and substantial amounts could be paid out rapidly (most victims were paid in less than 3 years after the incident). For a catastrophe of this size such a rapid management of claims had not been heard of. The alternative would have been a litigation of hundreds of thousands of claims via different courts. Not only would this have taken many years and led to a lot of uncertainties, also with the victims that would probably still today not have been compensated. Moreover, generally in the US in mass damage class actions often one third of the available compensation goes to plaintiffs' lawyers. Compared to that the expenses for the running of the GCCF are very modest.[53] Of course, there were some problematic aspects in the functioning of the GCCF as well. For example, the costs of a consultancy firm (BDO) to verify payments (17 million US $) were extremely high. Also, the mere fact that initially it was signaled to the victims that 20 billion US $ was available undoubtedly had an attractive effect on the amount and number of claims. This may have created a few unjustified (and perhaps even fraudulent) claims. However, on the whole, the advantages of such a fund solution (via the GCCF) seem to be overwhelming, especially when compared to traditional solutions via the court system. The important function was to reassure the victims that payment would be available, thus avoiding hundreds of thousands of claims initiated by victims, supported by a strong US plaintiff bar. The latter could potentially have led to the insolvency of BP as a result of which victims may never have been compensated at all and with potentially devastating consequences for British

[48] For a discussion on various mechanisms used in mass tort claims, see DE Greenspan and MA Neuburger, 'Settle or Sue? The Use and Structure of Alternative Compensation Programs in the Mass Claims Context' (2012) 17 *Roger Williams University Law Review* 97.

[49] Greenspan and Neuburger, 'Settle or Sue', 99.

[50] Ibid.

[51] Interview with Kent Syverud in Saint-Louis on 5/3/2013.

[52] Interview with Kenneth Feinberg, special administrator of the GCCF in Haifa on 16/6/2013.

[53] Ibid.

pension holders as well (since BP is largely owned by British pension funds). That is why there were many interests in avoiding the tort system and providing rapid reassurance to the victims that compensation would be rapidly available.[54]

There are particular features which made this GCCF apparently a success. In addition to the aspects already mentioned, we should point at the high distrust against BP shortly after the Deepwater Horizon incident. Promises by BP that payments to victims would follow were therefore not credible. The creation of the GCCF therefore functioned as a confidence builder.[55] It could indeed reassure victims that money would be available if they made their claim to the fund and the insolvency could hence be adverted. Moreover, the manager of the GCCF used ADR techniques *inter alia* to present a draft of the protocol for advanced payments to potential victims at many meetings that took place in various locations in the US where victims were located. Hence, victims were involved in drafting the protocol which clearly stipulated the conditions under which payment would take place and could have a voice in the formulation of this protocol, thus adding to the legitimacy of the procedure. Moreover, the fact that such a protocol was drafted and discussed with victims before decisions on payment were made also had the advantage that it showed that the administrators of the GCCF would not take arbitrary decisions or pay at random, but according to clearly specified criteria laid down in the protocol. This method apparently allowed the administrator of the fund to verify the validity of the claims rapidly, equally allowing them to turn down many unjustified claims and to pay full compensation of both pecuniary and non-pecuniary losses to victims within a rapid period of time. However, differently than with the tort litigation system, punitive damages were not paid.

The GCCF can therefore be regarded as a meaningful step towards achieving the best of both worlds.[56]

36.4 Policy Analysis

36.4.1 Need for a Rapid Claims Settlement Mechanism

As we argued in the introduction there may be particular circumstances, especially when victims have been hit by a catastrophe, which may make rapid payment of an extreme importance. Again, the case of oil pollution can be illustrative. Rapid payment may more particularly be of importance, for example, for restaurants and hotels in coastal areas affected by offshore related pollution, but also for the fishing

[54] Ibid.

[55] Interview with Kent Syverud in Saint Louis on 5/3/2013.

[56] There are also more critical views on the GCCF. It is, for instance, being argued that the gains achieved by the fund solution have not been distributed to the polluters and the victims alike. The victims arguably would have been better off in court litigation, see Issacharoff and Rave, 'The BP Oil Spill Settlement'.

sector. Often those industries have financed their activities based on credit. Hence, when for example a fisher or hotel would lose income as a result of business interruption following an offshore related incident this can have devastating consequences and potentially lead to bankruptcy since further income may be lacking, whereas loans still need to be paid back. Hence, the question arises to what extent more particularly within pooling mechanisms a rapid claims settlement can be arranged such that payments e.g. to hotel/restaurant owners and fishermen can be guaranteed in order to prevent further damage resulting from their insolvency. The rapid payment importantly prevents a negative impact on social welfare because it prevents insolvencies. The traditional liability mechanism (via civil procedure) has the disadvantage (as also the Ghislenghien case showed) that court procedures in order to establish liability may take very long, with potentially devastating consequences for the financial situation of the victims. The policy argument in favor of a rapid claims mechanism is that a delay in payment could in fact lead to a much higher damage which rapid payment could precisely avoid. The Belgian case, even if one acknowledges certain weaknesses, is a nice example of an attempt to arrange for cost recovery to be taken care of later and without an impact on the victims. The American GCCF likewise achieved quick compensation for victims.

36.4.2 Identifying the Challenges

As indicated in the introduction and illustrated by the case studies, in order to successfully achieve that such a rapid claims management scheme combines the best of both worlds, i.e. provide fair and quick compensation to victims on the one hand and still expose tortfeasors to the social costs of their activities, thus providing efficient deterrence, on the other, one needs to design it cautiously. One should, of course, not immediately run to the conclusion that speed is therefore always desirable and that civil litigation is in all circumstances to be avoided. After all, the fact that a civil procedure related to a liability case that may take a substantial amount of time can also be important in order to review whether the goals of tort law (adequate deterrence and compensation) are actually served in this particular case.[57] Hence, to an important extent the procedure will need to verify whether the amounts claimed by the victim are indeed correctly representing the loss suffered by the victim (in order to avoid moral hazard on the victim's side) and whether it is indeed the tortfeasor who caused the loss (in order to obtain a correct risk allocation to that operator). Opportunistic behavior is also possible on the side of the victims. The US example indicates that the arguably generous offer by BP may potentially have attracted frivolous claims for compensation. This danger exists similarly with all alternatives according to which payment would not take place via liability law, but rapidly e.g. through a government commission, facility or fund which would not apply the conditions of liability law in the same way as it would be done under the

[57] See e.g. Issacharoff and Rave, 'The BP Oil Spill Settlement'.

court procedure. The advantage is that in that particular case payment can take place rapidly; the disadvantage may be that moral hazard on the side of the victim could arise (if fraudulent claims will still lead to payment) or that risks are not correctly allocated to the offshore operator (if damages are either assessed too high or too low).

Also representatives of the International Group of P&I Clubs[58] pointed at various problems with respect to the inefficient outcome of rapid claims settlement mechanisms. For example, in the case of the Hebei Spirit[59] some 120,000 claims were launched according to the 1992 CLC/Fund Convention, but 80,000 were deemed inadmissible, which could show that many claims were brought which did not necessarily meet the requirements of proof to be effectively compensated. A similar problem occurred in the case of the Prestige: the Spanish government felt guilty because they had refused a port of rescue to the Prestige.[60] When the spill afterwards occurred the Spanish government generously offered compensation to every victim, at least to everyone who claimed to have suffered damage related to the Prestige incident. Later these advanced payments were claimed back based on the CLC (hence from the P&I Clubs) and from the Fund. The problem is that in such a case disaster relief payments may have been made by governments (in some cases for political reasons) which often do not meet the admissibility criteria of the CLC (or the Fund) under liability law.[61]

These observations show that there are particular policy considerations to be taken into account when attempting to develop a rapid claims management system for particular victims: in order to avoid opportunistic behavior from both the potential tortfeasors and the victims, these mechanisms need to be carefully designed by paying attention to efficient risk differentiation, the scope of such mechanisms, i.e. the interrelation with an insurance system and their mandatory nature or whether it should be the victims' choice which system to pursue.[62] One may still see a role for the courts in the system after all. It has to be ensured that liable operators (and others who contributed to the risk) are exposed to the full costs of their activity; only those victims who really suffered losses due to the particular incident should be compensated and only for the damage resulting from that incident. An adequate mechanism has to be designed in awareness that a fully correct appraisal of the damage via civil procedure may take too long and that, hence, any alternative claims settlement (via alternative dispute resolution or an administrative procedure) may have the advantage of speed and can avoid disastrous consequences for this particular category of victims.

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[58] Interview in London on 1/5/2013.

[59] See further on this case JZ Hu, 'Legal Issues from the Hebei Spirit Oil Spill Incident' in MG Faure, L Han and H Shan (eds), *Marine Pollution Liability and Policy. China, Europe and the US* (Alphen a/d Rijn, Kluwer Law International, 2010).

[60] See on the right of entry in maritime ports for ships in distress E Somers, 'Marine Pollution and the Right of Entry in Maritime Ports for Ships in Distress' in Faure, Han and Shan (eds), *Marine Pollution Liability and Policy*.

[61] So representatives of the International Group of P&I Clubs, interview in London on 1/5/2013.

[62] See Faure and Weber, 'Security Mechanisms for Insolvencies in the Package Travel Sector'.

36.4.3 A Conditional Support

Based on the examples we discussed so far, especially the GCCF, experiences with disaster funds and the new Belgian Act on technological accidents, it can be held that there is a strong argument in favor of designing a rapid claims settlement mechanism. This argument is particularly strong when damage would occur to a particular sensitive category of victims whose damage would be disproportionally larger without rapid payment; where delays in the payments would be particularly detrimental. The nightmare of lengthy civil procedures (for example the Exxon Valdez in the US or Ghislenghien in Belgium) should be avoided by creating mechanisms in those particular cases to ensure prompt and adequate handling of compensation claims. After all, long court procedures also send the wrong signals to potential tortfeasors about the probability of being held liable. The trade-off is that there is hence a necessity to provide rapid payment, but on the other hand also to evaluate claims adequately. Rapid payment should still avoid the danger of being too speedy and paying compensation in unjustified claims. The latter could either lead to moral hazard on the side of victims or to an insufficient allocation of risk to the operator. The examples we discussed so far show that it may be possible to realize the best of both worlds (obtaining speedy compensation for a special category of victims and still having a correct allocation of risks) via different models.

One model may be to create a mechanism such as the Belgian solution for technological accidents, but reforming it in line with economic principles. This would entail the following:

- a facility would be created which rapidly prepays the damage to a specific category of victims;
- the liable operator or his insurer would be forced to pre-finance the compensation to the facility;
- a claims verification takes place, verifying that under normal rules of tort law those claims would be compensated as well (thus avoiding moral hazard on the side of the victim);
- to the extent the operator would not have pre-financed the facility, the facility would be subrogated in the rights of the victim, thus claiming back the compensation from the person(s) liable for the incident in order to create a correct allocation of the risk.

Another alternative would be to use the model of the GCCF.

The nature of the moment of claims verification is crucial as this is the moment of balancing the speed of payment and the thoroughness of a judicial procedure. As said, looking for solutions outside of the court room may amount to a preference for ADR solutions as opposed to judicial procedures. There are strong economic arguments that, under certain circumstances, favor court litigation as opposed to any decisions taken out of court, such as within ADR mechanisms. Lower procedural costs with an ADR body come at a cost. To name just some of these features: out of court negotiations are characterized by less strict procedural laws. This increases

the danger of mistaken decision, so-called error costs.[63] This may be a particular issue in mass cases, as one wrong judgment will affect a lot of victims as opposed to just one in individual litigation.[64] Accuracy is capable of reducing these costs. This may be one argument in favor of involving a court.[65] Whereas the expectations as to impartiality are very high for judges, this is much less clear for any decision-maker involved in non-judicial procedures.[66] As already discussed low cost non-judicial procedures may attract a frivolous amount of complaints by victims. Another concern may be the lack of a mandatory procedure with certain non-judicial solutions. Regarding a settlement structure under OPA, such as the GCCF, there are many unknowns as to the concrete design. A court procedure is a given. When it comes to concerns about shares that American lawyers, for instance, would have gained had the matter been solved within class litigation, it is a valid remark that high payments went to consultancy firms (instead).

Overall not every rapid claims settlement achieves its goals of putting the victims in a better situation. The key is in the fine-tuning between some fast payments, possibly only a limited amount, and the right dose of judicial control. To some extent this can only be achieved on a case-by-case basis. Cases furthermore need to be distinguished as to man-made as opposed to natural disasters as they logically lead to different incentives for potential tortfeasors. Companies may profit from lower litigation costs when solving problems out-of-court. On top companies may profit from a fast solution in terms of benefits for their reputation—this was indeed a concern for BP.

36.5 Concluding Remarks

The devil is in the details and in considering many elements of the complex world of law enforcement. The best of both worlds can only be achieved by involving both worlds, by allocating a role to a fund that can make quick payments but by also allotting a role to court control to ensure that the procedure served the goals as desired by society. In this context importance has to be given to weighing the effects on the behavior of different parties. Companies (that may or may not care about their repu-

[63] This reasoning is analogous to that stipulated for administrative vs. criminal law procedures and their differences; for those findings, see AI Ogus, MG Faure and NJ Philipsen, 'Best Practices for Consumer Policy: Report on the Effectiveness of Enforcement Regimes', Report prepared for the UK Department of Trade and Industry and OECD (2006) 47.

[64] RA Posner, *Economic Analysis of Law*, 8th ed (New York, Aspen Publishers, 2011) 787.

[65] F Weber, *The Law and Economics of Enforcing European Consumer Law—A Comparative Analysis of Package Travel and Misleading Advertising* (Aldershot, Ashgate, 2014).

[66] See A Shleifer et al., 'Courts' (2003) 118 *Quarterly Journal of Economics* 453 f; RA Posner, 'The Theories of Economic Regulation' (1974) 5 *The Bell Journal of Economics and Management Science* 335, 351 ff. For criminal law judges, see R Bowles, MG Faure and N Garoupa, 'The Scope of Criminal Law and Criminal Sanctions: An Economic View and Policy Implications' (2008) 35 *Journal of Law and Society* 389, 392 ff.

tation), factual victims and those that are inclined to behave opportunistically and insurers or other participants in pools that may be involved in cross-financing payments. The insurer's ability to monitor insurees and carry out risk-differentiation has to be exploited on top.

An important lesson seems to be that political pressure should not be able to upset all conditions of due process. The Spain example shows that this may lead to undesirable results after all.

It is an interesting point to consider is if lawyers will actually support a system that will lead to less work for them—which may be particularly true in legal systems where contingency fees are the rule. Thus, when suggesting a mechanism, close attention has, of course, to be paid to the particular contingencies of the specific legal system.

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Chapter 37
Enforcement by the New European Supervisory Agencies: Quis Custodiet Ipsos Custodes?

Rob van Gestel and Thomas van Golen

Abstract The financial crisis enabled the EU to move forward in terms of centralised supervision of financial institutions by moving away from the Lamfalussy committees towards a new regime of European agencies, the ESAs. Despite the newfound powers these agencies enjoy, there are several flaws in the system of supervision remaining. This contribution addresses three of these flaws: (1) the double role of national supervisory authorities as both addressees of the oversight by the ESAs and as their watchdogs; (2) the reliance on soft law with uncertain legal consequences; (3) the obscure constitutional embedding of the ESAs in the system of the TFEU and the case law of the ECJ. In order to overcome the half-way house situations the ESAs are in right now, the ESAs should be given a more independent position. Instead of deriving their legitimacy from the EU legislature via the Commission, we suggest to cut-through this 'transmission belt' but at the same time increase the accountability of the ESAs by codifying procedural rules with regard to stakeholder participation, consultation, and judicial review for those affected by the rules and decisions of regulatory agencies.

> 'If politics prevail over law, the outcome could well be that the European Union would 'face a rapid process of dilution and would soon be transformed into one of the many international organisations which rub along more or less effectively according to the changing interests of the contracting states' I will not hide my admiration for the wisdom of judges and their sense of 'realism and passion' in building the EU legal order, while I equally admit the moral right, even the necessity, to raise the question of legitimacy.' [Hans-W Micklitz, The Politics of Judicial Co-operation in the EU, Cambridge: Cambridge University Press, 2005, 2]

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_37,

37.1 Setting the Scene

History shows that the perspective of legal scholars on compliance and enforcement of financial regulation in the EU has undergone dramatic changes lately. Before the 2008 credit crunch, the literature on financial market regulation was drenched with the belief that 'light touch regulation' would be the best way not to disturb global finance systems. Geoffrey Wood, for example, wrote in 2003 about this topic: 'Historical experience with regulation and supervision is considered, and it is argued on the basis of that examination that a fairly 'light touch' in regulation is likely to achieve the objectives that governments and citizens require regulation to achieve.'[1] In the aftermath of the crisis this regulatory strategy, which at the time matched perfectly with the EU's 'Better regulation' and 'New governance' policy in which the promotion of self-regulation, co-regulation and other alternatives to 'command and control regulation' played an important role, has been denounced as naïve by experts in the field of regulation.[2] Moreover, in the report from the Larosière group issued by the European Commission to analyse the functioning of the system of financial supervision in Europe, it was concluded that the system of 'home state control'[3], in which EU Member States were primarily responsible for enforcement of EU rules for financial institutions, was no longer fit for purpose because it resembled setting the fox to keep the geese:

> A sound prudential and conduct of business framework for the financial sector must rest on strong supervisory and sanctioning regimes. Supervisory authorities must be equipped with sufficient powers to act when financial institutions have inadequate risk management and control mechanisms as well as inadequate solvency of liquidity positions. There should also be equal, strong and deterrent sanctions regimes against all financial crimes—sanctions which should be enforced effectively. Neither of these exist for the time being in the EU.[4]

In the meanwhile a new supervisory structure for macro and micro prudential supervision of financial markets has been established. The macro-prudential supervision in this system is in the hands of the newly created European Systemic Risk Board (ESRB), and the micro-prudential supervision of banks and other financial

[1] GE Wood, 'Too Much Regulation' (2003) 23 *Economic Affairs* 21.

[2] Julia Black has, for example, argued that: 'In particular, the reputations of four broad categories of regulatory approach and technique have suffered heavy casualties: principles based regulation, risk based regulation, reliance on internal management and controls, and market based regulation.' She immediately adds to this, however, that detailed rule based regulation did not particularly fare well either. See: J Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) *LSE Law, Society and Economy Working Papers* 13/2008, 2.

[3] See: A Ottow, 'The New European Supervisory Architecture of the Financial Markets' in M Everson, C Monda and E Vos (eds), *European Agencies in Between Institutions and Member States* (The Hague, Kluwer Law International, 2013) Chap. 8 (forthcoming). She gives the example of the Banking Dir 2006/48/EC on the basis of which a bank licensed by an EU Member State was permitted to establish a branch in another Member State without having to apply for a new licence. The home state was responsible for supervision of the credit institution as a whole.

[4] High Level Group on Financial Supervision in the EU, 25/2/2009, ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

institutions rests on the interplay between the national regulatory authorities and three new European Supervisory Agencies (ESAs)[5], namely: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). These institutions are brought together under the umbrella of the European System of Financial Supervision (ESFS).[6]

As far as the ESRB is concerned, its task is primarily to serve as a correction mechanism for possible flaws in the sphere of micro prudential supervision since the crisis has shown that even if financial institutions, individually, might satisfy certain minimum supervisory requirements, systemic risk can still build up and jeopardize the stability of the financial infrastructure. The ESRB's oversight, which is designed to operate without legally-binding powers[7], is supposed to remedy a flaw in the old system where national regulatory authorities were depending on each other's monitoring and compliance activities and the Lamfalussy committees were lacking binding decision-making powers to intervene fast and effectively in case Member States failed to comply with harmonized European standards.[8] In order to remedy the shortcomings of the previous regime, the EU legislature has tried to strengthen the system of European financial supervision by giving more powers to the newly established ESAs. However, in this contribution we will argue that there are at least three major shortcomings in the design of this new system, namely: (1) the double role of national supervisory authorities as both addressees of the oversight by the ESAs and as watchdogs of these 'independent' European agencies; (2) the reliance on soft law, whether or not as a relic from the past, without clarity about their function, about their legal consequences and about the possibility of judicial review; (3) the obscure constitutional embedding of the ESAs in the system of the TFEU (e.g. Articles 114 and 290/291) and the case law of the ECJ (e.g. *Meroni* and *Romano* and UK versus Council and EP).

[5] The new ESA are to a certain extent a follow-up of the old Lamfalussy level 3 committees (CEBS, CESR, and CEIOPS).

[6] The ESRB, COM(2009) 499, consists of a network of national financial supervisors working together with the ESAs, which are created by the transformation of existing Committees for the banking securities and insurance and occupational pensions sectors: European Banking Authority, COM(2009) 501; European Insurance and Occupational Pensions Authority COM(2009) 502 final; European Securities and Markets Authority COM(2009) 503. See E Ferran, 'Understanding the New Institutional Architecture of EU Financial Market Supervision' (2011) *University of Cambridge Faculty of Law Research Paper* No 29/2011, available at ssrn.com/abstract=1701147.

[7] E Ferran and K Alexander, 'Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board' (2011) *Cambridge Legal Studies Research Paper Series*, Paper No 36/2011. Available at: papers.ssrn.com/sol3/papers.cfm?abstract_id=1676140.

[8] Already before the crisis hit Europe it became clear that the Lamfalussy process caused too much differentiation in the implementation of EU financial regulation and was not flexible enough to keep up with the dynamics of the international financial markets.

37.2 Research Question and Order of the Argument

Although the combination of macro and micro prudential supervision by European regulators is an improvement compared to the home land model it remains to be seen whether the new system will prove to be much more effective. The ESRB will probably benefit from the knowledge and resources of central banks in the EU and from the expertise of national supervisors. At the same time it lacks the power to intervene directly in case of systemic risks because it depends to a large extent on national supervisory agencies in case of non-compliance. The same applies mutatis mutandis to the ESAs. For the most part they also lack the power to give direct instructions to national supervisors and individual financial institutions while the expectations from the side of the Member States are high.

Behind all this lies an institutional battle between the European Parliament (EP) that wanted more and stronger powers for the ESAs and the Council, aiming to preserve the influence of national supervisors, with the Commission caught somewhere in the middle. Our hypothesis is that behind this institutional power struggle there are two conflicting constitutional perspectives on how to ensure the democratic legitimacy of these new regulatory agencies. In the traditional view, the regulatory competences of the ESAs are derived from a top down transmission of power and democratic legitimacy by the EU primary legislature via the Commission. In what could be labelled as 'the New governance view', direct accountability of the ESAs towards the Commission and indirectly towards the EP and Council is partly replaced by bottom up alternatives to traditional political representation, which rely more heavily on participation of stakeholders in the regulatory process, accountability and transparency with regard to the ESAs use of rule-making and enforcement powers, completed by the possibility of judicial review. These views represent different perspectives on the role of the legislature in the constitutional embedding of regulatory agencies. Hence our research question reads:

> What sort of constitutional embedding would be required for the ESAs to be able to move beyond the half-way house situation in which they possess hardly any direct supervisory powers, while it is seen as their primary duty to respond effectively to the materialization of systemic financial risks?

In order to answer the research question we will first give a brief overview of the differences between the old Lamfalussy committees and the supervisory tasks of the new ESAs. Where did the previous regime go wrong and why are the ESAs supposed to be able to do a much better job? Next, we are going to take a closer look at the regulatory competences of the ESAs and their potential to steer the behaviour of national supervisors and financial institutions but also at the way in which national regulatory authorities may still be able to influence the decision-making of ESAs. How independent are the ESAs, taking into consideration their accountability towards the Commission, the EP, and Council on the one hand, and the influence of the national supervision authorities in the boards of the ESAs, on the other hand? After that, our focus will shift to the role of soft law in the enforcement policy of the ESAs. In areas not covered by delegated or implementing acts, the ESAs issue

guidelines and recommendations on the application of Union law to 'ensure transparency and to strengthen compliance' by national supervisory authorities. What is the added value of these measures and is there a big stick somewhere in case of non-compliance? Moreover, to what extent are these soft law measures subjected to judicial review? Having charted the history and competences of the ESAs, it is time to take a closer look at their institutional position from a constitutional perspective since the ESAs are sometimes seen as a new generation of independent regulatory agencies because they have more rule-making powers than earlier generations of agencies, which were first and foremost focused on implementation of rules and policies from the side of the Commission.[9] What is: (1) the legal basis of the ESAs (114 or 352 TFEU or…?); (2) how does the ESAs drafting of regulatory technical standards, implementing technical standards, and guidelines and recommendations, relate to the framework for delegated and implementing acts in article 290/291 TFEU; and (3) to what extent does the 'delegation' of rule-making powers to the ESAs match with the case law of the ECJ. Regarding the latter, special attention will be given to a pending case before the ECJ, in which the Advocate General (AG) advises the court to set aside the '*Meroni* doctrine' for ESA-rule-making and criticizes the lack of a sound legal basis for their power to intervene in emergency situations. The ECJ however saw no flaw in using art. 114 TFEU as the legal basis for the interventionist powers of ESMA, and left open the question of how to effectively deal with agency powers in the new post-Lisbon framework. Finally, a conclusion will be drawn.

37.3 A Short History: From Lamfalussy to New Regulatory Agencies

The Lamfalussy committees were the result of a process that started with a committee of Wise Men-report, chaired by Alexandre Lamfalussy.[10] In that report, the regulatory system for the financial securities markets was labelled as:

> [T]oo slow, too rigid, containing too much ambiguity and is therefore resulting in inconsistent implementation and over-reliant on primary legislation for determining detailed rules.[11]

The remedy proposed to tackle these shortcomings was a 4-tiered system where level 1 contained the drafting of European framework legislation, level 2 concerned the implementation of this legislation by the Commission after consulting two Se-

[9] M Busuioc, 'Rule-making by the European Financial Supervisory Authorities: Walking a Tight Rope' (2013) 19 *European Law Journal* 111, 112.

[10] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, 15/2/2001, available at ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.

[11] Initial report of the Committee of Wise Men on the Regulation of the European Securities Markets, Brussels, 9/11/2000, ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf.

curities committees (ESC and CESR).[12] Level 3 entailed the CESR to commit to 'improving the consistency in day-to-day transposition and implementation of level 1 and 2 legislation'.[13] Level 4 envisioned enforcement by the Commission, which was supposed to check Member States' implementation of the Directive and take enforcement action for any inconsistent or failing implementation. This new set-up was supposed to improve the flexibility and coordination between European and national supervisors in order to consolidate the single market for capital in the EU.

Although the review report of the Inter-Institutional Monitoring Group for securities markets after the first 3 years hailed the Lamfalussy-process as a success with increased speed of the legislative process, better inter-institutional coordination and greater transparency, there were also points that needed further attention such as still too much detail in level 1 legislation, lack of convergence between Member States levels of compliance and a missing legal basis for soft law stemming from CESR on level 3.[14] Several financial institutions confirmed the problems of overly detailed implementation, arbitrariness in the choice between directives and regulations and on level 3, insufficient consultation of market parties and a lack of convergence of methods in supervision between Member States.[15] In 2004 the CESR published their 'Himalaya-report' which also mentioned that the CESR needed more supervisory tools to ensure a level playing field and enable national supervisors to more effectively solve cross-border disputes.[16] If that was not possible, the Member States and EU institutions should create more supervisory tools for the CESR.[17] An IMF report in 2007 confirmed the absence of an effective framework of coordination between European and national supervisors with respect to the oversight of cross-border operations of financial institutions as an important weakness to be able to respond effectively to transnational financial crises.[18]

The change from Lamfalussy to the new ESAs was accelerated by the 2008 global financial crisis. It started off with observations in the Larosière-report that the Lamfalussy-committees had been unable to converge supervisory methods at the national and EU level into a well-functioning European system of monitoring

[12] ESC stands for European Securities Committee and CESR for Committee of European Securities Regulators. In 2003 and 2004 the CEBS and CEIOPS were installed along the same Lamfalussy-lines in the field of banking and insurances & pensions.

[13] Final Report of the Committee of Wise Men, 37.

[14] Inter-Institutional Monitoring Group Third Report monitoring the Lamfalussy Process, 17/11/2004, ec.europa.eu/internal_market/securities/docs/monitoring/third-report/2004-11-monitoring_en.pdf.

[15] See: ec.europa.eu/internal_market/securities/lamfalussy/monitoring/index_en.htm. Especially useful are the responses of Barclays PLC, BBA and BDB. Interesting to see is that the BDB response already envisioned a single supervisory authority for financial markets as the way forward for truly establishing a single market.

[16] See also European Commission, Review of the Lamfalussy process- Strengthening Supervisory Convergence, COM(2007) 727.

[17] Preliminary progress report: which supervisory tools for the EU securities markets? An analytical Paper by CESR, Paris October 2004 (www.esma.europa.eu/system/files/04_333f.pdf).

[18] IMF, Regional Economic Outlook: Europe, November 2007, www.imf.org/external/pubs/ft/reo/2007/eur/eng/ereo1107.pdf.

and enforcement of financial regulations.[19] A number of major flaws were identified such as a lack of effective macro-prudential supervision, insufficient cooperation between supervisors, and the incapacity to respond immediately in situations of crisis.[20] In order to strengthen European supervision over financial institutions, a new organisation structure was proposed.[21] The Larosière-report recommended reforming the old Lamfalussy-committees into three separate European supervisory authorities instead of establishing one single supervisory authority, probably to prevent accusations of a European supervision monopoly.[22]

To embed the ESAs in a more robust legal framework, three regulations were enacted with detailed rules concerning the duties and competences of the ESAs.[23] The regulations are supposed to provide the ESAs with a firm set of powers, especially compared to the former Level 3 committees under the Lamfalussy procedure. The biggest changes are that the new Authorities have the ability to craft binding technical standards, to offer binding mediation between national supervisors and even to overrule the latter in case of breaches of EU law in emergency situations. Unlike their predecessors, who were involved in a regulatory process as advisors and promoters of coherent supervision[24], the ESAs take a more active part in the regulatory process.[25] Even though formally the Commission has to approve the technical regulatory and implementing standards the ESAs can draft, they are de facto in control and, among others, responsible for public consultation, cost-benefits analyses and retrieving expert opinions from the Stakeholder Group.[26] When faced with an emergency situation, the ESAs may even issue binding decisions for financial institutions (e.g. banks, insurance companies and pension funds) in the Member States, which also increases their authority and strengthens their independency towards national supervisors.[27]

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[19] High Level Group on Financial Supervision in the EU, 75.

[20] Ibid, 40–42.

[21] Ibid, 56. It contains a list of 7 new competences compared with the Level 3 Lamfalussy-committees.

[22] K Alexander, 'Reforming European financial supervision and the role of EU institutions' (2010) *Amicus Curiae* 2, 10. See also P Schammo, 'EU Day-to-Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision?' (2012) 32 *OJLS* 771, 775.

[23] Reg (EU) 1093/2010 establishing a European Supervisory Authority (European Banking Authority), [2010] OJ L 331/12 (EBA Regulation); Reg (EU) 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), [2010] OJ L 331/48 (EIOPA Regulation) and Reg (EU) 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), [2010] OJ L 331/84 (ESMA Regulation). When referring to all three, they will be mentioned as 'the Regulations'.

[24] Alexander, 'Reforming European financial supervision', 5.

[25] They now draft standards which will be adopted as delegated legislation. See Arts 10 and 15 of the Regulations.

[26] Art 10(1) of the Regulations.

[27] L Szegedi, 'Challenges of Direct European Supervision of Financial Markets' (2012) 57 *Public Finance Quarterly* 347, 349. See also Art 18 of the Regulations.

To counter these emergency powers, a stringent procedure has been set up in which first the Commission has to act and an emergency state has to be declared by the Council before the ESAs may intervene. Despite their new-found powers, there are a few weaknesses that have not been filtered out during the transformation process from Lamfalussy-committees to ESAs. The most important one being that the new system remains a compromise between direct European supervision and home state control, as the day-to-day supervision of financial institutions remains with the national supervisors.[28] Because of this it will remain difficult for the ESAs to efficiently monitor compliance, as they are dependent on data that the national supervisors collect and share.[29] Next to this, the fact that the ESAs need consent from the Commission or the Council in performing important regulatory duties may hinder them to respond swiftly and effectively in case of threats to the financial system as a whole.

37.4 National Supervisors Supervising Themselves?

The Regulations establishing the ESAs envisioned a way for national supervisors to retain influence in the EU-level supervision of financial institutions by seating a representative in the Board of Supervisors (BoS).[30] As the BoS is the main decision-making body of the ESAs, it is important that the chairperson and voting members of the Board of Supervisors shall act independently and objectively as required by Article 42 of the Regulations. This means that they may not be influenced by the Member States or by EU institutions and have to act solely with the interest of the EU in mind. One may, nevertheless, wonder how independent the representatives of national supervisors can actually be, especially when preparing individual decisions that may be directed towards financial institutions in their own country. The other way around, it will be difficult for the national supervisors in the BoS to be tough on other countries' institutions as well when there is a possibility that their member state institutions might later face sanctions as well. As Schammo has stated, in order for the supervision on financial institutions to work, the national supervisors have to make sure they 'show a greater willingness to challenge and confront each other when necessary'.[31]

Another problem arises with the voting mechanisms in place for the different kind of decisions the ESAs are able to produce. After a lengthy discussion during the legislative phase of drafting the ESA-regulations, the result is a compromise between smaller Member States without large financial centres looking for more influence through a one-country one-vote system, and bigger Member States which host large financial institutions who would favour Quality Majority Voting (QMV)

[28] Schammo, 'EU Day-to-Day Supervision', 792.

[29] Art 35 of the Regulations.

[30] Art 40(1)(b) of the Regulations.

[31] Schammo, 'EU Day-to-Day Supervision', 796.

as this voting procedure would strengthen their position.[32] Although the regulations establishing the ESAs declare that the BoS takes decisions based on simple majority voting, nearly all important decisions concerning draft technical standards, guidelines and recommendations and decision to ban certain kinds of financial products (e.g. credit default swaps) are subjected to QMV.[33] Only the decisions towards competent supervisors during cross-border disputes are subjected to simple majority voting, but with the additional catch that the certain decisions can be rejected by members representing a blocking minority.[34] This creates the possibility for larger Member States to exert a strong influence on decision-making in the ESAs. In case a level playing field is the most important goal for the ESAs, this appears to be illogical. In that case a one-country, a one-vote system would probably suffice. Although a case can be made for QMV to reflect the sizes of the financial centres in Member States more clearly, should this be a consideration when trying to establish decision-making? The question of reflecting the differences between financial centres in the EU is especially relevant considering the management boards of the ESAs. These are responsible for the preparation of technical standards as well as day-to-day operations of the ESAs. Its composition should be 'balanced and proportionate and reflect the Union as a whole'.[35] However, some representatives of national supervisors in the management of the BoS have a double role, by creating as well as executing the work programme of the ESA, and influence the decision-making on two levels. Furthermore, one may wonder in what way there is a correct reflection of the Union as a whole while at the same time have a balanced and proportionate Management Board which takes into consideration the differences between countries and financial centres. Is it possible that the larger Member States exert more influence in the boards of the ESAs? Looking at the different Management Boards of the ESAs, the UK and France are present as members in all three boards, while Germany has membership in both the boards from the EBA and EIOPA.[36] This means that in almost all the preparatory work for the BoS of the ESAs, at least two of the three Member States with the largest financial centres are at work. If the ESAs were supposed to be a technical and independent agency to promote sufficient oversight on financial systems, why are they so dependent on the national supervisors' expertise? This becomes especially troubling if ESAs are unwilling to request information from national supervisors as they already anticipate a rejection

[32] AB Spendzharova, 'Power to the European Supervisory Authorities: Explaining the Incremental Evolution of European Financial Regulation' (2012) Paper prepared for the 2012 UACES conference, 13. Available at uaces.org/documents/papers/1201/spendzharova.pdf.

[33] Art 44(1), second paragraph of the Regulations. This means that all the quasi-rulemaking powers (standards, guidelines and recommendations based on Arts 10 and 16) fall outside the scope of simple majority voting. Budgetary matters as well.

[34] Art 44(1), third paragraph of the Regulations. This seems confusing, for a clearer answer look at Article 16(4) TFEU and in Art 3 of the Protocol (No 36) on transitional provisions which describes the different kind of voting procedures.

[35] Art 45(1), third paragraph of the Regulations.

[36] See www.eba.europa.eu/about-us/organisation/management-board/members, eiopa.europa.eu/organisation/management/management-board/index.html and www.esma.europa.eu/mb.

of that request by the BoS.[37] It is one of the reasons German banks have been advocating a truly EU-level supervisor as it is difficult for national supervisors to keep track of cross-border operating financial institutions.[38]

37.5 ESAs Regulory Powers: Hard Law, Soft Law or Hoft Law?

Without any exaggeration the regulatory powers of the ESAs can be called controversial. This is not only the case for the binding supervisory decisions the ESAs can take against national supervisory authorities and individual financial institutions in case of emergency situations but also for the drafting of technical or implementing standards. Perhaps more surprisingly at first sight, is that the controversy is not limited to binding decisions and regulations but extends over non-binding guidelines and recommendations representing the most common and day-to-day regulatory measures drafted by the ESAs, which are probably not so soft as one would perhaps expect.[39]

The importance of soft law already starts with the fact that the ESAs do not need permission or consent from the Commission to issue guidelines and recommendations addressed to competent authorities or financial institutions in order to establish consistent, efficient and effective supervisory practices within the ESFS. Although non-binding, these rules will be hard to neglect since they come with the obligation of compliance reporting from the side of national supervisory authorities and financial institutions. Article 16 of the Regulations introduces a sophisticated system of 'comply or explain' obligations for the latter and requires the ESAs to report this information in case of non-compliance to the EP, Council and Commission. The regulations also give ESAs the right to publish the reasons for supervisory authorities' non-compliance with guidelines and recommendations.[40] This 'naming and shaming' of especially financial institutions themselves is likely to carry weight because it comes with reputation costs, while there is always the threat that the EU legislature will impose binding measures in case of continued non-compliance ('the big stick behind the door'). A possible initiative from the side of the Commission to

[37] Draft Report with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review (2013/2166(INI)), available at www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-521.510+01+DOC+PDF+V0//EN&language=EN.

[38] See the aforementioned BDB-response to the third report on the Lamfalussy-structure as well as the report from Deutsche Bank Research, Financial supervision in the EU Incremental progress, success not ensured, Frankfurt am Main 4 August 2011, available at www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000276501/Financial+supervision+in+the+EU%3A+Incremental+progress,+success+not+ensured.PDF.

[39] Which is exactly why these are the regulatory instruments one should watch out for. See Busuioc, 'Rule-making by the European Financial Supervisory Authorities', 113.

[40] Ibid, 118 f.

issue strict legislation in case certain national supervisors neglect ESA guidelines and recommendations may cast its shadow and will probably increase peer pressure to comply from the side of other financial institutions afraid of being confronted with less flexible rules at higher costs.

Apart from the fact that ESA soft law may sometimes serve as a forerunner of future legislation, it is certainly imaginable that national supervisory authorities will simply take over ESA's guidelines and regulations thereby transforming these non-binding rules into binding or semi-binding legal norms.[41] Perhaps this is why Möllers calls this sort of guidelines and recommendations a 'third kind of secondary law'; next to hard law and soft law, there is now 'hoft law'.[42] Hoft law is hard to disregard, needs to be complied with, and in case of non-compliance, extensive reasons must be given. That is why Möllers sees it as a mixture of hard and soft law. The only trouble is that it is hard to predict beforehand what the (legal) consequences of ESA soft or hoft law are going to be and how the addressees of these rules are going to respond in different situations. What we know from experience, though, is that the effectiveness of international institutions in this sector without binding legal powers depends to a large part on their ability to develop a strong reputation in terms of technical competence and predictive judgment.[43] However, it is hard to predict what the ECJ would decide in case national supervisors, banks or other financial institutions are going to dispute the validity of ESA guidelines and recommendations. Although Article 263 TFEU, in principle, opens the possibility of judicial review against agency-decisions which are of direct and individual concern to them, it also requires that they 'intended to produce legal effects'. Exactly this particular feature is controversial here since the legal status of ESA guidelines and recommendations is kept ambiguous by the EU legislature.[44] In the consultation responses on the review of the ESFS the ambiguity of the guidelines is a problem that is indicated by several respondents.[45]

With regard to ESA decisions and draft technical regulatory and implementing standards the situation appears to be clearer at first sight but looks might be deceiving here. Although formally binding, the area where ESAs may draft technical standards are always defined by primary EU legislation, which are not supposed

[41] See for example the 'Policy rule application guidelines EBA' of the Dutch Central Bank that are being applied in relation to the enforcement of the Act on financial supervision, *Staatscourant* 2012, no 4959.

[42] TJ Möllers, 'Sources of Law in European Securities Regulation—Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to de Larosière' (2010) 11 *European Business Organization Law Review* 379, 400. Interesting is whether the ECJ can review guidelines and recommendations by agencies since Art 263 TFEU refers to 'acts intended to produce legal effects *vis-à-vis* third parties'.

[43] Ferran and Alexander, 'Can Soft Law Bodies be Effective?', 32.

[44] The EP amended the specific article concerning guidelines and removed the word 'non-binding' but thereby leaving open room to debate whether this means it's binding or some sort of third option, see www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A7-2010-166&language=EN.

[45] See for example responses from HSBC, Allianz and Federation of Finnish Financial Services at ec.europa.eu/internal_market/consultations/2013/esfs/contributions_en.htm.

to involve policy choices, otherwise the validity of these acts would be at risk. Moreover, the Commission has to endorse those standards in order to give them binding legal effect, whereas the EP and Council can, in the case of delegated acts, always revoke the delegation afterwards. The adoption of individual legally binding decisions by the ESAs is even more dependent of others because the Council must whether an emergency situation exists first, a decision it will probably not take lightly, because that declaration may act as a trigger for the ESAs to intervene directly in financial market activities. Hence direct supervisory decisions will probably remain an instrument of last resort since is it obliges national authorities to take immediate action and where the obligations of the violated EU regulations address individual financial institutions, the ESAs can even bypass national supervisors. One wonders whether these powers can still be regarded as non-discretionary in terms of the *Meroni* doctrine.

In *Meroni v High Authority*, the ECJ analysed the constitutional limits of a delegation of powers to in that case private agencies ('bodies established under private law, having a distinct legal personality and possessing powers of their own') as such.[46] While noting that Article 8 ECSC did not provide an explicit legal basis for such a delegation, the Court nonetheless decided that the possibility of delegation cannot be excluded, but this delegation shall not contain political choices. Although the present-day meaning of the *Meroni* doctrine is highly contested,[47] it is believed to have prevented European agencies so far from exercising important political choices involving discretionary powers. Doubts may be cast, however, whether the establishing of European supervisory agencies with public legal personality and a separate budget makes much sense if these supposedly 'independent' supervisors would not be allowed to make any choices that allow for at least some margin of discretion towards the Commission and the Member States.

37.6 An Appropriate Legal Basis for the ESAs?

In the EU Treaties, there is no article that explicitly refers to the creation of European Supervisory Agencies as there is, for example for the ECB (see Article 13(1) TEU). As a specific legal basis for establishing regulatory agencies is lacking, the EU legislature had to make a choice whether to base the ESAs on Article 114 TFEU or on Article 352 TFEU. Article 114 opens the possibility to enact legislation with a harmonizing effect regarding rules covering the internal market.[48] Opting for Article 114 TFEU could be justified by the fact that the functioning of the internal

[46] Case 9/56 *Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community* [1958] ECR 133.

[47] M Chamon, 'EU agencies between 'Meroni and Romano' or the devil and the deep blue sea' (2011) 48 *CML Rev* 1055.

[48] This article refers back to Art 26 TFEU which states that 'the Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market'.

market was threatened by the financial crisis,[49] and thus the ESAs are a way of harmonizing national efforts to more effectively supervise financial institutions. However, Article 114 may not be used when a more straightforward article is available.[50] This restriction seems relevant since the ESAs have been given certain sanctioning powers that, according to some, appear to be going beyond harmonisation of technical rules.[51] In the ENISA case, however, the ECJ decided that Article 114 TFEU may be used as a legal basis for the creation of agencies as long as this facilitates the approximation of laws and the tasks conferred to the agencies are *closely linked* to the acts aiming at harmonisation.[52] Prohibiting short selling by ESMA (see hereafter) could, for example, affect the stability of financial markets and hence might be labelled as such. Thus as soon as agency rule-making appears to achieve some sort of genuine effort to improve the internal market, agency rule-making could be passed on the basis of Article 114 TFEU even though other objectives might also be present.

One could argue, though, that cross-border financial services are internal market related and so does the supervision by the ESAs. The only problem is that it is also defendable that certain supervisory tasks, and especially individual decisions by the ESAs directly addressing financial institution in the Member States, go well beyond harmonizing rules and (implementing) standards.[53] In light of the latter, it is sometimes claimed that Article 352 TFEU would provide a better legal basis for the ESAs. This Article is normally used when there is no Treaty basis available to grant legislative powers but the objectives have been specified in the Treaties. In order to prevent competence creep by the EU legislature, national parliaments have to be warned by the Commission that a proposal is planned based on Article 352 as a means of subsidiarity control.[54] Moreover, the article requires unanimous voting in the Council as to make sure all Member States agree to grant EU institutions new powers. This is why in the past most agencies have been based on Article 352 TFEU.

As Weatherill has shown[55], the ECJ has been rather lenient with regard to the use of Article 114 TFEU as well. However, in a case pending before the ECJ, the UK challenges the use of this Article as the legal basis for Article 28 of Regulation (EU) 236/2012 because the emergency powers the ESMA are granted move

[49] See recital 7 of the Regulations.

[50] See also Case C-338/01 *Commission v Council* [2004] ECR I-4829, paras 54–61.

[51] N Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market—A Tale of Two Competences: Part (2) Rules in Action' (2011) 12 *European Business Organisational Law Review* 177, 219.

[52] Case C-217/04 *United Kingdom v European Parliament and Council* [2006] ECR I-3771, paras 44 f.

[53] E Fahey, 'Does the Emperor Have Financial Crisis Clothes? Reflections on the Legal Basis of the European Banking Authority' (2011) 74 *MLR* 581, 593.

[54] Art 352(2) TFEU.

[55] S Weatherill, 'The Limits of Legislative Harmonization Ten Years after *Tobacco Advertising*: How the Court's Case Law has become a 'Drafting Guide' (2011) 12 *German Law Journal* 827.

beyond the harmonisation of laws and should therefore be declared *ultra vires*.[56] Advocate General Jääskinen agrees with the UK on this point, and concludes that 'the outcome of the activation of ESMA's powers under Article 28 of Regulation No 236/2012 is not harmonisation, or the adoption of uniform practice at the level of the Member States, but the replacement of national decision making under Articles 18, 20 and 22 of Regulation No 236/2012 with EU level decision making'.[57] One of the interesting arguments put forward by Jääskinen is that Article 352 does offer an appropriate legal basis for the emergency powers of ESMA because in an integrated market of financial instruments, inaction or inadequate action by a competent national authority in relation to short selling may have significant cross-border effects which create distortions in the banking systems of other EU Member States than where short selling takes place. Therefore, a centralised decision making procedure enabling uniform application of EU rules on short selling is regarded as both necessary and proportionate by the AG. A centralised emergency decision making process that replaces the decision of the competent Member State authority, without its consent, or which provides a substitution for the absence of one, however, would go well beyond 'approximation of the provisions laid down by law, regulation or administrative action in Member States' under Article 114 TFEU. This is why he feels that unanimous decision-making is required in this case.[58]

The ECJ however considers art. 114 TFEU a perfectly viable legal basis for the emergency powers handed to the ESMA, as the article relates to harmonization of Member States' law and is clearly intended to improve the conditions for the establishment and functioning of the internal market. The ECJ does not refer to art. 352 TFEU so even though art. 114 TFEU is a suitable article for these kind of powers, there is no certainty if art. 352 TFEU would provide a more democratically suited recourse for the EU legislator. So for now it seems that art. 114 TFEU is saved as a provision which can support increasingly powerful legislation aimed at financial stabilization under the guise of promoting the functioning of the internal market.[59]

At the same time, the latter raises a very fundamental question. After all, what is more democratic: unanimity and thus the possibility for one country, such as the UK,[60] to halt the conferral of emergency powers, or QMV where a qualified majority could dictate the rules to a (vehemently opposed) minority? We believe that unanimity should never be able to serve as an alibi for Member States to undermine the stability of financial markets by being allowed to attract certain financial transactions, which are prohibited by EU law because they encourage forum shopping and thereby jeopardize the functioning of the internal market.

[56] AG Jääskinen, Opinion of 12 September 2013, case C-270/12 *United Kingdom v Council and Parliament*, not yet reported, para 35.

[57] Ibid, paras 52 f and 59.

[58] Ibid, para 58.

[59] Case 270/12 *United Kingdom v. Parliament and Council*, not yet reported, paras 102–116.

[60] It is needless to say that the UK has an interest in keeping a unique position in the short selling branch.

37.7 The Legal Framework for Delegated and Implementing Acts

Apart from the dispute over the legal basis on which Article 28 of Regulation 236/2012 rests, it is also interesting to notice that AG Jääskinen has argued that the conferral of powers in Article 28 falls outside the scope of Article 290/291 TFEU. In his eyes Article 28 TFEU does not entail a (sub)delegation of legislative powers or transfer of implementing powers to an agency that have previously been conferred on the Commission or the Council. We should, instead, see ESMA's powers under Article 28 as a direct attribution of administrative powers from the EU legislature through an Article 289(3) TFEU legislative act.

Why is the latter the case? Close reading of the AG's opinion reveals that he feels that in light of the *Romano* case,[61] the EU legislature cannot delegate its legislative powers directly to an agency, and sub-delegation to an agency by the Commission of the powers delegated to it under Article 290 TFEU would be unlawful. The reason for this is that Articles 2 and 10 TEU dictate that any power to adopt an EU measure that can alter the non-essential elements of an EU legislative act must be exercised by an EU institution that is directly democratically accountable. This would give the Commission a monopoly position because the ESAs are not directly accountable to the European Parliament. Moreover, because the legislature has attributed implementing powers to ESMA, Article 291 would also not apply. Therefore, according to the AG, the *Meroni* prohibition of conferring inordinately broad and/or arbitrary implementing powers remains relevant here. The conferral of excessive implementing powers by the EU legislature would blur the distinction between legislation and implementation and disregard the primacy of the democratic legislature, recognised in the constitutions of several Member States and in Article 290 TFEU. So what Jääskinen is basically saying is that: (a) *Meroni* still applies in case of direct attribution of executive powers by the EU legislature, (b) this implies that no genuine policy choices may be conferred to agencies because (c) that would disregard the distinction between delegated and implementing acts and as a consequence violate the (emerging?) primacy of the democratically elected legislature at the EU level.

Doubts may be cast, however, as to what extent the *Meroni* and *Romano* doctrine is still capable of grasping the complexities of delegation of regulatory powers to the ESAs.[62] First of all, according to a strict reading of *Meroni* and *Romano*, EU agencies would not be allowed to adopt binding measures and would be not allowed to make any discretionary choices. As Chamon has argued,[63] there are not many examples one can think of in which it is worthwhile to establish EU regulatory agencies with such limited powers, while the agency is quite a heavy public law organisation form, given its separate legal personality and budget, if the EU

[61] Case 98/80 *Giuseppe Romano v Institut national d'assurance maladie-invalidité* [1981] ECR I-1241.

[62] COM(2009) 114 final, 5.

[63] See M Chamon, 'Le recours à la soft law comme moyen d'éluder les obstacles constitutionnels au développement des agences de l'UE' (2014) *Revue du Marché Commun et de l'union européenne* forthcoming.

legislature would not have wanted the ESAs to make any independent choices. By reading the Court's judgment in C-270/12 it seems as if Meroni is now the sole basis for limiting delegation to agencies as the Court states that 'it cannot be inferred from *Romano* that the delegation of powers to a body such as ESMA is governed by conditions other than those set out in *Meroni v High Authority*'.[64]

Secondly, with regard to EBA, ESMA and EIOPA, the EP has consistently tried to fortify their regulatory powers towards both national supervisors *and* the Commission. In relation to the EBA, for example, the EP amended the Commission proposal in order to broaden the scope of the regulations to be prepared by the EBA from purely 'technical' rules to 'regulatory standards to complete, update or modify elements that are not essential to the legislative acts referred to in Article 1(2).'[65] The EP also introduced the possibility for the EBA to act in case of breaches of Union law, including failures to comply with regulatory technical standards and implementing technical standards developed by the EBA itself, although initially the Commission had reserved this power exclusively for itself.[66]

Similar developments can be witnessed with regard to EIOPA and ESMA. In each case the EP has tried to strengthen the position of the ESA in relation to the powers of the Commission to overrule ESA decisions, whereas one would expect just the opposite when looking at Article 290/291, which mention the Commission as the sole addressee of delegated and implementing acts instead of administrative agencies. Hence, while the three regulations establishing the ESAs provide the Commission with the power to (not) approve and amend the regulatory technical standards (Article 10) and implementing technical standards (Article 15) drafted by the ESA's, the Commission may only do so if the interest of the Union requires this and *after* consulting of the ESA's.[67] This shows that as far as supervision of financial services is concerned, the EU legislature apparently has more faith in the ESAs than in the Commission. See for example recital 23 of the Preamble to the regulations establishing EBA and ESMA and recital 22 of the Preamble of the regulation establishing EIOPA where it comes to the preparation of technical standards, which state among others that:

> The Commission should endorse those draft regulatory technical standards by means of delegated acts pursuant to Article 290 TFEU in order to give them binding legal effect. They should be subject to amendment only in very restricted and extraordinary circumstances, since the Authority is the actor in close contact with and knowing best the daily functioning of financial markets. Draft regulatory technical standards would be subject to amendment if they were incompatible with Union law, did not respect the principle of proportionality or ran counter to the fundamental principles of the internal market for financial services as reflected in the acquis of Union financial services legislation. The Commission should not change the content of the draft regulatory technical standards prepared by the Authority without prior coordination with the Authority. To ensure a smooth and expeditious adoption process for those standards, the Commission's decision to endorse draft regulatory technical standards should be subject to a time limit.

[64] Case 270/12 *United Kingdom v. Parliament and Council*, not yet reported, para 66.

[65] Draft European Parliament legislative resolution on the proposal for a regulation establishing a European Banking Authority, EP doc A7-0166/2010, amendment 86.

[66] Art 17 of the EBA-regulation.

[67] E Chiti, 'European Agencies' Rulemaking: Powers, Procedures and Assessment' (2013) 19 *ELJ* 93, 96.

Here it is clearly not the Commission that is protected against a too far-reaching exercise of regulatory powers by the ESAs but rather the other way around. Time will tell how strict these exceptions on the basis of which the Commission can intervene are, but it is clear that the EU legislature felt that the Commission should leave the supervisory agencies a rather wide margin of discretion.[68] That appears to be logical because if the Commission would have been the best suited institution to exercise supervision over financial services in the EU, we would probably not have needed the ESAs and the regulations would not have to stress the importance of their independent position. Simultaneously, however, the required independence of the ESAs raises fundamental questions in relation to the 'primacy of the EU legislature' in which democratic legitimacy of agency decision-making is traditionally seen as ultimately being derived from legislation by the ordinary legislature and hence with involvement of the EP. The question is whether this 'transmission belt theory' still holds ground for the tasks we require the ESAs to fulfil.

37.8 Balance Sheet: ESAs Moving Forward or Backward?

Looking back at the issues we have discussed so far there seem to be a number of recurring problems.

As far as the development from Lamfalussy committees to ESA's is concerned there appears to be a constant tug-of-war between the independence of European supervisory authorities and the accountability towards the Commission and the Member States. As Lavrijssen and Ottow have mentioned the: 'new European supervisors must serve two masters: their respective national supervisors and the EU bodies. This 'double-hattedness' is reflected in their complex governance structure. They are part of a multi-level administration: the national administration and the EU administration. Conflicts of interest are likely and could put the European agencies and their respective NRAs in a difficult position.'[69] For instance, although independence does not necessarily result in a zero-sum game with accountability[70], the ESAs are constrained by their BoS, in which the Member States have a strong say and are also depending on national supervisors for data to effectively monitor compliance of financial institutions operating from within the Member States, which begs the question just how independent the ESAs can be.[71] As far as their

[68] N Moloney, 'Reform or Revolution? The financial crisis, EU financial markets law, and the European Securities and Markets Authority' (2011) *60 ICLQ* 521, 532.

[69] S Lavrijssen and A Ottow, 'Independent Supervisory Authorities: A Fragile Concept' (2012) 39 *Legal Issues of Economic Integration* 419, 439.

[70] M Scholten, 'Independent, Hence Unaccountable? The Need for a broader debate on the Executive' (2011) 4 *Review of European Administrative Law* 5, 43.

[71] The last sentence of Art 1(5) of the Regulations states that 'When carrying out its tasks, the Authority shall act independently and objectively and in the interest of the Union alone'.

constitutional embedding is concerned, the ESA's largely depend on the Commission for developing binding rules but at the same time they are expected to operate independently from political influences (hence the Commission has no voting power in the BoS) and stay within the contours of the *Meroni* doctrine (indicating that the ESA are mere agents of the Commission without the power to draft binding rules or make important policy decisions). This threatens to turn them into a jack of all trades, and a master of none.

As far as the reliance of the ESAs on soft law is concerned there is no formal control on the issuance of guidelines and recommendations, as is the case with the technical standards that need to be endowed by the Commission, but it remains unclear to what extent these rules are legitimate and subject to judicial review. Moreover, while the procedural requirements for the adoption of binding technical standards and implementing rules are laid down in the regulations, rule-making by the ESAs through soft law remains largely underproceduralised.[72] This could be regarded as a flaw in the accountability of the ESAs but one may also see the reliance on soft law as a way to move beyond the constitutional constraints of the *Meroni* and *Romano* case law. The constraints discussed in paragraph 6 and 7 create problems for the ESAs. Insecurity about the proper legal basis for the ESAs hangs as a sword of Damocles above their operations and the way democratic legitimacy is conveyed to the ESAs through Article 290 and 291 hinders the effective fulfilment of their responsibilities and affects their independency towards EU institutions and the Member States.

Under the current legal regime as laid down in the treaties, it remains unclear what direction the ESAs should take to make sure they can live up to their tasks set out in the establishing regulations.[73] The case of UK versus Council and Parliament seems to be of great importance in moving forward for the ESAs. There is, however, a chance the ECJ will refrain from presenting a clear view on the way the *Meroni* and *Romano* case law fits in with the transition European supervision in the financial sector has gone through over the years in which the responsible supervisory bodies have: (a) gradually been given more regulatory powers to influence the decision-making process by the Commission, (b) gained hierarchical authority over their national counterparts and (c) received a broader range of tools to ensure compliance (e.g. from naming and shaming to binding decision-making powers for emergency situations). Therefore we will hereafter move beyond a possible minimalistic approach by the ECJ, in order to think about how a more structural embedding of the ESAs in the constitutional framework of the EU could be shaped as to improve their supervisory capacities, increase their independence but without losing out on the accountability side.

[72] Chiti, 'European Agencies' Rulemaking', 109.

[73] Recitals 11 to 13 of the EBA- and ESMA-Regulation and Recitals 10 to 12 of the EIOPA-Regulation.

37.9 A Way to Move Forward: Leaving Behind the 'Transmission Belt Theory'

From a traditional constitutional perspective, regulatory duties should preferably be carried out by institutions directly accountable to the electorate. That is why delegation to the executive (secondary legislation) or to administrative agencies (agency rule-making) is usually viewed with suspicion. Both at the national and the European level this has led to oversight mechanisms that should enable parliaments to exert control. Article 290 and 291 TFEU, for example, give the EP (delegated acts) and the Member States through comitology (implementing acts) instruments to keep a grip on rule-making by organisations that are not directly accountable to the electorate. These oversight mechanisms, however, still heavily rely on what Richard Stewart has branded as the 'transmission belt theory' of administrative law in which legislation by the formal (in EU terms: 'ordinary') legislature serves to transfer democratic legitimacy to administrators and delegated rule-makers at the same time constraining their actions so that they advance legislative goals.[74] Looking at the consequences of agencification at the EU-level in which independent supervisory agencies have now gained regulatory and decision-making powers in relation to national supervisors and financial institutions in the Member States, it seems hard to deny that the transmission belt theory is stretched to its limits.

Almost every author who has previously written about agencification refers to the *Meroni* case[75], despite the fact that the ECJ has never actually applied this ruling on an agency case yet and *Meroni* was delivered as early as 1958 under the ECSC Treaty and concerned a case about delegation to private organisations.[76] Even though the *Romano* case, dating back to 1981, seems to confirm that no discretionary powers can be delegated to agencies, the world of agency rule-making has changed tremendously since that time. Under the regime of the regulations establishing the ESAs, the Commission still formally adopt all delegated and implementing acts but Chamon is right that this should first and foremost be seen as a 'pragmatic constitutional fix' in order to circumvent the restrictions imposed upon agency rule-making by the *Meroni* and *Romano* case law.[77] After the judgment in the short selling case we know for certain that Meroni is the correct framework with which to perceive the delegation to agencies. Nevertheless it seems that the transmission belt that connects the EP and Council with the Commission and the Commission on its turn with the ESAs is, at least partly, cut through because for implementing acts the EU

[74] R Stewart, 'The Reformation of American Administrative Law' (1975) 80 *Harvard Law Review* 1667.

[75] E Chiti, 'An Important Part of the EU's Institutional Machinery: Features, Problems and Perspectives of European Agencies' (2009) 46 *CML Rev* 1420.

[76] AG Geelhoed, however, argued in 2003 that *Meroni* would apply to agencies. See his opinion in Case C-378/00 *Commission v European Council and Council* [2003] ECR I-937. In hindsight of C-270/12 AG Geelhoed seems to be in the right with his argument.

[77] Chamon, 'EU agencies', 1069.

legislature is able to confer decision-making powers directly to agencies without intervention by the Commission as long as these powers are imbedded in a grand mechanism with checks and balances leading to financial stability. We could take the argument by Jääskinen one step further, though, because a clear distinction between the drafting of technical standards and the adoption of policy choices probably does not exist in practice.[78] As far as the *Meroni* and *Romano* case law with regard to democratic legitimacy is concerned, this could perhaps also be remedied by strengthening consultation and public participation rights with respect to agency-rule-making and proceduralisation of the rule-making process accompanied by the reinforcement of judicial review regarding the use of technical and implementing standards and various sorts of soft law.

As Gerardin has argued before[79], the EU legislature could probably learn something with regard to agency rule-making from the situation in the US, where the Supreme Court has long abandoned the idea that Congress cannot delegate broad rule-making powers to regulatory agencies.[80] In fact the number of regulations by agencies exceeds by far the number of statutes enacted by Congress and many of these regulations leave the agency with a considerable amount of discretion to make policy choices.[81] Rubin gives the example of the Federal Communications Act (FCA) of 1934, which creates an agency and then instructs it to develop and implement rules to regulate commercial broadcasting.[82] The Act gives the Federal Communications Commission (FCC) the power the enact regulations:

> *not inconsistent with law as it may deem necessary* to prevent interference between stations and to carry out the provisions of this Act: Provided, however, That changes in the frequencies, authorized power, or in the times of operation of any station, shall not be made without the consent of the station licensee unless, after a public hearing, *the Commission shall determine that such changes will promote public convenience or interest or will serve public necessity*, or the provisions of this Act will be more fully complied with [italics added by RvG/TvG][83]

Rubin calls statutes like the FCA 'intransitive' because they do not specify any operative rules. According to him, what the statute really says is: 'The FCC is hereby

[78] Ibid, 1070. See also P Craig, 'Delegated acts, implementing acts and the new Comitology Regulation' (2011) 36 *EL Rev* 671, 672.

[79] D Gerardin, 'The Development of European Regulatory Agencies: What the EU should Learn from American Experience' (2005) *Columbia Journal of European Law* 1.

[80] See for instance *Mistretta v United States* 488 US 361, 372 (1989) in which the Supreme Court ruled, among others that: 'our jurisprudence has been driven by a practical understanding that in our increasingly complex society, replete with ever changing and more technical problems, Congress simply cannot do its job absent an ability to delegate power under broad general directives.'

[81] In 2008, for example, 284 federal statutes were enacted against 3,995 agency regulations. See L Schultz Bressman, E Rubin and K Stack, *The Regulatory State* (Aspen Publishers, New York, 2010) 2.

[82] E Rubin, 'Shocking News for Legislatures and Law Schools: Statutes are Law' in HR Schouten, *De opleiding van wetgevingsjuristen en wetgevingsonderzoekers in vergelijkend perspectief* (Nijmegen, Wolf Legal Publishers, 2011) 12.

[83] Public Law No 416, June 19, 1934, Sec 303 (f).

created and given authority to regulate commercial broadcasting in whatever way it decides to do so.'[84] In the US context this is considered acceptable because the Administrative Procedure Act (APA) provides a general constitutional framework containing important procedural rules and principles with regard to issues of independence, accountability, transparency, participation and judicial review for all administrative agencies. What might the European legislature learn from this? The answer is probably that laying down the foundations for agency rule-making in some sort of European Administrative Procedure Act (EAP), which codifies procedural rules, principles of good governance, and participation rights, completed by a system of judicial review that enables a broad range of stakeholders to have agency regulations reviewed in court, may prove to be a good substitute for a system in which democratic legitimacy is formally derived from the EU legislature via a lengthy transmission belt that can break at any given moment because it is seriously overstretched. Especially for the new generation of regulatory agencies to which the ESAs belong, it is of the utmost importance that their independence towards the Member States, which by nature focus on national interests, and towards the Council and Commission as political bodies in their capacity as 'executive leg' of the EU legislature, is sufficiently guaranteed. Without a proper balance between the margin of policy discretion that is necessary for the ESAs to be able to operate effectively and the accountability towards democratically elected bodies and the public behind those bodies, European financial supervision will remain in the current half-way house situation that sooner or later will result in new crises.

37.10 Conclusion

'Never waste a good crisis' is a popular expression often used to explain that crisis situations can serve an accelerator for reforms, which otherwise would not stand a chance. The EU legislature has tried to apply this wisdom to revise the system of financial supervision by introducing three new regulatory agencies that are supposed to monitor compliance and enforce EU laws and regulations meant to reduce financial risks spreading from one financial institution (e.g. banks) to the other and even from one Member State to others.

In this contribution we have argued that the new system with centralised European supervisory agencies has certainly brought some major improvements in terms of increased expertise, a more sophisticated regulatory toolbox with new instruments, such as naming and shaming, and the possibility for ESAs to directly intervene in the Member States financial systems in emergency situations. Nonetheless, there are still three major flaws in the new system, namely: the double role of national supervisory authorities as addressees of the oversight by the ESAs but simultaneously as watchdogs on the Boards of Supervisors of these 'independent'

[84] Rubin, 'Shocking News for Legislatures and Law Schools', 12.

regulatory agencies, which may affect the possibilities for swift and decisive interventions; (2) the reliance on soft law without clarity about the various functions that recommendations and guidelines are supposed to play and uncertainty about the extent to which soft law instruments are subjected to judicial review; (3) a rather obscure constitutional embedding of the ESAs in the system of the TFEU as far as their legal basis and competences are concerned.

Most of our attention in the second part of this article has been devoted to an analysis of the mismatch between the high expectations surrounding the ESAs and the limited competences they possess to live up to these expectations. The whole debate about the proper legal basis for the ESAs is basically caused by the fact that both Articles that are currently being used to establish (regulatory) agencies, namely Articles 114 and 352 TFEU seem to be ill-suited to serve as a foundation for the regulatory duties the ESAs are supposed to fulfil. Basing regulatory agencies on Article 114 requires stretching the concept of harmonisation, whereas the requirement of unanimity that is attached to Article 352 may create unreasonable obstacles to establish regulatory agencies with sufficient powers to intervene directly into the financial systems of the Member States and, where necessary, overrule decisions by national supervisory authorities, which disrespect EU law. With regard to the competences of the ESAs something similar is going on. On the hand the increased use of soft law by the agencies might be seen as a pragmatic way to move forward in establishing consistent, efficient and effective supervisory practices within the ESFS. On the other hand, the increased use of soft law and the combination of non-binding guidelines and recommendation with all sorts of comply or explain mechanisms could also be seen as way to circumvent the limitations to agency rulemaking following from the *Meroni* and *Romano* case law. In that way, one could also see the growing importance of soft law as an indicator for the need to reform current constitutional rules and practices.

With respect to the latter, we have sketched a new line of thinking for the future of the ESAs in the last part of this Article in which we—for a large part—say goodbye to the idea that independent regulatory agencies need to derive their legitimacy from the EU legislature via the Commission, which needs to endorse the rules and policy choices that ESAs have to make in practice. This does not mean that the guards of the financial system should become fully unguarded themselves. The question is, however, whether the Commission should stay the primary guardian of the ESAs or that the ESAs should become more directly accountable. We believe that instead of relying on a 'transmission belt theory' in which the ESAs are seen as mere agents of the Commission, one could also increase their independence while simultaneously strengthening their accountability towards stakeholders, such as national supervisory authorities, individual financial institutions and consumer organisations.

Inspiration for this might be drawn from the situation in the US where the APA contains rules with respect to stakeholder participation, consultation and access to justice for those affected by the rules and decisions of regulatory agencies. The pos-

sibility opened under Article 298 TFEU to establish rules of administrative procedure could be used to develop a more comprehensive constitutional framework for new generations of regulatory agencies, such as the ESAs, that need stronger rule-making competences and more leeway to make policy choices and take binding decisions against national supervisory authorities and individual financial institutions. Probably the only way the Member States will ever accept European supervisory agencies moving beyond the half-way house situation they are in right now is when the constitutional framework for the regulatory competences of ESAs is sufficiently robust, transparent and kept as simple as possible. It is needless to say that this is not the case at the moment. That is why the legislature should take advantage of the situation and take the lead in the on-going process of agencification.

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Chapter 38
Access to Justice and Public Interest Litigation: Getting Nowhere Quickly?

Laurence W. Gormley

Abstract This contribution examines the recent approaches of the Court of Justice and the General Court of the EU to issues of standing, particularly as regards regulatory acts not involving implementing measures, and as regards public interest litigation. This overview does not yet lead to the conclusion that either aspect is satisfactory at EU level; that the centralized Union judiciary has failed adequately to take account of calls for reform which could take place at the level of the judiciary, without needing intervention by the Member States; the reaction of the judiciary to the slight loosening of standing requirements introduced by the reforms made by the Treaty of Lisbon has been unduly restrictive and unconvincing.

38.1 Introduction

Access to justice in the context of European Union Law has always been unsatisfactory, at least as far as direct access is concerned,[1] so perhaps it is unsurprising that public interest litigation has been an unruly horse in the EU

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[1] See, inter alia, R Schwensfeier, *Individual's Access to Justice under Community Law* (Diss., Groningen, 2009) with extensive references to earlier literature; S Balthasar, 'Locus Standi Rules for Challenges to Regulatory Acts by Private Applicants: The new Article 263(4) TFEU' (2010) 35 *EL Rev* 542; LW Gormley, 'Access to Justice: Rays of Sunshine on Judicial Review or Morning Clouds on the Horizon?' (2013) 36 *Fordham International Law Journal* 1169; id, 'Judicial Review: Advice for the Deaf?' (2006) 29 *Fordham International Law Journal* 655; P Oliver, 'Access to Information and to Justice in EU Environmental Law: The Aarhus Convention' (2013) 36 *Fordham International Law Journal* 1423; L Parret, 'En wat met de rechtsbescherming?' (2009) 57 *SEW, Tijdschrift voor Europees en economisch recht* 103. As to judicial protection in general, see K Lenaerts et al., *EU Procedural Law* (3rd ed, Oxford, Oxford University Press, 2014) and H Schermers, D Waelbroeck and Slater, *Judicial Protection in European Union Law* (7th ed., Alphen aan den Rijn, Kluwer Law International, forthcoming).

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_38,

context.[2] The main considerations and criticisms of the Court's case-law, as well as the alleged justifications are well-known, and finally resulted in certain changes being made through the Treaty of Lisbon. Hans Micklitz has always been interested in judicial protection and in particular in public interest litigation, and the conference that he organized in Berlin in December 1985 had a major impact in causing European Law specialists to address the potential of public interest litigation in diverse areas of what was then European Community Law.[3]

38.1.1 Access to Justice—Direct or Indirect?

Challenging acts of the European Union institutions and other bodies, offices or agencies addressed to someone other than the applicant directly has always been a difficult process, ever since the infamously restrictive interpretation of the criteria of 'direct and individual concern' in Case 26/62 *Plaumann & Co. v Commission.*[4] While there have been some spectacular instances in which litigants have been successful in surmounting the hurdles erected by the Court of Justice,[5] the impression that in some of these instances the Court's reasoning has resembled more of an equitable rabbit pulled out of a hat, than a coherent policy formulation is difficult to avoid.[6] Cutting a long story very short, it became clear that the Court was if anything becoming increasingly deaf to the chorus of criticism of its ostrich-like

[2] See LW Gormley, 'Public Interest Litigation' in D O'Keeffe and A Bavasso (eds), *Judicial Review in European Union Law* (*Liber Amicorum* for Lord Slynn of Hadley, Vol. I) (Alphen aan den Rijn, Kluwer Law International, 2000) 191 & (2001) 7 European Public Law 51.

[3] See, as to the results of that conference, H-W Micklitz and N. Reich (eds), *Public Interest Litigation before European Courts* (Baden-Baden, Nomos, 1996), and F Amtenbrink, 'Public Interest Litigation Before European Courts—A Summary of Conference Proceedings' (1996) 7 *European Business Law Review* 35.

[4] [1963] ECR 95, 107.

[5] E.g. Case C-389/89 *Extramet Industrie SA v Council* [1991] ECR I-2501; Case C-309/89 *Codorníu SA v Council* [1994] ECR I-1853; Case T-243/01 *Sony Computer Entertainment Europe Ltd v Commission* [2003] ECR II-4189. In *Extramet* and *Codorníu* the appeals were brought by the largest producer of the product concerned, whose economic activities largely depended on business transactions which would be adversely affected by the regulation concerned, and whose activity was severely affected by the contested regulation (see the Opinion of AG Lenz in *Codorníu* [1994] ECR I-1853 at 1870–71, para 58). In *Sony* the contested regulation included in the annex a photograph of the Sony product concerned, with the name of the product (PlayStation®2) clearly visible.

[6] This was certainly true in *Extramet*, for example. AM Arnull, 'Challenging Community Acts - an Introduction' in Micklitz and Reich, *Public Interest Litigation* 39 at 46, has rightly stated that in *Cordorníu* in particular, the judgment was 'terse, in places even incoherent'. He also rightly noted, however, that '[t]he message conveyed in the ruling, read in the light of the Advocate General's Opinion, seemed to be that the Community's political institutions were now sufficiently robust to withstand more intense judicial scrutiny of their activities.' (ibid). In *Sony* the challenge to a Binding Tariff Information regulation was successful for the first time ever; the negative result in Case T-82/06 *Apple Computer International v Commission* [2009] ECR II-279 is more typical of the fate of such challenges.

stance.[7] This stance grew more and more indefensible as the Court started to regard access to the courts as one of the essential elements of a Community based on the rule of law[8], but was sadly unable to spot the plank in its own eye, while being very willing to react to splinters in the eyes of others.[9] Leaving the matter to the Member States by way of a change in the Treaty pointedly ignored the fact that the problem was not the wording of the Treaty, but the Court's narrow interpretation of that wording.

The indirect route to the Court of Justice, through persuading a national court to make a reference for a preliminary ruling, now under Article 267 TFEU, was seen as being the solution. To an extent it might mitigate the sense of frustration at the lack of a direct remedy for persons other than the addressee of an act, but it is fraught with problems. Apart from the obvious point that a litigant first needs to persuade a national judge (who may well not be that conversant with or even inclined to follow EU law) that there is indeed a question concerning the interpretation of the Treaties and/or concerning the validity or interpretation of acts of the Union's institutions, bodies, offices or agencies, there are a number of other problems. Not the least of these is that there may be no national measure or action that is capable of challenge.[10] As Advocate General Jacobs correctly observed: 'Individuals cannot be required to breach the law to gain access to justice'.[11] National litigation, as a precursor to getting indirectly to the Court of Justice, may well be prohibitively expensive, particularly in Member States like the United Kingdom. Moreover, references to the Court of Justice take time, and even if the latter disposes of the matter by a reasoned decision, as opposed to by a full judgment, delay is inevitable. There may also be the risk of the question posed by the national court being declared inadmissible on the ground that the litigant could actually have appealed against the EU act involved under the Court's case-law but failed to do so.[12]

While the existence of the indirect route to the centralized Union judiciary compensates to an extent for the Court's narrow interpretation of the concepts of direct and individual concern, Advocate General Jacobs's observation that in fact the di-

[7] As is well-known, matters came to ahead in the ill-fated judicial dialogue in Case C-50/00 P *Union de Pequeños Agricultores v Council* [2002] ECR I-6677 (hereafter UPA) and Case T-177/01 *Jégo-Quéré et Cie SA v Commission* [2002] ECR II-2365 (reversed on appeal in Case C-263/02 P *Commission v Jégo-Quéré et Cie SA* [2004] ECR I-3425). In *UPA* (at 6682, n. 5) Jacobs, AG cited a notable list of critical writings by members of the Court of Justice and of the (then) Court of First Instance. As to examples of criticism by academic commentators, see those cited by Jacobs, AG in *UPA* (*ibid*., n. 6) and Gormley, 'Judicial Review: Advice for the Deaf?', 655, 664 n 49.

[8] This was rightly recalled by the Court of First Instance in Case T-177/01 *Jégo-Quéré et Cie SA v Commission* [2002] ECR II-2365 at 2380 (para 41).

[9] Requiring national legal systems to ensure the availability of appropriate remedies, for example.

[10] As was the case in both the *UPA* and the *Jégo-Quéré* sagas.

[11] Jacobs, AG in *UPA* [2002] ECR I-6677 at 6694 (para. 43), cited by the Court of First Instance in Case T-177/01 *Jégo-Quéré et Cie SA v Commission* [2002] ECR II-2365 at 2381 (para. 45).

[12] See Case C-188/92 *TWD Textilwerke Deggendorff GmbH v Bundesrepublik Deutschland* [1994] ECR I-833. As to the effect of this principle, see R Schwensfeier, 'The TWD principle post-Lisbon' (2012) 37 *EL Rev* 156.

rect action route is more appropriate for challenges to EU acts has considerable force.[13]

38.1.2 The New Régime: the Emperor's New Clothes?

Of the various amendments to the regime of judicial review in the new Article 263 TFEU,[14] certainly the most spectacular in terms of discussion has been the slight liberalization of standing for individuals to challenge a 'regulatory act which is of direct concern to them and does not entail implementing measures.' Taking the most straightforward point first, it is clear that the concept of 'direct concern' should be interpreted consistently throughout Article 263 (4) TFEU.[15] The meaning of the term 'regulatory act' has, however, proved rather more puzzling, giving rise to a diversity of interpretations.[16] The General Court and the Court of Justice have now settled a number of points: regulatory acts are not legislative acts, and the purpose of the relaxation of the standing requirement in respect of such acts was to enable actions to be brought against acts of general application other than legislative acts (which continue to be open to challenge only in accordance with the previous restrictive case-law).[17] However, neither the General Court, nor Advocate General

[13] Jacobs, AG in *UPA* [2002] ECR I-6677 at 6694–6695 (paras. 45–48).

[14] The reference to 'legislative acts', i.e. those adopted by the ordinary or a special legislative procedure (Art 289(3) TFEU; the opening up of acts of the European Council intended to produce legal effects vis-à-vis third parties to challenge; the conferral of semi-privileged litigant status on the Committee of the Regions; the specific availability of judicial review of the acts of bodies, offices or agencies of the EU intended to produce legal effects vis-à-vis third parties, and the tidying up and limited extension of the conditions under which individuals may challenge acts not addressed to them. The seemingly strange omission to confer semi-privileged litigant status on the Economic and Social Committee is perhaps explicable because it is not a political institution as such. However, it may be thought inappropriate to deprive it of formal semi-privileged status. By analogy with how semi-privileged status was first conferred on the European Parliament, it may well be that the Court would be prepared to hear a challenge brought by the Economic and Social Committee if it had not been consulted when it should have been. In that light, the time for its inclusion in the list of semi-privileged litigants is, with respect, long overdue.

[15] This is also the approach which has been followed in the case-law, see, implicity, the Order in Case T-18/10 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2011] ECR II-5599 at 5619 (para. 50) and the Opinion of Kokott, AG in the appeal in Case C-583/11 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2013] ECR I-nyr (Opinion of 17 January 2013, paras. 29–31), but the Court did not deal with this point in its judgment on 3 October 2013. See also explicity in Case T-262/10 *Microban International Ltd. et al. v Commission* [2011] ECR II-7697 at 7712 (paras. 31–32).

[16] See e.g. M Dougan, 'The Treaty of Lisbon 2007: Winning Minds, Not Hearts' (2008) 45 *CML Rev* 617, 677–679; Schwensfeier, *Individual's Access to Justice;* Balthasar, *Locus standi rules*; LW Gormley, 'Access to Justice' S Peers and M Costa, 'Judicial review of EU acts after the Treaty of Lisbon' (2012) 8 *European Contract Law Review* 82.

[17] See the Order of the General Court in Case T-18/10 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2011] ECR II-5599 at 5619 & 5621 (paras 50 and 56) and the judgment of the Court on the appeal in Case C-583/11 *Inuit Tapiriit Kanatami et al. v European Parlia-*

Kokott nor the Court of Justice explained in the *Inuit* cases just why it should be that the term 'regulatory measures' only concerned measures of general application. The first part of the conclusion, that regulatory measures are distinct from legislative measures is uncontroversial as such: it is clear that the intention was to maintain the strict *Plauman* interpretation, as developed and applied by the old case-law, for EU legislative measures.[18] But limiting the concept of regulatory acts to acts of general application is not supported at all by reference to the Convention's *travaux préparatoires*. In the Discussion Circle on the Court of Justice members who were in favour of amending the old Article 230 EC had actually been in favour of a reference to 'an act of general application' but the Praesidium rejected that approach, siding with those in the Discussion Circle who preferred the term 'a regulatory act', thus making a key distinction between legislative and regulatory acts.[19] The apparent aim of the Discussion Circle and the Praesidium was simply to deal with the situation of persons being forced to break the law in order to challenge it, has only partially been achieved.[20]

The problems in the judicial analysis of the meaning of regulatory acts start with the General Court's judgment in *Inuit*. The General Court claimed that it was 'apparent from the ordinary meaning of the word 'regulatory' that the acts covered by the liberalized standing were also (like legislative acts) of general application'.[21] Yet that approach is simply not supported by dictionary definitions of the term 'regulatory'.[22] The General Court's confusion stems from the analysis initially of the fourth paragraph of Article 230 EC and then of the fourth paragraph of Article 263 TFEU.[23] There was no reason to conclude that the fourth paragraph of Article 230 meant that a person other than the addressee of an act was confined to challenging acts of general application: the terminology used referred to 'a decision addressed to

ment & Council [2013] ECR I-nyr (judgment of 3 October 2013, para 60). See also the judgment of the General Court in Case T-262/10 *Microban International Ltd. et al. v Commission* [2011] ECR II-7697 at 7709–7710 (paras 20–25) and the Order of the General Court in Case T-381/11 *Europäischer Wirtschaftsverband der Eisen- und Stahlindustrie (Eurofer) ASBL v Commission* [2012] ECR II-nyr (4 June 2012, paras 42–45).

[18] See the Final Report of the Discussion Circle on the Court of Justice, CONV 636/03, para 23 and the Cover Note of the Praesidium to the Convention CONV 734/03, 20.

[19] See the Cover Note, *ibid*.

[20] Peers and Costa, 'Judicial Review', 100: if direct concern cannot be shown or if the act entails implementing measures, even a regulatory act of general application will be immune from judicial review at the behest of an individual, save through the indirect route through the national courts with a reference under Article 267 TFEU.

[21] Case T-18/10 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2011] ECR II-5599 at 5617 (see para 42).

[22] The Oxford English Dictionary's definition, for example, does not support the General Court's view. For an interesting linguistic discussion of the meaning of 'regulatory acts' in the different language versions of the TFEU, see C Werkmeister et al., 'Regulatory Acts within Article 263(4) TFEU: A Dissonant Extension of Locus Standi for Private Applicants' (2012) 13 *Cambridge Yearbook of European Legal Studie*s 311.

[23] Case T-18/10 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2011] ECR II-5599 at 5617, (paras 41f).

that person or against a decision which, although in the form of a regulation or a decision addressed to another person …'. The fourth paragraph of Article 263 TFEU refers to 'act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures.' Here too, there is no suggestion of limitation to acts of general application. A person who can demonstrate direct and individual concern could bring an appeal against an act addressed to another individual; by the same token, if the act concerned were a regulatory act, it would suffice to demonstrate direct concern, providing that the act did not entail implementing measures. The General Court did correctly understand that the first paragraph of Article 263 TFEU set out two categories of EU acts which could be open to challenge, namely legislative acts and other binding acts intended to produce legal effects vis-à-vis third parties; these latter could be individual acts or acts of general application.[24] The General Court's purported conclusion, however, in relation to appeals other than those brought by the addressee of an act, that the fourth paragraph of Article 263 TFEU, read in conjunction with its first paragraph, permitted a legal or natural person to institute proceedings '(i) against a legislative or regulatory act of general application which is of direct and individual concern to them and (ii) against certain acts of general application, namely regulatory acts which are of direct concern to them and do not entail implementing measures' is wholly unsubstantiated. The only, and very insubstantial, argument in favour of the General Court's conclusion is that the EU rules involved were of general application, and that as it was not required to deal with a challenge to an act addressed to another individual, the General Court did not need to pronounce on whether such an act could be regulatory in nature.

Looking at how the relevant part of the General Court's Order in *Inuit* above is built up, it is striking how poor the reasoning is. But poorly reasoned conclusions have a habit of developing a life of their own, so it scarcely surprising that the subsequent case-law just trots out the conclusion without ever actually thinking about whether it needs tweaking. This is not to suggest that the overall result in these cases is wrong (the EU act was clearly a legislative act), but merely that the definition of a regulatory act is incomplete. In its judgment in the appeal in *Inuit* the Court of Justice approved the General Court's distinction between legislative acts and regulatory acts, and also took on board the restriction of the term regulatory acts to acts of general application, again drawing the latter conclusion without any supporting reasoning.

The present writer has argued extensively elsewhere that the term 'regulatory acts' should be interpreted not merely to cover acts of general application but also certain acts which are individual or hybrid in nature.[25] On the basis of the judgment in *Microban*, action (usually by the Commission) to replace an annex, even to a legislative act, under delegated powers, or to make additions to positive or negative lists will have little difficulty in fulfilling the criterion for classification as regula-

[24] *Ibid*, para 44.

[25] See e.g. Gormley, 'Access to Justice', 1182 ff.

tory measures. The distinction between delegated acts and implementing acts, with in particular the new style of the latter) also brings its own problems.[26]

The remaining point in relation to the liberalization of standing requirements concerns the condition that the regulatory acts must not entail implementing measures. Such implementing measures may be at EU level or at national level (specifying further details or putting flesh on the skeleton of the original EU measures). Clearly it may be possible to attack implementing measures at EU level themselves, even if the parent measures cannot be (because of a lack of individual concern).[27] The General Court has recently given some interesting judgments in relation to implementing measures, which merit discussion. In *Microban* it observed that the non-inclusion of 'triclosan' in the positive list meant that the prohibition on its marketing was automatic and mandatory, as it involved the removal of the product from the provisional list, even although the Member States had the option of adopting implementing measures to permit certain use and marketing during a transitional period. As the challenge related to the prohibition, and not to the use of a transitional period, there were no relevant implementing measures that needed to be considered.[28] However in Case T-279/11 *T & L Sugars Ltd. et al v Commission*[29] it considered that rules enabling importers to import quantities of sugar under favourable conditions required the adoption of national measures before they could produce legal effects for third parties, there was no automatic operation of the Union level measures concerned.[30] In its Order in Case T-379/11 *Hüttenwerke Krupp Mannesmann GmbH et al v Commission*[31] the General Court noted that the emissions trading scheme involved implementing measures to be taken by the Commission and by the Member States, and proclaimed that whether the Member States had a discretion in applying the relevant measures was irrelevant. In the Order of the General Court in Case T-381/11 *Europäischer Wirtschaftsverband der Eisen- und Stahlindustrie (Eurofer) ASBL v Commission*[32] the General Court took a similar line: Eurofer's members were in any event able to challenge the national implementing measures and were

[26] *Ibid*, 1184–1186.

[27] See e.g. Case T-526/10 *Inuit Tapiriit Kanatami et al v Commission* [2013] ECR I-nyr (25 April 2013) in which the General Court dismissed the appeal as wholly ill-founded, without first ruling on the admissibility of the appeal. This judgment is under appeal to the Court of Justice as Case C-398/13 P *Inuit Tapiriit Kanatami et al v Commission* (pending).

[28] Case T-262/10 *Microban International Ltd. et al. v Commission* [2011] ECR II-7697 at 7713 (para. 34), summarized by the General Court in Case T-279/11 *T & L Sugars Ltd. et al v Commission* [2012] ECR II-nyr (6 June 2013, para 55).

[29] Case T-279/11 *T & L Sugars Ltd. et al v Commission* [2012] ECR II-nyr (6 June 2013, para 56).

[30] The General Court also noted that the application of the condition relating to the non-existence of implementing measures, as set out in the fourth paragraph of Art 263 TFEU, could not be made conditional on the existence, within the legal systems of the Member States, of an effective legal remedy which made it possible to call in question the legality of the contested European Union act. (*Ibid*, para 69). This was an unsurprising conclusion in view of the Court of Justice's unwillingness to start evaluating national procedural law, which, in the context of assessing the legality of an EU act, would be beyond its jurisdiction (see *ibid.*, para 70).

[31] Order of 4 June 2012 [2012] ECR II-nyr (para 50).

[32] Order of 4 June 2012 [2012] ECR II-nyr (paras 59–62).

not left without recourse to judicial protection. Perhaps more surprising was the conclusion in relation to customs tariff classification in Case T-380/11 *Anonymi Viotechniki kai Emporiki Etairia Kataskevis Konservon—Palirria Souliotis AE v Commission*[33] that the classification of goods in the Combined Nomenclature effected by the regulations issued by the Commission was 'liable to produce real and definitive legal effects on the situation of importers only through the intervention of individual measures taken by the national customs authorities following submission of the customs declaration, since those measures could, depending on the case, lead to the release of the goods or the communication to the debtor of the amount of duty payable'. While the view that such measures were regulatory measures has been upheld, the result of the view on implementing measures is that it will not, after all, be easier to challenge binding tariff or origin rulings emanating from the Commission.[34]

The perhaps somewhat sad conclusion from this case-law is that Schwensfeier may well be proved right, that the liberalization of standing will prove to be something of a 'sham package.'[35] The initial optimism for a new dawn and rays of sunshine on judicial review is starting to give way to a feeling that the practical results are disappointing: certainly a finding that a measure is a regulatory act is a step in the right direction, although, as has been demonstrated above, an incomplete one, but the question of whether it entails implementing measures has proved rather more complex than might have been thought.

Perhaps it is time to think again about direct access to the centralized Union judiciary. While it is true that the workload is expanding and the Member States are not inclined to create more judges to cope with it, the impression is unavoidable that the system of judicial protection deserves a better fourth paragraph in Article 263 TFEU than we have at the moment. To adapt the (then) Court of First Instance's formulation in *Jégo Quéré* into the framework of Article 263 TFEU, without opening the floodgates to busybodies and the purely litigious, it might be sensible to redraft the fourth paragraph of Article 263 TFEU along the following lines:

> Any natural or legal person may, under the conditions laid down in the first and second paragraphs, institute proceedings against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and which affects their legal position, in a manner which is both definite and immediate, by restricting their rights or imposing obligations on them.

Clearly, a more radical version would be to jettison the concept of individual concern altogether, so that the provision would then read:

> Any natural or legal person may, under the conditions laid down in the first and second paragraphs, institute proceedings against an act addressed to that person or which is of

[33] Judgment of 12 September 2013 [2013] ECR II-nyr (para 42).

[34] See LW Gormley, 'Some Problems of the Customs Union and the Internal Market' in N Nic Shuibhne and LW Gormley (eds), *From Single Market to Economic Union* (Essays in memory of John A. Usher, Oxford, Oxford University Press, 2012) 87, 90–92.

[35] Schwensfeier, *Individual's Access to Justice,* 341 f.

> direct concern to them and which affects their legal position, in a manner which is both definite and immediate, by restricting their rights or imposing obligations on them.

The emphasis would then move to whether the appellant's rights were definitely and immediately affected; a careful assessment of the genuineness of such a claim should suffice to keep out the merely troublesome and unmeritorious litigant. In either variant, the reference to implementing measures could be dropped: national implementing measures can be challenged before national courts, with a reference under Article 267 TFEU where appropriate; the absence of implementing measures at EU level could mean in certain circumstances that a claim would fail because the manner in which the appellant's legal position had been affected was not yet definite and immediate, but in other cases (such as in a *Cordorniú*[36] situation) the claim would still succeed. Perhaps there might be hope for some real reform, although as so often, the advice is probably that one should not hold one's breath!

A few observations also appropriate about the link between Article 263 TFEU and the more general concept of the availability of effective judicial protection. The Court does not regard the obligation on the Member States set out in Article 19(1) TEU to 'provide remedies sufficient to ensure effective judicial protection in the fields covered by European Union law' as intending to create new remedies to ensure the observance of EU law other than those already laid down by national law: the only exception being if the national legal system provide for no remedy making it possible, even indirectly, to ensure respect for rights which individuals derived from EU law, or if parties could only gain access to a court by being compelled to act unlawfully.[37] Appeals to Article 47 of the Charter of Fundamental Rights of the European Union[38] have also been met with a similar approach: there was no intention to change the system of judicial protection laid down in the Treaties, and particularly in relation to the admissibility of direct actions brought before the centralized Union judiciary.[39]

38.1.3 Public Interest Litigation

Unsurprisingly, in view of the observation by Bebr that the purpose of the criteria of direct and individual concern made it clear that the (then) Community legal order had set its face against an *action popularis* or the torpedoing of acts of the Community administration,[40] the Court has refused to treat actions brought by associations

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[36] Case C-309/89 *Codorniú SA v Council* [1994] ECR I-1853.

[37] Case C-432/05 *Unibet (London) Ltd. et al v Justitiekanslern* [2007] ECR I-2271 at 2317 (para 41); Case C-583/11 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2013] ECR I-nyr (judgment of 3 October 2013, paras 103 f).

[38] See now [2012] OJ L 326/391, 405.

[39] See e.g. Case C-583/11 *Inuit Tapiriit Kanatami et al. v European Parliament & Council* [2013] ECR I-nyr (judgment of 3 October 2013, paras 97 f), citing earlier case-law.

[40] G Bebr, *Development of Judicial Control in the European Communities* (Leiden, Nijhoff, 1981) 21.

more generously than actions brought by individuals.[41] Those given procedural rights have not been able to translate them into challenging substantive assessments, although the distinction drawn is understandable.[42] A possible approach to establishing a generic system for public interest litigation has been suggested,[43] but it seems, with respect, that the institutions have relatively little interest in embracing an even modestly more far-reaching system of public interest litigation. In the field of environmental protection the international lead is given by the Aarhus Convention, to which the European Union is a party, and to which all of its Member States are parties.[44] The centralized Union judiciary has had little difficulty in interpreting Directive 2003/4 on public access to environmental information[45] in a manner which is compatible with the Aarhus Convention.[46] However, it does sometimes seem to have great difficulty in accepting that NGO's have standing to seek judicial review.[47] Articles 10–12 of Regulation 1367/2006[48] make provision for NGO's to request internal review of EU administrative acts under environmental law. The criteria which an NGO has to meet are specified in Article 11(1) of that directive, namely:

a) '(a) it is an independent non-profit-making legal person in accordance with a Member State's national law or practice;
b) it has the primary stated objective of promoting environmental protection in the context of environmental law;
c) it has existed for more than 2 years and is actively pursuing the objective referred to under (b);
d) the subject matter in respect of which the request for internal review is made is covered by its objective and activities.'

These criteria reflect the desire to ensure that national, as well as pan-European organizations can request internal review and obtain access to the Union's centralized judiciary. They bear interesting comparison with the suggestions made for a generic

[41] See e.g. Case C-321/95 P *Stichting Greenpeace Council (Greenpeace International) et al v Commission* [1998] ECR I-1651. The recent judgment in Case T-381/11 *Eurofer* (see n 31, *supra*) demonstrates the continuing difficulties which are experienced by associations.

[42] See e.g. Order of the Court of Justice (Eighth Chamber) of 5 May 2009 in Case C-355/08 P *WWF-UK Ltd. v Council* [2009] ECR I-73* (the full judgment is available on the Court's website, see paras. 43–46). The distinction also mirrors the difference in the rights of privileged and litigants and those of semi-privileged litigants in Art 263 TFEU itself.

[43] See n 2, *supra*.

[44] The Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters ('Aarhus Convention') 2161 UNTS 447; [2005] OJ L 127/4. See, generally, Oliver, 'Access to Information', 1424 in particular at 1442 ff and GJ Harryvan and JH Jans, 'Internal Review of EU Environmental Measures' (2010) *European Review of Administrative Law* 53.

[45] [2003] OJ L41/26.

[46] See e.g. Case C-279/12 *Fish Legal et al. v Information Commissioner et al.* [2013] ECR I-nyr (19 December 2013); Case C-515/11 *Deutsche Umwelthilfe eV v Bundesrepublik Deutschland* [2013] ECR I-nyr (18 July 2013).

[47] See n 41, *supra*.

[48] [2006] OJ L 264/13.

public interest litigation framework.[49] Those were, principally, that the organization should have legal personality, non-profit or charitable status, be financially transparent, preferably be democratically constituted, and established permanently, as opposed to being established ad-hoc short-term interest.

But, as noted above, it is one thing to have procedural rights; it is another thing to be able to translate those into substantive challenges, unless the scheme of the legislative framework concerns also confers substantive rights on interlocutors of the EU institutions. The very limitation of the right to request review of administrative acts under Regulation 1367/2006 to individual acts[50] was successfully challenged before the General Court in Case T-338/08 *Stichting Natuur en Milieu et al. v Commission*[51] While the Aarhus Convention Compliance Committee was not convinced in April 2011 that the EU had failed to comply with the Convention, it did express concern and recommended that 'a new direction of the jurisprudence of the EU Courts should be established in order to ensure compliance with the Convention.'[52] Time for improvement is clearly ripe, if not long overdue.

38.2 Conclusions

This brief overview of access to justice and public interest litigation does not yet lead to the conclusion that either aspect is satisfactory at EU level. The real question is whether one should be surprised, in view of the increasing workload of the centralized EU judiciary, and the unwillingness of the Member States to do something to ensure increased efficiency and effectiveness of judicial protection within the EU legal order. There does seem to be a resounding deafness in this area, and it appears that earlier advice to the Court of Justice (and to the Member States) that it was time to 'prick up your ears' needs to be reiterated and perhaps more widely received.[53]

38.3 Valedictory

Hans, your outstanding reputation in so many fields of law serves as a beacon to those scholars to walk with you along some of the paths that you have chosen to investigate. You have talent-spotted, inspired and encouraged many generations of students and colleagues. Emeritus status, of course, really changes little, save, as Gordon Slynn once said to me, when you are an emeritus professor, you don't teach,

[49] See n 2, *supra*.

[50] In Art 2(1)(g) of the regulation.

[51] [2012] ECR II-nyr (14 June 2012), under appeal in Joined Cases C-404/12P & 405/12P *Council et al. v Stichting Natuur en Milieu* (pending).

[52] Aarhus Convention Compliance Committee, Findings ACCC/C/2008/32 (Part I).

[53] See Gormley, 'Judicial Review: Advice for the Deaf?', 689.

you lecture. May your commitment to research and scholarship long continue undiminished!

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Chapter 39
Consumer Redress: Ideology and Empiricism

Christopher Hodges

Abstract This chapter examines the means by which redress can be delivered to consumers. Public and private enforcement has been a continuous interest for Hans Micklitz, and this chapter is offered to him with deep admiration and appreciation for his support and friendship.

The analysis adopts a strictly empirical approach. It starts by asking what subject matter C2B claims comprise, and how much money they involve, before reviewing the evidence on the extent to which the main procedural options for processing them satisfy consumers' and businesses' needs. It notes that traditional assumptions that providing consumers with 'the means to take matters into their own hands' through enforcing rights to compensation through private or collective litigation in courts crumble when viewed against empirical evidence, and that new structures are being built in the EU for the resolution of consumers' claims with traders (C2B claims). It identifies recent developments that private enforcement in Europe has been overtaken by what has been called 'Consumer ADR' (CDR) and public enforcement as more effective and efficient means of consumer redress. The goal of providing 'access to justice' for consumers and extensively increasing consumer redress is now realizable through the adoption of fresh techniques.

39.1 The Nature of Consumer Claims

The analysis has to be grounded on the nature of C2B claims. What are they about, and how much money do they involve? It is only if we know the answers to those questions that we can consider what process might best resolve them. The data show that most consumer problems are about very simple issues, and each issue typically

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation,* Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_39,

involves a small amount of money. That finding should suggest that procedures to resolve such issues have to be simple, cost-effective, cheap and quick.

A British survey in 2008 found that the goods or services for which consumers reported the highest proportion of problems were telecommunications, domestic fuel and personal banking.[1] Fifty-five per cent of such problems resulted in a financial detriment below five pounds. Only 4 % of problems led to detriment levels higher than £ 1,000.[2] A further British survey in 2012[3] found that a fifth of consumers (22 %) had experienced one or more problems with goods or services purchased in the last 12 months. The average financial loss that a consumer incurred from a problem with a product or service was £ 196. This rose to £ 464 for problems in the professional and financial services sector. Consumers took action to resolve two-thirds of problems (66 %). But only half of problems were resolved (50 %), while over a third (36 %) were not considered to be resolved at all. Half of all problems were connected with purchasing household fittings and appliances and other household requirements, and just over a third (37 %) were with essential regulated services such as energy, water, postal services and communications including fixed landline telephones, mobile telephones, internet and broadband providers and broadcast services.

The European Consumer Centres (ECCs) handle inquiries from consumers who experience problems while purchasing goods or services from a trader located in another Member State. In 2012, they received 72,000 contacts, of which 32,000 were complaints and 26,399 were requests for information.[4] The most frequent reasons for complaining to ECCs in 2012 concerned non-delivery of the product or service (16.9 %), the product or service having defects (12.1 %) or not conforming with the order (9.1 %) are linked to distance purchases, which are all issues associated with distance purchasing. Other important issues concerned the rescission of the contract and the additional charging of supplements. Together, these problems accounted for almost half of all complaints (Fig. 39.1).[5]

The sectoral breakdown of 2012 complaints to ECCs (Table 39.1)[6] shows that around 60 % of complaints concerned e-commerce. If complaints are split by sectors, the transport sector was highest, attracting about one third of all cross-border complaints, of which 22 % concerned air transport.

The average value of consumer losses was estimated by the European Commission 2011 survey to be € 375, and median € 18.[7] The nature of an issue will, of

[1] Office of Fair Trading, *Consumer detriment.Assessing the frequency and impact of consumer problems with goods and services* OFT992 (2008), http://www.oft.gov.uk/shared_oft/reports/consumer_protection/oft992.pdf.

[2] ibid.

[3] TNS BMRB, *Consumer Detriment 2012*, www.consumerfocus.org.uk/files/2012/10/TNS-for-Consumer-Focus-Consumer-Detriments-2012.pdf.

[4] ECC, *Help and Advice on your Purchases Abroad. The European Consumer Centres Network 2012 Annual Report*, http://ec.europa.eu/consumers/ecc/docs/report_ecc-net_2012_en.pdf.

[5] *The Consumer Conditions Scoreboard 2013*, http://ec.europa.eu/consumers/consumer_research/editions/docs/9th_edition_scoreboard_en.pdf: quoting source as ECC Network.

[6] ECC, Annual Report 2012, 13.

[7] European Commission, *Special Eurobarometer 342. Consumer empowerment* (2011), http://ec.europa.eu/consumers/consumer_empowerment/docs/report_eurobarometer_342_en.pdf 175.

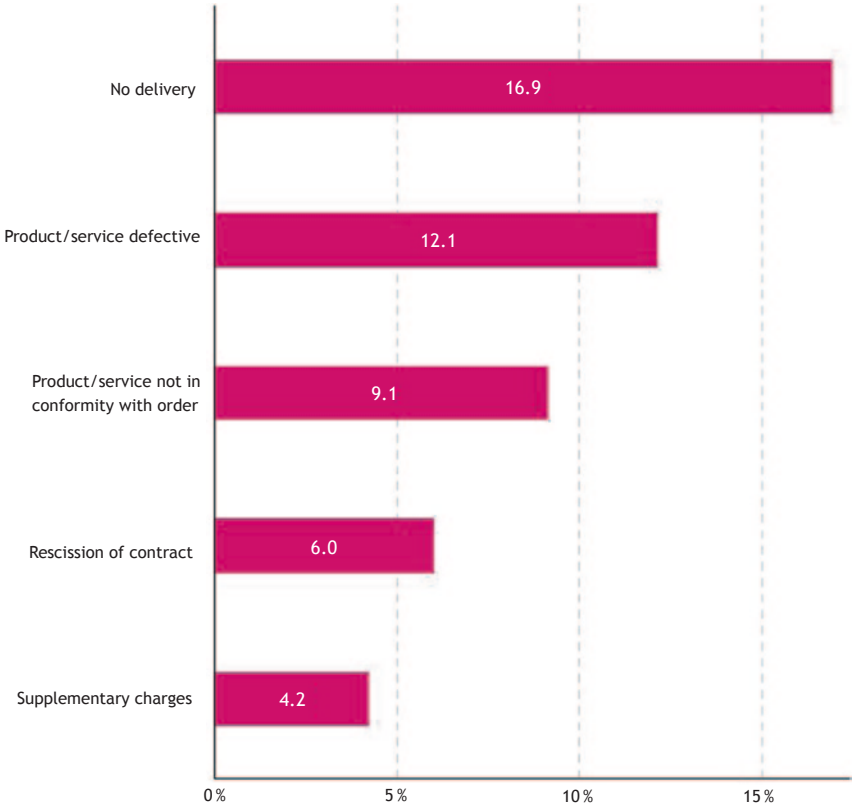

Fig. 39.1 Normal complaints and disputes referred to ECC 2012—by nature of complaint. (Only the main categories are included)

Table 39.1 Complaints to ECC-Net in 2012 by sector

Main economic sectors concerned by complaints	Percentage
Transport, of which:	32.1
Air transport (including problems with luggage)	21.6
Car rental	3.4
Timeshare related products and package holidays	7.4
Recreational, sporting and cultural services	7.0
Furnishing, household equipment and routine household maintenance	6.8
Audio-visual, photographic and information processing equipment	5.6
Health	5.1
Communication	4.7
Clothing and footwear	4.5
Hotels and restaurants	4.5
Personal care goods and services	3.0
Financial services and insurance	2.5

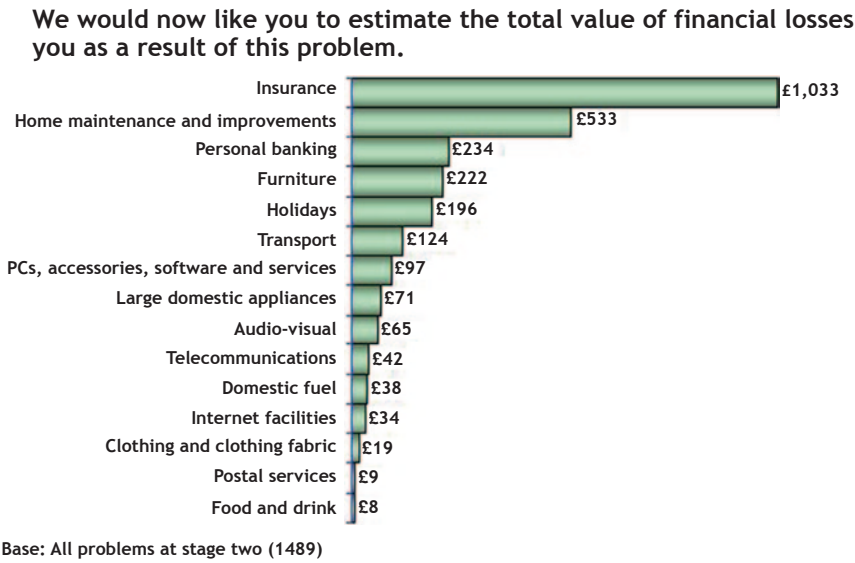

Fig. 39.2 Highest and lowest average consumer detriment by type of goods or service category

course, give rise to variation in the inherent complexity between different types of claim, and their value. A 2008 UK survey[8] shows these variations (Fig. 39.2). The highest average financial detriment per problem occurred in insurance problems, followed by home maintenance and improvements and personal banking. The inherently low level of average detriment can also be seen, with all categories apart from two being under £ 235, and several under £ 100.

The 2012 Oxford study of CDR entities (Hodges et al. 2012, 381) found the following examples of typical claims data for 2010:

- In France, the FFSA médiateur handled many cases valued at around € 100 and some as low as € 5. The average award of the national energy médiateur was € 373, the average amount in dispute in the cases of the médiateur of EDF was € 1,120 (with 23 % of cases over € 2,000).
- In Spain, the average value of an award in the consumer arbitration system was € 366.
- The average amount claimed in cases before the UK's Ombudsman Service: Communications was £ 587 and the average award was £ 198.
- In Germany, 86 % of claims made to the Insurance Ombudsman involved under € 5,000, and over 90 % were under € 10,000. A normal claim made to the transport ombudsman (Söp) was between € 10 and € 200.
- In the Netherlands, the average claim value for geschillencommissie cases varied between sectors, from € 206 for taxis and an average of € 5,980 for housing guarantees. In 2009, 9 % of the geschillencommissie claims were less than € 250, there was no claim involving a value of more than € 10,000, and the largest segment of claims (24 %) were for € 1,001–2,000.

[8] OFT, *Consumer detriment*.

These data suggest that consumer claims have intrinsically low value, and can involve simple issues and facts. If the rule of law is to be upheld then dispute resolution processes have to be able to attract and deal with them. That point leads to considerations of cost and cost-proportionality.

39.2 Consumers' Attitudes to Cost-Proportionality

Economists refer to a sum as constituting the break-even point above which the cost of taking action to enforce a right will exceed the risks, and below which the person whose right has been infringed will act with rational apathy in not taking action. The calculation is more complicated than that statement may seem, since the decision may be affected by issues that are difficult to quantify and compare, such as the accessibility or user-friendliness of a dispute resolution procedure.

The Commission's 2004 survey found that only 18% of EU citizens were prepared to go to court for amounts higher than € 500 and another 18% for amounts higher than € 1,000.[9] Only 29% of European citizens would be prepared to bring a claim of less than € 500 to court.[10] Studies conducted for the European Commission in 1995 and 1998 found that legal costs in all Member States exceeded the value of claims for all amounts of claim below 2,000 ECU[11] and that 'in most member states a dispute value of 50,000 ECU might be a reasonable value to pursue a cross-border dispute.'[12] On the basis of these data, the 2007 Leuven Report concluded that small claims procedures would generally only be used by European consumers if the amount involved exceeds around € 200.[13]

The Commission's 2011 survey found that the level of financial loss that would have caused people to go to court was given by the majority (53%) as between € 101 and € 2,500.[14] Only 5% said they would go to court for a loss of under € 20 and 3% would only go to court over a financial loss in excess of € 5,000. A relatively large proportion of consumers either refused or felt unable to answer this question (17%) and 8% said they would never take the business to court, no matter the sum involved.

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[9] European Commission, *Special Eurobarometer, European Union citizens and access to justice* (Oct 2004), 28.

[10] ibid.

[11] B Feldtmann, H von Freyhold and EL Vial, *The Costs of Legal Obstacles to the Disadvantage of Consumers in the Single Market, a Report for the European Commission* (1998), available at http://ec.europa.eu/dgs/health_consumer/library/pub/pub03.pdf, 277 f, referring to H von Freyhold, V Gessner, EL Vial and H Wagner, *Costs of Judicial Barriers for Consumers in the Single Market, A report for the European Commission* (1995), available at http://aei.pitt.edu/37274/1/A3244.pdf.

[12] Von Freyhold et al. *Costs of Judicial Barriers*, 276.

[13] J Stuyck, E Terryn, V Colaert, T Van Dyck, N Peretz, N Hoekx and T Tereszkiewicz, *Study on Alternative Means of Consumer Redress other than Redress through Ordinary Judicial Proceedings* (Catholic University of Leuven, 2007) 41, available at http://www.consum.cat/documentacio/9028.pdf.

[14] European Commission, *Special Eurobarometer 342*.

National variations exist on consumers' willingness to take action. The 2011 EU survey found that around a fifth of those in Greece, Estonia, Bulgaria and Austria maintain that they would never take a business to court, no matter how high their financial loss.[15] At least a third of consumers in five countries (Latvia, Lithuania, Poland, Slovakia and Spain) had quite low thresholds, claiming that they would take a business to court for sums lower than € 200. By contrast, relatively few people in Cyprus (7%), Malta (9%), Greece (11%) or Finland (12%) would consider going to court for such losses. The highest thresholds, where larger numbers of respondents would only go to court if their losses were above € 1,000, € 2,500 or even € 5,000, occurred in Cyprus (46%), Finland (40%), Denmark (38%), and Sweden (37%).

Socio-demographic analysis revealed that the highest percentages of those who would never go to Court were: the oldest respondents aged 55+ (12%), the lesser educated who left school aged fifteen or younger (13%), people who live alone (12%), house persons (11%), retired people (12%), widowed respondents (17%), and those who never use a computer (15%).[16] The question arises how such people, who have fallen into a 'justice void', could be enticed to bring forward their problems. Even filling in a form may be too off-putting for many.

The policy conclusion is that dispute resolution systems for C2B claims cannot involve a level of cost, or risk of cost liability, that is more than minimal. The economic 'rational apathy' threshold is very low for consumer disputes, before taking account of factors such as accessibility, the amount of effort and time needed. The lower the cost threshold and risk of adverse costs, the more consumer claims will be raised (and therefore identified) and resolved.

39.3 Evidence of Consumers' Behaviour in Claiming or Ignoring

The EU 2011 consumer survey found that more than one in five (21%) of respondents from 56,471 interviews across the EU had encountered a problem with a good, a service, a retailer or a provider in the previous 12 months, for which they had a legitimate cause to complain.[17] The 'legitimate cause to complain' threshold meant that the nature of the problem was more than legally trivial and gave rise to a rational concern that rights had been infringed.

The 2011 survey found that more than three-quarters took some form of action in response (77%) while 22% took no action. Those who took action were most likely to have made a complaint to the retailer or provider (65%), with far fewer complaining to a public authority (16%), the manufacturer (13%), utilizing an ADR body (5%) or court (2%) (see Fig. 39.3). The most frequently cited reason

[15] ibid, QA38a, 217.

[16] ibid, 217.

[17] ibid.

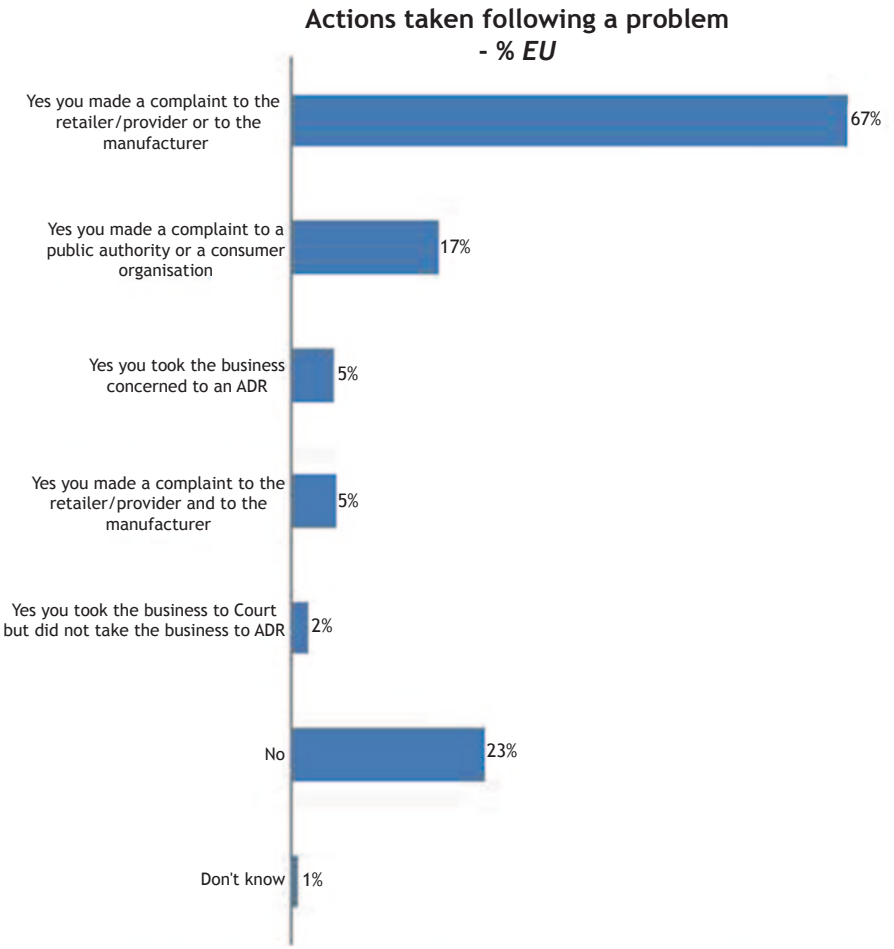

Fig. 39.3 Actions taken following a problem. (ibid, Table 5.4.4. Base: Respondents who experienced a problem (n = 10945))

for not making a complaint was that the individual had already received a satisfactory response from the retailer/provider (44%). (Earlier research found that 46% of consumers who complained to a trader and were not satisfied with the way their complaint was dealt with took no further action.[18]) The major reasons in 2011 for not making a court claim were that the individual had already received a satisfactory response from the retailer/provider (40%), the sum involved was too small (26%), it would have taken too much effort (16%), it would have been too expensive (13%)

[18] European Commission, *Flash Eurobarometer 299 on consumers' attitudes towards cross-border sales and consumer protection*, http://ec.europa.eu/consumers/strategy/docs/consumer_eurobarometer_2011_en.pdf, 21.

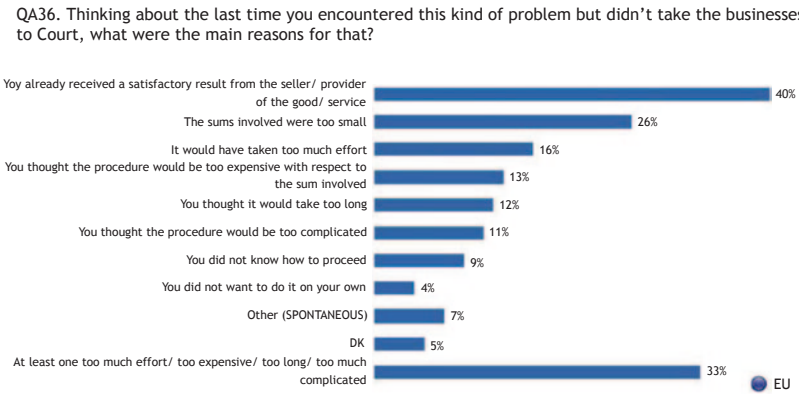

Fig. 39.4 Reasons for not pursuing a court claim. (ibid, QA36, p. 204)

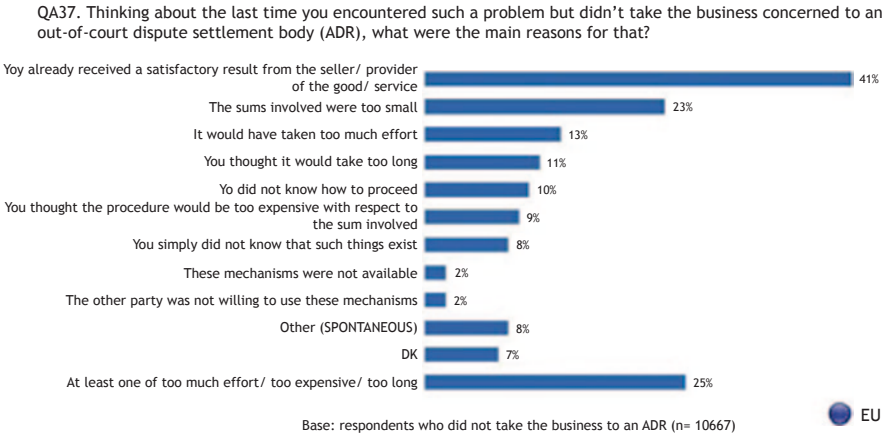

Fig. 39.5 Reasons for not pursuing a claim with an ADR body. (ibid, QA37, p. 210)

or too long (12%) (Fig. 39.4). In total, 78% of European consumers did not take their dispute to court because they thought it would be too expensive, lengthy and complicated.[19] This clearly does not indicate that court processes are attractive and responsive to consumers' needs.

In comparison, the reasons for not taking a complaint to an ADR body were similar to, but had lower numbers than, courts, apart from the fact that 8% said they were unaware of an ADR body (Fig. 39.5). Importantly, 41% said they had already received a good result from the trader: this is something to be celebrated

[19] European Commission, *Special Eurobarometer 342*, 204.

but expanded. However, another way of looking at the data is that 71% were not attracted to CDR for a series of different reasons, and the CDR community should aim for that figure to zero.

Looking at CDR from the business perspective, the Commission's 2009 business report found that on average only 8% of retailers in the EU had used ADR mechanisms to settle disputes with customers in the past two years.[20] The figure increased to 9% by 2011.[21] In some countries, such as the Nordics and the Netherlands, it is close to 100%, so this is a problem that arises as a potential challenge on a national basis in some Member States. However, satisfaction with CDR is high amongst those who have used it. Over three-quarters (76%) of retailers in the 2009 survey who had used ADR mechanisms in the previous two years reported that the outcome of their most recent such case had been successful. Use of ADR and ODR has been increasing. EU figures were 410,000 in 2006 and 530,000 in 2008.[22] Equally, disputes related to cross-border transactions have increased. The volume of cross-border complaints received by the ECC network reached 35,000 in 2009, an increase of 55% compared with 2005. By 2012 it had reached 72,067. The share of complaints on e-commerce transactions was greater than 55% in 2009 and 2010 and had doubled since 2006.[23] In 2012, the 56 members of FIN-NET reported 1854 cross-border cases, comprising 992 in the banking sector, 518 in the insurance sector, 315 in the investment sector and 29 which were not attributed to any particular sector.[24]

39.4 The Economic Rationale for Taking Consumer Claims Seriously

How seriously should we take C2B claims? How important is it that we should provide a mechanism that is effective in enabling consumers to raise their concerns and disputes about business practices and to obtain actual redress? As noted above, more than one in five (21%) of respondents across the EU had encountered

[20] European Commission, *Flash Eurobarometer 278. Business attitudes towards enforcement and redress in the internal market. Analytical report*, http://ec.europa.eu/consumers/strategy/docs/Fl278_Analytical_Report_final_en.pdf.

[21] European Commission, *Flash Eurobarometer 300 on business attitudes towards cross-border trade and consumer protection*, http://ec.europa.eu/consumers/strategy/docs/retailers_eurobarometer_2011_en.pdf, 76

[22] Civic Consulting, *Assessment of the compliance costs, including administrative costs/burdens on businesses linked to use of alternative dispute resolution (ADR)* (2011) 8.

[23] ECC, *2010 Annual Report*, 12, http://ec.europa.eu/consumers/ecc/docs/2010_annual_report_ecc_en.pdf

[24] FIN-NET, *FIN-NET activity report 2011*, http://ec.europa.eu/internal_market/fin-net/docs/activity/2011_en.pdf.

a problem with a good, a service, a retailer or a provider in the previous 12 months, for which they had a legitimate cause to complain.[25]

Even if individual losses may be small and relatively insignificant for each individual who suffers them, the aggregated total illicit profit for traders may add up to a significant sums, the retention of which is not only offensive to maintenance of the rule of law but also a drag on the legal redeployment of the money on other legitimate trading. The loss to European consumers because of problems with purchased goods or services was estimated by the Commission at 0.4% of Europe's GDP.[26] The detriment related to cross-border shopping was estimated at between € 500 million and € 1 billion.[27]

The importance of maintaining consumer satisfaction and confidence lies at the heart of the EU's strategy for economic growth in the single market. The 2010 Monti report on the new strategy for the internal market[28] emphasised the need to place consumers and consumer welfare at the centre of the next stage of the Single Market, notably through enhanced means of redress. The 2011 Single Market Act identified establishing an effective pan-EU CDR function as one of the twelve levers to boost growth and strengthen confidence.[29] Its purpose is 'to establish simple, fast and affordable out-of-court settlement procedures for consumers and protect relations between businesses and their customers. This action will also include an electronic commerce dimension'. Providing an EU-wide online redress tool for e-commerce is stated in the flagship initiative 'Digital Agenda for Europe'[30] to be essential so as to build up consumers' and businesses' confidence in the digital market.

The 2011 Impact Assessment estimated potential savings for European consumers at around € 20 billion, corresponding to 0.17% of EU GDP, if they can refer their dispute to a well functioning and transparent ADR scheme.[31] Estimated losses due to the lack of efficient ADR dealing with disputes linked to cross-border e-commerce were estimated to amount to around € 2.5 billion, corresponding to 0.02% of EU GDP, and to be likely to increase due to further development of the digital retail internal market and more competitive markets in the products and services sectors.[32]

Savings for businesses through use of CDR instead of going to court were conservatively calculated as ranging from € 1.7 billion to € 3 billion.[33] Time saved

[25] European Commission, *Special Eurobarometer 342*.

[26] Commission Staff Working Paper.*Impact Assessment.Accompanying the document:Proposal for a Directive of the European Parliament and of the Council on Alternative Dispute Resolution for consumer disputes (Directive on consumer ADR) and Proposal for a Regulation of the European Parliament and of the Council on Online Dispute Resolution for consumer disputes (Regulation on consumer ODR)*, SEC(2011) 1408 ('CDR Impact Assessment').

[27] ibid.

[28] 'A new Strategy for the Single Market—At the service of Europe's economy and society', Report to the President of the European Commission (9/5/2010).

[29] Commission Communication 'Single Market Act', COM(2011) 206, 9.

[30] Europe 2020 flagship initiative: A Digital Agenda for Europe, COM(2010) 245, 13.

[31] CDR Impact Assessment, Annex II.

[32] See Annex II for the calculation method.

[33] CDR Impact Assessment, Annex XII.

through using CDR was estimated at up to 258 days.[34] Other calculations[35] indicated that handling a domestic dispute in court could cost on average € 25,337,[36] in which case the savings for businesses would then vary from a minimum of € 3 billion to a maximum of € 13 billion. In contrast, the costs for businesses for handling a domestic dispute via ADR amounted to € 472.[37]

Dissatisfaction with traders is reflected in levels of consumer trust. The 2013 Consumer Scoreboard found trust in online purchases showed a high degree of variation across the EU.[38] When averaging the percentages of consumers who felt confident buying online domestically and from another EU country, the highest values were seen in Ireland (71%), Denmark (67%), the United Kingdom (62%) and Luxembourg (61%), compared to 29% in Croatia, 34% in Estonia and 35% in Hungary and Italy. Outside the EU, Norway also registered a high level of trust in online purchases (66%).

In 2012, 60% of complaints registered by ECCs were related to online purchases. This proportion has been growing over the years in line with the general development of e-commerce. As noted above, the major problems with goods purchased via the Internet are non-delivery and late delivery. Delays affect almost a third of respondents (29.7%) who have made domestic online purchases and 19.3% of those purchasing from other EU countries. Non-delivery is reported for 8.2% of domestic and 5.8% of EU cross-border online purchases. Higher incidence of problems in domestic transactions may be at least partly due to the fact that consumers on average conduct more online transactions with domestic rather than with foreign sellers. This clearly indicates that swift ODR procedures are called for.

39.5 Pathways for Resolution of C2B Disputes

The traditional means by which modern states enable breach of a person's rights to be rectified is through providing a system for individual citizens to institute actions in the state's courts. This gives rise to rhetoric such as 'enabling consumers to vindicate their rights', 'take the law into their own hands, enhancing autonomy, individual freedom and choice' and 'expanding access to justice'. However, a number of alternative techniques are available to personal litigation. Viewed mechanistically,

[34] See Annex XII for the calculation method.

[35] *The Cost of Non-ADR—Surveying and showing the actual costs of Intra-community Commercial Litigation*. Funded by the European Union (specific programme Civil Justice 2007-2013), implemented by a consortium led by ADR Center, in collaboration with the European Company Lawyers Association (ECLA) and the European association of Craft, Small and Medium sized Enterprises (UEAPME).

[36] Based on a domestic dispute in the EU for a value of € 200,000. However, in Annex XII a more conservative approach regarding the cost and time-savings is considered for the calculations (i.e. € 7,000).

[37] Civic Consulting, *Assessment of the compliance costs*. However, in Annex XII of the CDR Impact Assessment the more extreme figure of € 854 was used for the calculations, since this was the cost for dealing with ADR for the first time.

[38] Consumer Scoreboard 2013, 14.

the optional pathways for enforcement of legal rights can be broadly grouped into three pillars: personal (civil) litigation, public (criminal or regulatory) enforcement action, and the relatively recent approach of alternative dispute resolution (ADR).[39]

The first pillar comprises not just personal litigation but two developments that have attempted to respond to problems posed by the existence of barriers to bringing small claims, namely 'small claims procedures' that aim to reduce costs and formality, and collectivisation of multiple similar claims into a single aggregated procedure. The latter aggregated approach has traditionally been known under its American name of a 'class action' but European debate on such mechanisms has adopted the name of 'collective action'.

The second, public pillar comprises two broad techniques. Firstly, citizens may 'piggy-back' on a criminal investigation (saving costs on investigation and avoiding any adverse costs risk) and have their civil claims dealt with as a second stage after the conviction of any defendants, or make use of the evidence produced publicly in separate civil proceedings. This *partie civile* method is available in many European states, and was originally designed to benefit the victims of violent or fraudulent crime. It is only in those jurisdictions where the criminal court is required to adjudicate on the civil claims, as opposed to having discretion to adjudicate them, that the procedure has been of particular use for consumers. The mandatory approach applies in Belgium, where a series of large mass harm cases have been processed through the two stages of criminal then civil liability.[40]

Secondly, public regulatory authorities in some states have been given powers to order or oversee mass redress. The leading examples are Denmark and the United Kingdom. In Denmark, the national enforcement authority for consumer protection (the Consumer Ombudsman) has the power to initiate a class action but sole power to request the court to order that the class action be operated on an opt-out basis. (In contrast, any class member may initiate a class action but only on an opt-in basis.) In the United Kingdom, almost every public regulatory authority that deals with consumer or environmental law enforcement now has a duty in taking enforcement action to ensure that redress is made by an entity that has broken the law.[41] Some authorities have been given express powers to impose redress schemes, such as those responsible for financial services[42] or energy.[43]

These regulatory redress powers have proven to be highly effective in delivering swift mass redress. Their effectiveness lies not just in their intrinsic nature as requiring (maybe through a court order) payment of mass compensation but the fact that

[39] N Creutzfeldt, 'The Origins and Evolution of Consumer Dispute Resolution Systems in Europe' in C Hodges and A Stadler (eds), *Resolving Mass Disputes: ADR and Settlement of Mass Claims* (Cheltenham, Edward Elgar, 2013).

[40] S Voet, 'Public Enforcement & A(O)DR as Mechanisms for Resolving Mass Problems: A Belgian Perspective' in Hodges and Stadler (eds), *Resolving Mass Disputes*.

[41] Pursuant to a requirement on regulators under the Legislative and Regulatory Reform Act 2007, s 22 (2) and (3) to comply with the Regulators' Compliance Code, made under s 22 of that Act, which includes the aim of eliminating any financial gain or benefit from non-compliance.

[42] Financial Services and Markets Act 2000, as amended, ss 383 and 404.

[43] Energy Bill 2013.

they can be deployed as one tool amongst others that comprise the comprehensive toolbox of a public regulatory authority's enforcement armoury. It is the collective use of all relevant enforcement tools at the same time that achieves efficient and effective enforcement. Thus, traders are incentivised to negotiate agreements that resolve all (criminal, regulatory and civil) aspects of a problem at the same time. The Danish Consumer Ombudsman invokes his mass redress power regularly, but has so far not had to initiate a collective court action, since he has resolved every issue through agreement. He finds that companies prefer to seek to resolve redress issues as a priority, since that may give them the opportunity to seek lower public sanctions or to seek reputational benefits by announcing that they have voluntarily agreed to repay everyone. The similar technique has a shorter history in the United Kingdom but initial evidence is very similar to that in Denmark. The result is that payment of redress can be achieved in weeks rather than in the years that class actions would often take. The European litigation systems intentionally exclude the massive financial incentives that exist in the United States of America where they promote settlement of virtually every class or multi-district action that passes the certification stage.

This chapter is primarily focused on compensatory redress but it is useful to note that injunctive enforcement of general consumer protection law on unfair commercial practices can be by public or private sector bodies (harmonized by the Injunctions Directive).[44] The enforcement architectures of Member States differ in this respect. Thus, for example, the model in the United Kingdom places primary emphasis on enforcement of unfair contract terms and public authorities (the Office of Fair Trading, reformed from 2014 as the Competition and Markets Authority, and at local level Trading Standards Departments of local authorities), whereas the model in Germany and Austria is based on self-regulatory activities by trade bodies and consumer associations (respectively Wettbewerbszentrale and Verbraucherzentralen). It is only where private sector associations have significant funding that they are prepared to undertake extensive litigation and the associated private regulatory role. Thus, the German trade association has extensive business funding, and the German consumer associations are largely funded by public funds. The result is that such bodies are not only acting in the public interest when they carry out these regulatory functions but the consumer associations' public funding means that they function largely as a privatised public authority, even if in carrying out some other functions it is more of a private sector consumer policy lobbyist.

A further example of privatised public regulation exists in many Member States in relation to regulation of misleading advertising, which is widely carried out by private entities largely funded by businesses.[45] Such bodies often demonstrate a two-tier regulatory structure. Most or all of the self-regulatory activities are undertaken by the private entity, but it functions particularly well if there exists a public

[44] Dir 2009/22/EC on injunctions for the protection of consumers' interests.

[45] F Weber, *The Law and Economics of Enforcing European Consumer Law. A Comparative Analysis of Package Travel and Misleading Advertising* (Farnham, Ashgate, 2014).

authority that has wide criminal enforcement powers as a superior back-stop and as a watchdog over the activities of the private entity.

The Commission's 2008 Report on the Injunctions Directive[46] 'shows that the mechanism created by the Directive which enables qualified entities of one Member State to act in another Member State has clearly not been as successful as it was hoped.'[47] But it confirmed that whilst injunctive actions are rarely used for cross-border infringements, several Member States and consumer associations stated that these actions are used fairly successfully by consumer associations for national infringements, such as misleading advertising or unfair contract terms.[48] Instead, the more promising enforcement mechanism for cross-border cases is that which involves the network of public regulatory authorities (the first pillar), under the 2004 Consumer Protection Cooperation Regulation.[49] 'In certain sectors, such as financial services, transport, telecommunications and energy, regulators play an important role in market surveillance.[50] It should be noted though that these mechanisms often do not foresee compensation for harm suffered by consumers.'[51] However, as noted above in discussing the first pillar, redress powers are used effectively by public enforcement authorities in Denmark and the United Kingdom, and it would be advisable for other Member States to adopt this technique.

Reverting to the first, litigation-based, pillar, the evidence suggests that the two reforms made to try to address the access to justice barrier preventing the bringing of small claims have failed. First, small claims mechanisms operate in most Member States, but on different bases, such as regarding whether a fee is charged and whether there is a loser pays rule. The extent to which consumers use such national small claims procedures varies, influenced by factors such as variations in costs (lawyers and courts) and duration.[52] The European Small Claims Procedure (ESCP) applies to cross-border claims with an upper limit of € 2,000.[53]

The second attempt to address the access to justice barrier for small claims rests on aggregating them so as to achieve economies of scale by bringing a single representative or collective procedure. As noted above, where the collective procedure seeks an injunction remedy, it appears that a single action brought in the general

[46] Report from the Commission concerning the application of Directive 98/27/EC of the European Parliament and of the Council on injunctions for the protection of consumers' interest, COM(2008) 756 final.

[47] CDR Impact Assessment, 14.

[48] eg Bulgaria, Czech Republic, Germany, France, Italy, Latvia, Austria, Sweden, Slovakia and the UK.

[49] Reg (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws, [2004] OJ L 364/1.

[50] For example, the recently adopted EU legislation in the energy sector reinforces regulators' powers and duties in monitoring the development of competition and ensuring enhanced customer protection and information. The regulators will have new powers, such as the power to issue binding decisions, carry out investigations and impose effective, proportionate and dissuasive penalties. See Dir 2009/72/EC and 2009/73/EC, [2009] OJ L 211/55 and 94.

[51] CDR Impact Assessment, 14.

[52] Stuyck et al. *Study on Alternative Means of Consumer Redress*, 214-222.

[53] Reg (EC) No 861/2007 establishing a European Small Claims Procedure, Art 2(1).

public interest is a successful technique when operated nationally but not on a cross-border basis. However, where the collective action seeks damages, the evidence from the Member States that have such procedures is not impressive.

The most recent pillar for resolution of consumer disputes is that based on CDR. ADR techniques have been introduced to operate within or alongside the litigation pillar, such as with the requirement that mediation options shall be available in civil procedure systems.[54] In contrast, CDR systems have links with litigation, by being alternative means of resolving both individual and mass disputes, but also have string links with public regulatory systems, by providing the means of collecting extensive data on the trading activities of trading and traders, which is then passed back to traders and passed on to the public and to regulatory authorities for them to respond to the behaviour that is revealed. Hence, the dual nature of CDR systems justifies them being classified as having their own distinctive pillar, between private and public enforcement. CDR schemes deploy familiar ADR techniques of triage, mediation/conciliation, and a decision, but operate within their own unique architecture of CDR bodies that are separate from courts and (in most cases) regulatory authorities.

39.6 A Preliminary Evaluation of the Pillars: Cost, Duration and Accessibility

Having mapped the pillars and general techniques, we now turn to a preliminary evaluation of evidence on which of them best satisfies the criteria that are essential for responding to and solving consumer issues, namely low and proportionate cost, overcoming the risk of liability for adverse and especially uncertain costs, taking too long to resolve simple problems, and not being sufficiently user-friendly, accessible, simple and attractive enough to entice consumers to use them.[55] It is stressed that the evidence summarised here is not as complete as would be wished, but it is enough to form clear preliminary hypotheses.

39.6.1 Costs and Levels of Usage

It is well established that standard court procedures involve some cost, and that some national systems can be expensive.[56] Lawyers' fees vary per Member State but in most Member States the hourly amount paid to a lawyer is between € 100 and

[54] Dir 2008/52/EC on mediation in civil and commercial matters.

[55] It is interesting that many analyses of the merits of private enforcement omit the basic criteria of cost, duration and outcomes: see a recent analysis by SB Burbank, S Farhang and HM Kritzer, 'Private Enforcement' (2013) 17 *Lewis & Clark Law Review* 637.

[56] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation. A Comparative Perspective* (Oxford, Hart Publishing, 2010).

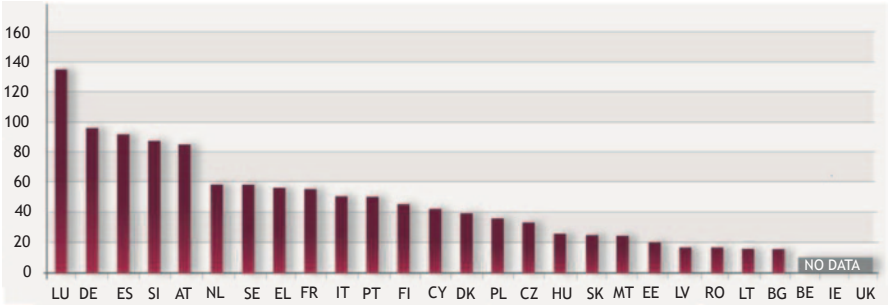

Fig. 39.6 Budget for courts (in EUR per inhabitant)

€ 300. In a few Member States it can even exceed € 700.[57] Courts are also a cost to governments, as shown in Fig. 39.6[58].

The 2010 CEPEJ data found a large variety between the states or entities with respect to the financial amount of disputes handled in national small claims courts, between extremes of € 72.41 in Lithuania and € 15,985 in Norway.[59]

The ESCP was 'intended to simplify and speed up litigation concerning claims in cross-border cases, and to reduce costs'[60] but appears to have been a significant failure.[61] It prescribes standard forms and time limits for service of documents and

[57] European Commission for the Efficiency of Justice (CEPEJ), *European judicial systems Edition 2010 (data 2008): Efficiency and quality of justice* (2010), available at http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2010/JAReport2010_GB.pdf, 159.

[58] EU Justice Scoreboard : A tool to promote effective justice and growth, COM(2013) 160 final, 13, Fig. 20, citing CEPEJ 2012. The annual approved (not the actually executed) public budget allocated to functioning of all courts (civil, commercial and criminal courts, without the public prosecution services and without legal aid), whatever the source of this budget. For the EU Member States whose total annual approved budget allocated to all courts cannot be separated from the figures for the public prosecution department (BE, DE, ES, EL, FR, LU, AT), the chart reflects the total figure (for BE, ES and AT the figure also includes the legal aid). Where appropriate, the annual approved budget allocated to the functioning of all courts includes the budget both at national level and at the level of regional or federal entities.

[59] CEPEJ, *European judicial systems Edition 2012*, http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2012/Rapport_en.pdf, ch 5.

[60] Reg (EC) No 861/2007 establishing a European Small Claims Procedure, Art 1.

[61] See C Crifò, 'Europeanisation, Harmonisation and Unspoken Premises: The Case of Service Rules in the Regulation on a European Small Claims Procedure (Reg. No. 861/2007)' (2011) 30 *Civil Justice Quarterly* 283: 'an ungainly juggernaut', 'the legal landscape appears, far from simplified, further complicated'; XE Kramer, 'Small Claim, Simple Recovery?' (2011) 1 *ERA Forum* 119; XE Kramer and EA Ontanu, 'The Functioning of the European Small Claims Procedure in the Netherlands: Normative and Empirical Reflections' (2013) 3 *Nederlands Internationaal Privaatrecht* 319: 'the number of cases handled in the ESCP is limited. (…) Apparently consumers still find it difficult to find their way to this procedure (…) the duration of the procedure is on average three to five months'.

response by parties and the court, which may end up making the process inevitably longer than a CDR procedure. Importantly, a loser pays rule applies.[62]

A survey by the ECC-Net found a series of inadequacies in the functioning of the ESCP.[63] Judges were not aware of the ESCP in 47 % of courts surveyed. The relevant forms were not made available on the premises or the websites of 41 % of the courts visited. Consumers found it difficult to fill in the forms on their own, while in 41 % of cases, assistance in filling in the forms and starting the procedure was not available to consumers. In 76 % of cases reported, the ESCP was free of charge for consumers but not in 24 %. Court fees ranged from € 15 to about € 200. Although a lawyer is not required, it is not known how many people used lawyers, and at what cost. The ECCs found that consumers faced practical problems that called for advice. Language was a significant problem (cited by 35 % of survey respondents), no assistance is foreseen and certified translators are usually too expensive.[64] Difficulties were found in determining the competent court, as well as with the execution of decisions. The ECCs cited problems of lack of awareness, information or support to consumers (courts not making forms available) and lack of effective enforcement of judgments. ECCs indicated that their caseload used the ESCP in less than 1 % of all handled cases.

Inherent cost and duration problems with a cross-border court procedure lie in the need to go through court proceedings in two jurisdictions. It was said in 1998 that use of the cross-border exequatur procedure would only rationally produce potentially positive economic effects for claims valued over 2,000 ECU.[65] Despite the abolition of the exequatur from January 2015, the system will still require a suit in the consumer's state, followed by obtaining a certificate there and then taking enforcement action in the state of the trader.[66]

The theory that collective actions for damages enhance access to justice by enabling economies of scale has basically not occurred in Europe in relation to mass consumer claims. This is because it is necessary to incentivise intermediaries who are necessary to organize and especially to fund a large action. The paradigm class action or multi-district action in the United States (mirrored to some extent in Australia and Canada) consciously provides significant incentives to intermediaries (attorneys and latterly also third party litigation funders) through mechanisms such as a no loser pays rule, large fees paid by defendants (both of which factors largely avoid the need for claimants to provide funding or security against loss), an opt-out

[62] Reg 861/2007, Arts 16 and 10.

[63] ECC-Net, *European Small Claims Procedure Report* (2012).

[64] EA Ontanu and E Pannebakker, 'Tackling Language Obstacles in Cross-Border Litigation: The European Order for Payment and the European Small Claims Procedure Approach' (2012) 5(3) *Erasmus Law Review* 169.

[65] N Reich, 'Jurisdiction and Applicable Law in Cross-Border Consumer Complaints.Socio-Legal Remarks on an Ongoing Dilemma Concerning Effective Legal Protection for Consumer-Citizens in the European Union' (1998) 21 *Journal of Consumer Policy* 315, 318; summarising V Gessner, 'Pursuing Cross-Border Claims in Europe' (1998) 21 *Journal of Consumer Policy* 334.

[66] Reg (EC) No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).

rule, the possibility of punitive damages or triple damages for antitrust actions, as well as collectivisation of individual claims. Theoretical justification for these features can be claimed through a national policy of emphasising private enforcement not only of private rights but also of public norms,[67] through encouraging activity by 'private attorneys general'[68] that has a strong element of regulatory in addition to compensation goals, backed by a theory that large financial penalties will deter corporate wrongdoing[69] and a belief that public agencies are captured and unreliable.[70]

In contrast, European legal theory and architecture adopts a clearer division between the nature and means of enforcement of public and private law, and relies far more on public enforcement of public and administrative rules, even if some of the actors operate within self-regulatory structures. There is a general preference for a loser pays rule, and mistrust that funding by intermediaries and large or contingent fees may produce conflicts of interest and abuse.[71] The thesis of this chapter is that empirical evidence suggests that private enforcement mechanisms of small claims, whether individually or collectively, simply does not work in Europe. The evidence from national class actions in those eighteen or so jurisdictions that have had them is relatively recent but indicates a general pattern of low usage and, importantly, cases that are complex, take years and have high transactional costs.[72] The high costs and

[67] H Kalven Jr and M Rosenfield, 'The Contemporary Function of the Class Suit' (1941) 8 *University of Chicago Law Review* 684; S Issacharoff and I Samuel, 'The Institutional Dimension of Consumer Protection' in F Cafaggi and H-W Micklitz (eds), *New Frontiers of Consumer Protection. The Interplay between Private and Public Enforcement* (Antwerp, Intersentia, 2009); C Hodges, 'Objectives, Mechanisms and Policy Choices in Collective Enforcement and Redress' in J Steele and W van Boom (eds), *Mass Justice* (Cheltenham, Edward Elgar, 2011).

[68] JC Coffee Jr, 'Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is not Working' (1983) 42 *Maryland Law Review* 215; B Garth, IH Nagel and SJ Plager, 'The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation' (1987–88) 61 *Southern California Law Review* 353; LM Grosberg, 'Class Actions and Client-Centered Decision-making' (1989) 40 *Syracuse Law Review* 709.

[69] G Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economy* 169; GJ Stigler, 'The Theory of Economic Regulation' (1971) 3 *Bell Journal of Economics and Management Science* 3; M Faure, A Ogus and N Philipsen, 'Curbing consumer financial losses: the economics of regulatory enforcement' (2009) 31 *Law & Policy* 161.

[70] R Baldwin and M Cave, *Understanding Regulation: Theory, Strategy, and Practice* (New York, Oxford University Press, 1999); SP Huntington, 'The Marasmus of the ICC: The Commission, the Railroads, and the Public Interest' (1952) 61 *The Yale Law Journal* 467; Stigler, 'The Theory of Economic Regulation'; ME Levine and JL Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) 6 *Journal of Law, Economics, & Organization* 167; J-J Laffont and J Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture' (1991) 106 *The Quarterly Journal of Economics* 1089; PJ May and S Winter, 'Regulatory Enforcement and Compliance: Examining Danish Agro-Environmental Policy' (1999) 18 *Journal of Political Analysis and Management* 625.

[71] Strong statements against the 'abusive' nature of US-style class actions were made by European leaders over several years, culminating in the European Parliament Resolution of 2/2/2012 'Towards a Coherent European Approach to Collective Redress' 2011/2089(INI)and Communication from the Commission 'Towards a European Horizontal Framework for Collective Redress' COM(2013) 401/2.

[72] C Hodges, 'Collective Redress: A Breakthrough or a *Damp Sqibb*?' (2014) *Journal of Consumer Policy* forthcoming.

loser pays rule mean that those who are required to fund in mass litigation have to undertake risk assessments before investing, and will choose cases with the best returns, low risk (such as cartel follow-on damages actions) and limited complexity. These factors make cases that involve multiple small amounts of damages inherently unattractive as investment propositions, since the potential profit compared with the administrative cost is unattractive, especially if liability is not completely clear. Capital is also likely to be committed for some years, and the prospect of an early and favourable settlement is unclear, unlike the position in the United States, where almost all class actions that pass certification stage will be settled.[73] So collective litigation for consumer damages turns out not to be the Holy Grail that it was thought to be but a cruel mirage. Accordingly, other mechanisms have to be found.

Turning towards ADR techniques, 48% of European consumers think it is easy to resolve disputes through arbitration, mediation or conciliation.[74] Consumers are more willing to resolve disputes through CDR rather than court (note the figures quoted above of 5% for CDR and 2% for courts). On the business side, 54% of businesses prefer to solve disputes through ADR rather than in court,[75] 82% who have already used ADR would use it again in the future,[76] and of those who used ADR 76% found it a satisfactory way to settle the dispute.[77]

The Commission's 2009 and 2011 CDR studies found that the vast majority of the CDR procedures are *free of charge* for the consumer, or of moderate costs (below € 50).[78] The 2012 Oxford study confirmed that CDR schemes are free to consumers in France, Spain and Sweden, and in almost all of the schemes in Germany and the United Kingdom (save for those post-conciliation arbitration stages of many private schemes, for which a charge is imposed). An exception applies in the Netherlands, where consumers pay a registration fee that varies depending on the sectoral Board, and generally ranges between € 25 and € 125.[79]

A distinction can be drawn in relation to cost between different types of ADR models. In general, ombudsmen systems are free to consumers. CDR systems that involve a mediation stage are usually free and those that involve arbitration can involve modest access costs. However, the costs are low and are intentionally kept attractive in comparison with the cost of court fees for small claims procedures.

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[73] Garth et al. 'The Institution of the Private Attorney General'.

[74] Eurobarometer 299, 30.

[75] CDR Impact Assessment, 21.

[76] Eurobarometer 300, 79. This evidence is further reinforced when looking at the satisfaction of businesses; of those who used ADR, 76 per cent found it a satisfactory way to settle the dispute European Business Test Panel, http://ec.europa.eu/yourvoice/ebtp/consultations/2010/adr/index_en.htm.

[77] European Business Test Panel, http://ec.europa.eu/yourvoice/ebtp/consultations/2010/adr/index_en.htm.

[78] Civic Consulting, *Study on the use of Alternative Dispute Resolution in the European Union. Final Report* (2009), 41; Civic Consulting, *Assessment of the compliance costs*. See also CDR Impact Assessment, 21.

[79] C Hodges, I Benöhr and N Creutzfeldt-Banda, *Consumer ADR in Europe* (Oxford, Hart Publishing, 2012) 381.

Nevertheless, if consumers choose to instruct a lawyer, even in relation to a small claims procedure, their cost will increase. Based on the finding that free CDR is the general rule, the 2013 Directive specifies that CDR services shall be either free or available at a nominal fee to consumers, and access does not require retaining a lawyer.[80] This should make CDR more attractive than courts. The word 'nominal' is significant: it does not connote full cost recovery by CDR entities. Some CDR bodies charge consumers a fee because in some types of case it can assist by encouraging some consumers to evaluate the basis and quantum of a claim in an objective manner. In short, it can help refocus annoyance at, for example, an unsatisfactory holiday into a level of compensation that is more realistic than an exaggerated sum.

Are operational costs of CDR schemes cheaper than lawyers and courts? Cost data is not fully available, but the Oxford study found that cost varies with the nature of the case type and whether a CDR scheme includes a triage-mediation stage or just a decision stage. In relation to differences arising from the nature of case types, a pension case may clearly involve more time and expertise than a simple non-delivery of goods case. Thus, the cost per case in 2010 for UK Pensions Ombudsman was roughly £ 3,000, and the inherent complexity was apparent from the longer average duration of his cases than some other schemes. In contrast, the cost for Ombudsman Services in 2012-13 was £ 66 per contact or, £ 411 per complaint resolved (thus including the cost of handling contacts), which covers a range of different complaint types for several sectors.[81] The cost per case in Sweden in 2010 was € 300 and the Netherlands perhaps € 900, but these are very general figures, averaged across many different types of cases. Comprehensive cost data is not available from Spain, but the average cost per case was over € 400 in 2010, whilst the average value of awards was only € 366.

The Dutch geschillencommissie system and the Nordic arbitration systems are notably cheap. In 2013, DGS has only 45 administrative staff, supporting 53 sectoral Boards. In 2010 its administrative cost was € 5.5 million. The Dutch system has historically used the arbitration model but it is to pilot the addition of a mediation stage in 2014 in relation to disputes involving kindergarten. It will probably use a panel of external mediators, paid on an hourly basis. An alternative would be to use a module fee, so parties have full predictability of cost, although different fees might have to be set for different types of case.

In examining the cost of CDR entities, account should be taken of the fact that CDR bodies perform functions additional to dispute resolution, by providing free advice to many consumers and provide the source of aggregate statistics on traders and trading problems that are highly valuable for markets and enforcement officials. The inquiry may be 'This has happened, is the trader in the right, or do I have grounds to complain?' The consumer could ask a lawyer this question, but there would often be a cost, or could ask an advice body, which might be free, but many such questions are directed to CDR bodies. Consumers may use the CDR body as a source of expert advice in consumer law and specialist sectoral rules, what is

[80] Directive on consumer ADR, Art 8(b) and (c).

[81] Ombudsman Services Limited, *Annual Report and Accounts 2012-2013* (2013), reporting gross turnover £8,088,517, 122,589 contacts and 19,639 complaints resolved.

acceptable market practice, and whether there might be cause for complaint, as well as a source of dispute resolution.

Every CDR body receives more inquiries than formal claims. One observation made in the Oxford study was that in countries where there is a strong and effective consumer advice function, the number of requests for post-purchase advice and complaints received by the national CDR body appears to be remarkably low. Thus, in 2010, the ARN in Sweden received on around 11,000 cases, although a relatively small number of sectoral CDR bodies also received an unidentified but seemingly modest number of cases.[82] The Swedish system is intentionally designed to provide effective pre- and post-purchase advice to consumers, and clearly does so. Design features that invest in advice systems do appear to produce more effective purchasing, and give rise to fewer complaints. This means providing good sources of independent pre-contract advice, and fully transparent information on products and services.[83] Both the advice system and the complaint system should operate within structures that are as simple as possible, so they can be easily understood by consumers, and hence maximise access.

39.6.2 Duration

The Council of Europe Project on European Justice (CEPEJ) has reported on data from national governments, recording that the average time in 2010 for resolution of litigious civil and commercial cases across 39 European jurisdictions (including EU Member States but also others) was 287 days.[84] The EU Justice Scoreboard 2013 drew on the CEPEJ data[85] to focuson Member State performance.[86] The figures showed a range from 55 days for Lithuania to 849 days for Malta, with the highly efficient German civil procedure system at 184 days. A significant number of Member States' court procedures took around 200 days to resolve civil and commercial cases (Fig. 39.7[87]), with 12 States above that figure up.

Of course these figures are averages and cover many types of claims, but the message of the length of court proceedings generally is clear. The Commission concluded that the figures

> show important disparities in the length of proceedings: at least one third of Member States have a length of proceedings at least two times higher than the majority of Member States.[88]

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[82] F Weber, C Hodges and N Creutzfeldt-Banda, 'Sweden' in Hodges, Benöhr and Creutzfeldt-Banda, *Consumer ADR in Europe*.

[83] Encouraged by, for example, Dir 2011/83/EU on consumer rights.

[84] CEPEJ 2012, n 57 above, Fig. 9.12, http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2012/Rapport_en.pdf.

[85] CEPEJ, Study on the functioning of judicial systems and the functioning of the economy in the EU Member States (2012), available at http://ec.europa.eu/justice/index_en.htm.

[86] EU Justice Scoreboard 2013.

[87] EU Justice Scoreboard 2013, Fig. 2, citing CEPEJ 2012.

[88] ibid, 7.

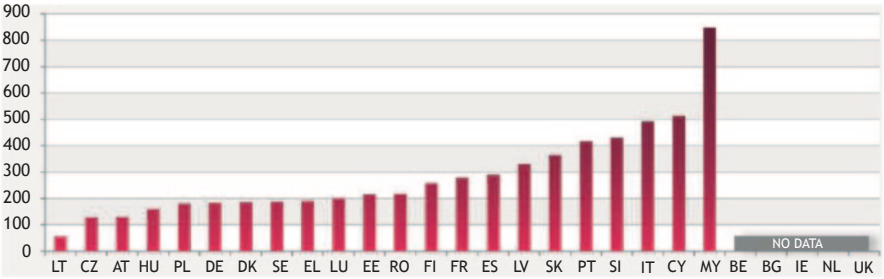

Fig. 39.7 Time needed to resolve litigious civil and commercial cases (in days)

> Certain Member States combine unfavourable factors: lengthy first instance proceedings together with low clearance rates and/or a large number of pending cases. Such situations merit special attention and a thorough analysis as they could be indicative of more systemic shortcomings for which remedial action should be taken.[89]
>
> The reduction of the excessive length of proceedings should be a priority in order to improve the business environment and attractiveness for investment.
>
> Alternative Dispute Resolution methods help to reduce the workload of courts.[90]

Almost all CDR bodies can achieve faster performance than courts. Some CDR services are capable of resolving issues very quickly. Most CDR cases are decided within 90 days.[91] The Directive adopted that benchmark and provides that the maximum time for CDR procedures shall be 90 calendar days, extendable for highly complex disputes.[92] Many CDR bodies achieve under that period. The Oxford study found the data set out in Table 39.2 for CDR bodies.[93] U.K. Ombudsman Services resolved 34% of complaints in 2012-13 (6,500) using early resolution and mutually acceptable settlement, by which it contacts both parties, preferably by phone, to discuss the complaint and its resolution and try to reach agreement. It cited the following case study:

> We received a call from a complainant at 2.50 pm and by 3.17 pm the same day the company and the complainant had agreed to a resolution. The customer had cancelled her contract but it had mistakenly rolled over—a simple shortfall in customer service. The complainant verbally accepted our account of the complaint and agreed to send across supporting evidence. When we spoke to the company it acknowledged the error it had made and agreed to the proposed resolution.[94]

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[89] ibid, 11.

[90] ibid, 17.

[91] Civic Consulting, *Assessment of the compliance costs*, 8. Litigious civil (and commercial) cases were defined to 'concern disputes between parties, for example disputes regarding contracts and the insolvency proceedings. By contrast, non-litigious civil (and commercial) disputes concern uncontested proceedings, for example, uncontested payment orders.'

[92] Dir on consumer ADR, Art 8(e).

[93] Hodges, Benöhr and Creutzfeldt-Banda, *Consumer ADR in Europe*, 381.

[94] Ombudsman Services Limited, *Annual Report and Accounts 2012-2013*, 13.

Table 39.2 Average duration per case in months by country and CDR scheme

France	Telecoms: 3	Insurance: 3–6	Banks: 6	Investment	GDF/ SUEZ: 2 National Energy mediator: 6	Travel: 2–4
Germany	Telecoms: 4	Insurance:4.1	Banks: no data			Travel: 3
Poland	Telecoms: no data	Consumer arbitration tribunals: 0.5–2	Banking: 1.1	Trade inspection consumer: no data	Energy: no data	
Spain	Telecoms: no data	Insurance / pensions: 4	Banking: 4–6	Investment: no data	Energy: 2	
UK	Telecoms: 6 or less	Pensions: 10.9	Banks/ Insurance: 2.2	FLA: 2	Energy: xx	Travel: 2–2.5

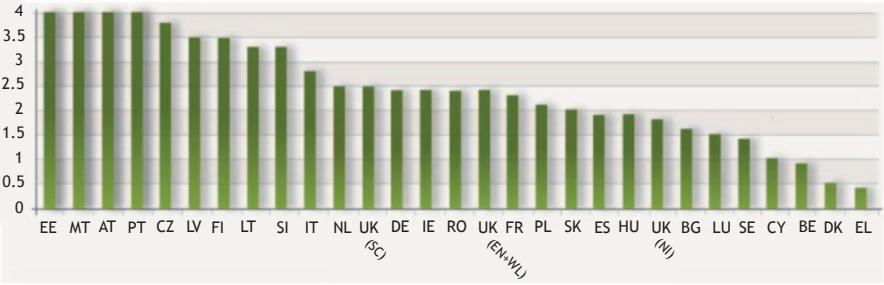

Fig. 39.8 Electronic communication between courts and parties (weighted indicator—min = 0, max = 4). (EU Justice Scoreboard 2013, Fig. 14, quoting source as CEPEJ)

39.6.3 User-Friendliness and Accessibility

It is clear from the consumer survey data quoted above that the extent to which it is easy to make a complaint or, conversely, it involves hassle, especially for elderly or young people, affects whether a consumer will expend the effort in lodging a complaint about a matter that has a low value. Some national court procedures, and especially small claims and money claims procedures, permit lodging claims online and have adopted electronic facilities for regular communications (Figs. 39.8, 39.9, 39.10 and 39.11). Online facilities for money claims are positive innovations and increasingly used.[95]

[95] In England see https://www.moneyclaim.gov.uk/web/mcol/welcome.

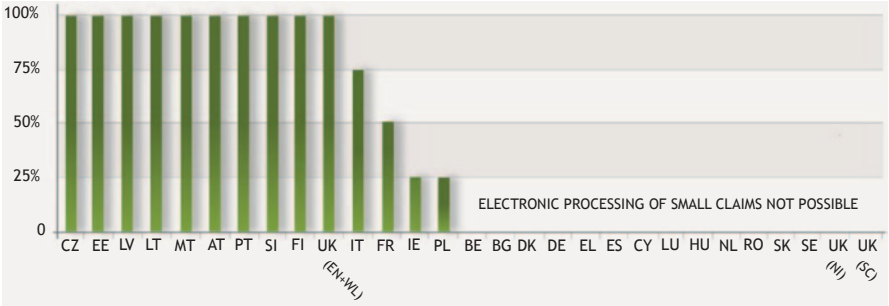

Fig. 39.9 Electronic processing of small claims (0 = available in 0% of courts; 4—available in 100% of courts. (EU Justice Scoreboard 2013, Fig. 15, quoting source as CEPEJ. The descriptor 'small claims' was stated to indicate a civil case where the monetary value of the claim is relatively low, the value varying among the Member States.)

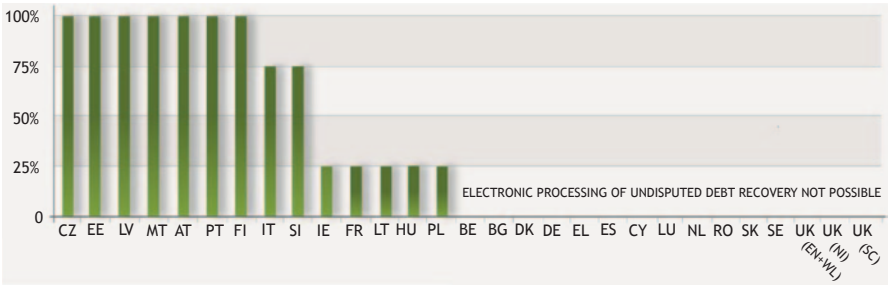

Fig. 39.10 Electronic processing of undisputed debt recovery (0 = available in 0% of courts; 4—available in 100% of courts. (EU Justice Scoreboard 2013, Fig. 16, quoting source as CEPEJ)

The Commission noted in 2011:[96]

> Very few ADR schemes (e.g. ECODIR,[97] Risolvi-online,[98] Der Online Schlichter[99]) handle the entire process online where consumers, traders and ADR schemes communicate during the whole procedure through a web-based system in order to resolve disputes.[100] About half

[96] CDR Impact Assessment.

[97] ECODIR stands for 'Electronic Consumer Dispute Resolution' and is concerned with disputes for transactions between businesses and consumers taking place over the Internet; http://www.ecodir.org/fr/index.htm

[98] RisolviOnline (http://www.risolvionline.com) is a service offered by the Milan Mediation Chamber that allows the resolution of commercial Disputes and can be used be used both by individual consumers/users and by enterprises.

[99] The Online Schlichter (https://www.online-schlichter.de/de/ueber_uns/index.php) is competent for the handling of e-commerce disputes, i.e. disputes over contracts which were concluded online.

[100] For example, for a brief history and overview of ODR, including at the international level, see P Cortes, *Online Dispute Resolution for Consumers in the European Union* (London, Routledge, 2011).

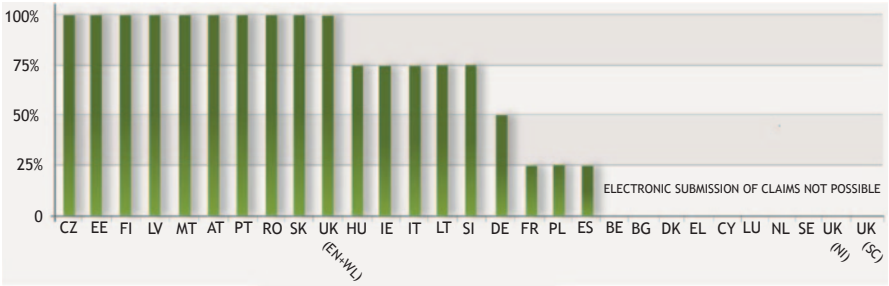

Fig. 39.11 Electronic submission of claims (0 = available in 0 % of courts; 4—available in 100 % of courts. (EU Justice Scoreboard 2013, Fig. 17, quoting source as CEPEJ)

> of the existing ADR schemes, however, provide for an online complaint form which can be submitted directly online or sent by post or email.[101] ODR is nevertheless perceived positively; about 60 % of businesses[102] and 64 % of consumers state that they would be willing to solve disputes with consumers through ODR.[103]

CDR systems increasingly accept online complaints, and some even decline telephone contacts so as to improve cost efficiency and make consumers focus on not wasting time by having to assemble the relevant documentation before just picking up the phone (such as the French telecom médiateur). In virtually every case, the procedure adopted by a CDR scheme will be more streamlined and less formal than normal court procedure. Small claims procedures have aimed to achieve the same goals, but cannot offer, for example, instant telephone advice and mediation. There could be a national portal, such as the Belgian national Belmed.[104]

ADR and CDR entities raise issues over the independence and impartiality of decision-makers,[105] but so do courts. Perceptions of judicial independence and of the independence of the judicial system vary across the EU and in no case reach full confidence (Figs. 39.12[106] and 39.13[107]).

[101] Civic Consulting, *Assessment of the compliance costs*, 100 and 143.

[102] European Business Test Panel results available at http://ec.europa.eu/yourvoice/ebtp/consultations/2010/adr/statistics_en.pdf

[103] Preliminary results on a study on the development of e-commerce in the EU, to be published in the second half of 2011.

[104] S Voet, 'Belgium' in Hodges, Benöhr and Creutzfeldt-Banda, *Consumer ADR in Europe*; Voet, 'Public Enforcement &A(O)DR'.

[105] These issued are addressed in Dir 2013/11/EU on consumer ADR, Arts 6-12.

[106] EU Justice Scoreboard 2013, Fig. 23, citing source as World Economic Forum. The survey was replied by a representative sample of firms in all countries representing the main sectors of the economy (agriculture, manufacturing industry, non-manufacturing industry, and services).

[107] EU Justice Scoreboard 2013, Fig. 24, citing source as World Justice Project.

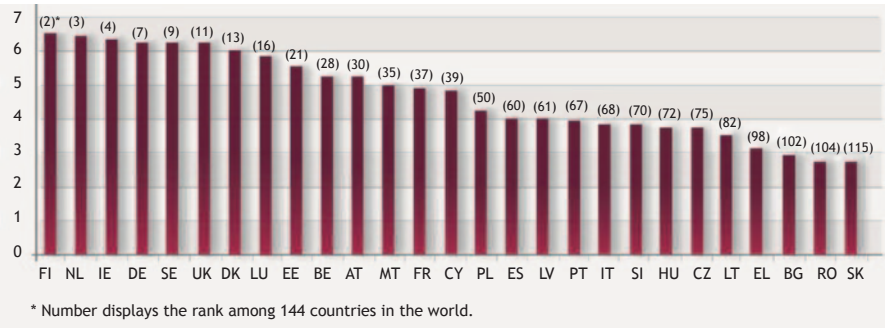

Fig. 39.12 Judicial independence (perception—higher value means better perception)

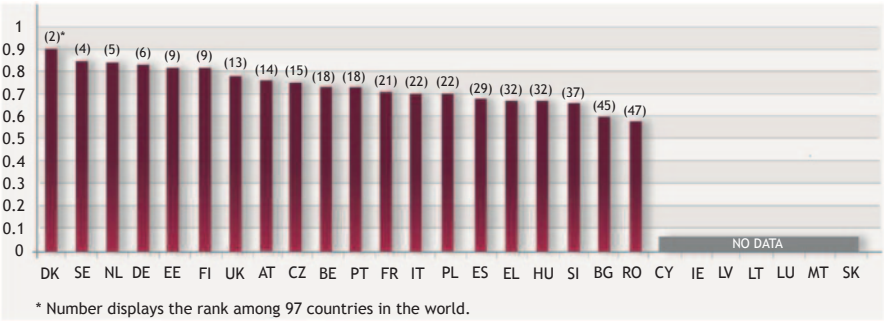

Fig. 39.13 Independence of civil justice (perception—higher value means better perception)

39.7 Conclusions

The data set out above suggest a series of conclusions. Firstly, the vast majority of consumer claims involve very low values. Thus, dispute resolution procedures must respond by providing cheap transactional costs, otherwise consumers will not raise such issues and some traders will distort the market by gaining illicit profits. Secondly, the vast majority of consumer claims are about matters that involve simple issues. Thus, dispute resolution procedures must enable simple means of resolution or adjudication, avoiding the cost and delay that will be inherent in overly complex procedures. Non-delivery, for example, needs minimal evidence: perhaps a couple of emails or documents evidenced by pdf, and perhaps a formal statement or delivery tracking record. Those cases that give rise to greater complexity, whether in terms of facts or law, should be identified and transferred to an appropriately proportionate track. Thirdly, even low cost court procedures are too expensive—and too off-putting—for many consumer claims. Fourthly, attempts at reducing overall cost through aggregation in collective court actions have not succeeded in Europe,

since the costs remain disproportionate and unattractive, leaving individual claimants with little or nothing, and duration is considerably lengthened.

Overall, the evidence is that consumers find lawyers, litigation and courts difficult to access, costly and slow.

> …when their rights are violated European consumers do not always obtain effective redress. This is because consumers believe court proceedings to be expensive, time-consuming and burdensome. Cumbersome and ineffective proceedings and their uncertain outcome discourage consumers from even trying to seek redress. In addition, consumers are not always aware of what their rights entail in concrete terms and therefore do not seek compensation when they are entitled to it.[108]

Consumers need rights. But expecting most consumers to be able to enforce those rights in almost all of the disputes that arise with traders is a political slogan that is illusory and unconnected with reality. The Commission summarised the position thus:[109]

> From the views expressed by consumers during the discussions some clear patterns emerge about what the characteristics of an ideal consumer redress mechanism would be. In general, consumers would prefer mechanisms which (in broad order of importance):
>
> - Are as low cost as possible
> - Resolve the issue as quickly as possible
> - Do not expose them to uncomfortable or distressing experiences
> - Are simple and straightforward to understand
> - Are demonstrably fair and fully transparent.

The evidence shows that the two techniques that can provide redress for consumer claims at speedy, low and proportionate cost are CDR and regulatory redress—particularly if both techniques are integrated so as to be used together. CDR itself offers enormous potential. It should be attractive for consumers to use, simpler, faster and inexpensive,[110] regimes that also regulate and improve market behaviour, and deliver collective redress far more quickly, cheaply and effectively than collective litigation. Overall, therefore, if they are designed and operated effectively, CDR schemes can offer advantages in relation to courts[111] of speed, accessibility, informality, expertise, lower cost to the state (but sometimes internalised cost to the sector), increased acceptability of decisions, potentially lower regulatory burden, and increased motivation. The age of actual consumer redress and fair trading standards is at last attainable.

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[108] CDR Impact Assessment, 5.

[109] ibid, 23.

[110] ibid, 20.

[111] CH van Rhee and A Uzelac (eds), *Civil Justice between Efficiency and Quality: from Ius Commune to the CEPEJ* (Antwerp, Intersentia, 2008).

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Chapter 40
On Beauty and Being Fair—The Interaction of National and Supranational Judiciaries in the Development of a European Law on Remedies

Chantal Mak

Abstract Truth is not only stranger than fiction, it is more interesting', a famous saying by William Randolph Hearst goes. It rings true not only for newspaper men, but also for judges who have to decide on politically charged legal questions in times of economic crisis. This Chapter will address one telling example from the European case law on the implementation, interpretation and application of Directive 93/13 on unfair terms in consumer contracts: the interaction among national and European Union (EU) legislature and judiciary in the Spanish case of *Aziz v Catalunyacaixa.*

An account of the *Aziz* case touches upon a number of subjects that Hans Micklitz has addressed in his extensive work on European consumer and contract law, including the evolution of consumer law in the EU, the normative design of European private law and the development of effective remedies for breaches of Union law by the judiciary. With this Chapter, therefore, I hope to contribute to the further analysis of these themes as well as to express my admiration and great appreciation for Hans Micklitz's work and for his open, sincere and thoughtful manner of engaging with other people's views and beliefs. His questions always challenge me to look beyond the obvious and sharpen my thoughts and the way in which to express them. One thing this has taught me is to look into the reception of the Court of Justice of the EU (CJEU)'s judgments in national legal systems to fully grasp their meaning and understand their importance for the conceptualisation of the legal order shaped by European contract law. The following analysis of the *Aziz* judgment may be read against this backdrop.

40.1 A Case Study

'Truth is not only stranger than fiction, it is more interesting', a famous saying by William Randolph Hearst goes. It rings true not only for newspaper men, but also for judges who have to decide on politically charged legal questions in times of

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_40,

economic crisis. This Chapter will address one telling example from the European case law on the implementation, interpretation and application of Directive 93/13 on unfair terms in consumer contracts:[1] the interaction among national and European Union (EU) legislature and judiciary in the Spanish case of *Aziz v Catalunyacaixa*.[2]

An account of the *Aziz* case touches upon a number of subjects that Hans Micklitz has addressed in his extensive work on European consumer and contract law, including the evolution of consumer law in the EU,[3] the normative design of European private law[4] and the development of effective remedies for breaches of Union law by the judiciary.[5] With this Chapter, therefore, I hope to contribute to the further analysis of these themes as well as to express my admiration and great appreciation for Hans Micklitz's work and for his open, sincere and thoughtful manner of engaging with other people's views and beliefs. His questions always challenge me to look beyond the obvious and sharpen my thoughts and the way in which to express them. One thing this has taught me is to look into the reception of the Court of Justice of the EU (CJEU)'s judgments in national legal systems to fully grasp their meaning and understand their importance for the conceptualisation of the legal order shaped by European contract law.[6] The following analysis of the *Aziz* judgment may be read against this backdrop.

40.2 Beauty or Truth

The discussion of the *Aziz* case in this Chapter will be placed within the debate on the European legal order's architecture in terms of monism and pluralism.[7] The consideration of EU law's implications for contracting parties within a Member State raises the question to what extent EU law, and its underlying policies, should interfere in the national legal order. An answer to this question depends on the view that is taken on the nature of the compound of private law rules deriving from different levels of governance that apply to such contracts. Hans Micklitz has argued

[1] OJ 1993 L 95, 29.

[2] Judgment of 14 March 2013, Case C-415/11 *Aziz v Catalunyacaixa*, not yet reported.

[3] H-W Micklitz, N Reich and P Rott, *Understanding EU Consumer Law* (Antwerp, Intersentia, 2009).

[4] H-W Micklitz, 'Monistic Ideology versus Pluralistic Reality—Towards a Normative Design for European Private Law' in L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart, 2013).

[5] H-W Micklitz, 'The ECJ Between the Individual Citizen and the Member States—A Plea for a Judge-Made European Law on Remedies' in H-W Micklitz and B de Witte (eds), *The European Court of Justice and the Autonomy of the Member States* (Antwerp, Intersentia, 2012).

[6] E.g. C Mak, 'Judgment of the Court (First Chamber) of 6 October 2009, Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira, Case C-40/08' (2010) 6 *European Review of Contract Law* 437.

[7] L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart publishing, 2013); C Mak, 'The One and the Many. Translating Insights from Constitutional Pluralism to European Conctract Law Theory' (2013) 21 *European Review of Private Law* 1189.

that private law within the EU has gradually developed into a pluralistic reality of national laws inspired by national ideals and ideas of social justice, which is complemented by a genuine EU regulatory private law that is submitted to the overall objective of the internal market:[8]

> The overall hypothesis is that the transformation of the Nation State private legal orders into a Market State European private legal order produces a diversification of private law regimes. On the one hand, there are the Nation State private legal orders that lose importance in practice and, concomitantly, as a source of inspiration for the new regulatory design. On the other hand is the Market State European private legal order *in statu nascendi* as a self-standing legal order, which unites the 'formal' and 'informal authority' of private lawmaking; the making of private law through the EU legislator via regulations and directives in combination and in cooperation with non-State actors; the yielding of a new pattern of justice—access justice (*Zugangsgerechtigkeit*).[9]

If the role of judges in such a constellation is imagined, the hypothesis would be that the CJEU should take goals of market regulation as a starting point when assessing preliminary questions in cases falling within the scope of measures of EU law, whereas national courts should integrate these goals into their own legal systems, possibly at the expense of national achievements of social justice. Yet, is regulating the market through EU law really what the CJEU does? And should it, given the fact that its judgments can hardly be detached from the national context in which they will take effect? How do national judges perceive of the role of the EU legislature and judiciary? And to what extent should they allow a market-oriented view of private law to interfere with their national systems? Furthermore, might they be able to turn the tables, and enhance social justice in national cases by referring to EU law?

In the following, it will be argued that, in a Micklitzian style, we should beware of accepting a certain model of the European legal order primarily because of its coherence or beauty. Recognising and studying the imperfections in the model may bring us closer to the truth,[10] in this case to a theoretical framework that can explain the dynamics of lawmaking in the EU and, in particular, the role of judges in this process.

40.3 *Aziz* and the Image of the European Judiciary

The facts of the *Aziz* case were the following:[11] In order to finance the purchase of a family home, Mr Mohamed Aziz had concluded a loan agreement with the Catalunyacaixa bank, security for which was provided by a mortgage on the house. When

[8] Micklitz, 'Monistic Ideology and Pluralistic Reality' and 'The ECJ Between the Individual Citizen and the Member States'.

[9] Micklitz, 'Monistic Ideology and Pluralistic Reality', 32 f.

[10] Cf D Orrell, *Truth or Beauty. Science and the Quest for Order* (New Haven, Yale University Press, 2012).

[11] The following is based on a case summary I posted earlier on the blog 'Recent developments in European consumer law', recent-ecl.blogspot.com, 14/3/2013.

Aziz lost his job, got into financial problems and failed to pay the monthly instalments of the loan on a regular basis, the bank made use of its contractual option to terminate the contract earlier (a so-called 'acceleration clause') and claim back the total amount of the loan. Furthermore, the bank started mortgage foreclosure proceedings regarding Aziz's property. In these proceedings, under Spanish law there are only limited grounds for objection against the foreclosure, none of which was applicable in this case. Moreover, Aziz did not appear in these proceedings nor manage to prevent the public sale of the house by paying the remaining amount of the loan plus interest and costs. Following a public sale that attracted no bidders, the bank obtained property of the house for 50 % of its contractually established value. Consequently, Aziz lost ownership of the house and was left with a remaining debt to the bank amounting to 40,000 €. In order to put the bank in possession of the house, finally, the Aziz family was evicted from the property.

The first preliminary question concerned the compliance of the Spanish system of levying execution on mortgaged property with the Unfair Terms Directive. In reply to this question, the CJEU held:[12]

> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts must be interpreted as precluding legislation of a Member State, such as that at issue in the main proceedings, which, while not providing in mortgage enforcement proceedings for grounds of objection based on the unfairness of a contractual term on which the right to seek enforcement is based, does not allow the court before which declaratory proceedings have been brought, which does have jurisdiction to assess whether such a term is unfair, to grant interim relief, including, in particular, the staying of those enforcement proceedings, where the grant of such relief is necessary to guarantee the full effectiveness of its final decision.

The CJEU, thus, considered Spanish law to infringe the Directive, in particular because it precluded the court that had jurisdiction to declare unfair a term of a loan agreement relating to immovable property from *staying the mortgage enforcement proceedings* initiated separately. The Court observed:

> 59 It must therefore be held that such procedural rules impair the protection sought by the directive, in so far as they render it impossible for the court hearing the declaratory proceedings—before which the consumer has brought proceedings claiming that the contractual term on which the right to seek enforcement is based is unfair—to grant interim relief capable of staying or terminating the mortgage enforcement proceedings, where such relief is necessary to ensure the full effectiveness of its final decision (see, to that effect, Case C-432/05 *Unibet* 2007 ECR I-2271, paragraph 77).
> 60 As also observed by the Advocate General in point 50 of her Opinion, without that possibility, where, as in the main proceedings, enforcement in respect of the mortgaged immovable property took place before the judgment of the court in the declaratory proceedings declaring unfair the contractual term on which the mortgage is based and annulling the enforcement proceedings, that judgment would enable that consumer to obtain only subsequent protection of a purely compensatory nature, which would be incomplete and insufficient and would not constitute either an adequate or effective means of preventing the continued use of that term, contrary to Article 7(1) of Directive 93/13.

[12] Case C-415/11 *Aziz*, para 64 and ruling.

The second preliminary question concerned the legal framework provided by the Directive for the assessment of specific terms in mortgage contracts. In reply to this question, the Court holds:[13]

> Article 3(1) of Directive 93/13 must be interpreted as meaning that:
> - the concept of 'significant imbalance' to the detriment of the consumer must be assessed in the light of an analysis of the rules of national law applicable in the absence of any agreement between the parties, in order to determine whether, and if so to what extent, the contract places the consumer in a less favourable legal situation than that provided for by the national law in force. To that end, an assessment of the legal situation of that consumer having regard to the means at his disposal, under national law, to prevent continued use of unfair terms, should also be carried out;
> - in order to assess whether the imbalance arises 'contrary to the requirement of good faith', it must be determined whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to the term concerned in individual contract negotiations.
> Article 3(3) of Directive 93/13 must be interpreted as meaning that the Annex to which that provision refers contains only an indicative and non-exhaustive list of terms which may be regarded as unfair.

Concerning the assessment of the specific terms at stake in the *Aziz* case, the CJEU followed Advocate General Kokott[14] in giving specific guidelines to national courts regarding the factors that should be taken into account:[15]

> 73 In particular, with regard, first, to *the term concerning acceleration*, in long-term contracts, on account of events of default occurring within a limited specific period, it is for the referring court to assess in particular, as stated by the Advocate General in points 77 and 78 of her Opinion, whether the right of the seller or supplier to call in the totality of the loan is conditional upon the non-compliance by the consumer with an obligation which is of essential importance in the context of the contractual relationship in question, whether that right is provided for in cases in which such non-compliance is sufficiently serious in the light of the term and amount of the loan, whether that right derogates from the relevant applicable rules and whether national law provides for adequate and effective means enabling the consumer subject to such a term to remedy the effects of the loan being called in.
> 74 Second, regarding *the term concerning the fixing of default interest*, it should be recalled that, in the light of paragraph 1(e) of the Annex to the Directive, read in conjunction with Articles 3(1) and 4(1) of the directive, the national court must assess in particular, as stated by the Advocate General in points 85 to 87 of her Opinion, first, the rules of national law which would apply to the relationship between the parties, in the event of no agreement having been reached in the contract in question or in other consumer contracts of that type and, second, the rate of default interest laid down, compared with the statutory interest rate, in order to determine whether it is appropriate for securing the attainment of the objectives pursued by it in the Member State concerned and does not go beyond what is necessary to achieve them.
> 75 With regard, finally, to *the term concerning the unilateral determination by the lender of the amount of the unpaid debt, linked to the possibility of initiating mortgage enforcement proceedings*, it must be held that, taking into account paragraph 1(q) of the Annex to the directive and the criteria contained in Articles 3(1) and 4(1) thereof, the referring court must in particular assess whether and, if appropriate, to what extent, the term in question

[13] ibid, para 76 and ruling.

[14] Opinion of AG Kokott of 8 November 2012, Case C-415/11 *Aziz*.

[15] Case C-415/11 *Aziz*, paras 73–75 (emphasis added, CM).

> derogates from the rules applicable in the absence of agreement between the parties, so as to make it more difficult for the consumer, given the procedural means at his disposal, to take legal action and exercise rights of the defence.

In its reasoning, furthermore, the CJEU took care to emphasise the division of tasks among national and supranational legislatures and judiciaries:

> 50 In that regard, in the absence of harmonisation of the national mechanisms for enforcement, the rules implementing the grounds of objection allowed in mortgage enforcement proceedings and the powers conferred on the court hearing the declaratory proceedings, which enjoys jurisdiction to analyse the lawfulness of the contractual clauses on the basis of which the right to seek enforcement was established, are a matter for the national legal order of each Member State, in accordance with the principle of the procedural autonomy of the Member States, on condition, however, that they are no less favourable than those governing similar domestic actions (principle of equivalence) and do not make it in practice impossible or excessively difficult to exercise the rights conferred on consumers by European Union law (principle of effectiveness) (see, to that effect, Case C-168/05 *Mostaza Claro* [2006] ECR I-10421, paragraph 24, and Case C-40/08 *Asturcom Telecomunicaciones* [2009] ECR I-9579, paragraph 38).

The Court, thus, at first sight affirmed an image of the European judiciary in which remedies for the enforcement of EU law in the first place should be provided on the national level and in which, subsequently, only a marginal assessment of the effectiveness and equivalence of the national procedural legal framework may be made on the European level. As such, the *Aziz* judgment would seem to fit well with Article 19 TEU, which provides that 'Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law'. Moreover, the judgment was placed in the key of the CJEU's earlier case law on the assessment of standard terms, notably its judgment in *Freiburger Kommunalbauten*, in which the Court held that:[16]

> It is for the national court to decide whether a contractual term such as that at issue in the main proceedings satisfies the requirements for it to be regarded as unfair under Article 3(1) of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

40.4 On Beauty…

'All's fair in love and…and academia,' Zadie Smith has one of the main characters proclaim in her novel *On Beauty*, from which the title of this section is borrowed.[17] One may wonder if this could be true for the modelling of a European private legal order in the terms set out in the previous sections. What could be wrong with a coherent, beautiful image of a multi-level private legal order in which competenc-

[16] Case C–237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v Hofstetter*, [2004] ECR I-3403, para 25 and ruling.

[17] Z Smith, *On Beauty* (London, Penguin Press, 2005) 366. In her turn, Smith was inspired by E Scarry, *On Beauty and Being Just* (Princeton, Princeton University Press, 2001).

es are neatly divided among national and supranational institutions? Could Hans Micklitz's hypothesis of a genuine EU pattern of *access justice* support this image?

The appeal of the depiction of the interaction among national and EU legislatures and judiciaries concerning the policing of unfair terms in consumer contracts as set out at the end of the previous section lies in its seemingly conclusive representation of how to establish who has the final say in a specific case on the enforcement of a party's rights under EU law—the national judge or, through a preliminary reference procedure, the CJEU. Since the Treaty on European Union assigns the task of enforcing EU law to the Member States, the supranational Court in Luxembourg in this model would only have to marginally evaluate whether national laws and procedures indeed offer sufficient protection. Market-oriented EU law would, thus, not interfere with national ideas of social justice, but allow Member States to integrate rules of Union law in their own legal systems.

This reading complies with a monist conceptualisation of the European legal order, to the extent that it assumes a certain harmony among legal (sub)orders.[18] The decision on who has the competence to decide follows from the conceptual framework: Either a fully monist model is accepted, according to which all judgments should eventually comply with a common set of principles at EU level. Or a moderately pluralist theory is adhered to, in which differences among suborders (in this case, the legal systems of the Member States and the EU) are reconciled through coordinating principles that function at a meta-level.

Hans Micklitz's hypothesis[19] of a genuine EU idea of justice in private law, *access justice*, which complements national conceptions of social justice, appears to be a theory of the second type, ie a moderately pluralist one. It distances itself from purely monist projects of codification and constitutionalisation of European (private) law in a European Civil Code or Constitution respectively. Instead, it seeks to reconstruct the development of a truly pluralist private law that overcomes established State-based assumptions. As Leone Niglia observes:[20]

> Micklitz thus contributes to thematising the issue of accommodation through locating the pluralist challenge in relation to the European regulatory realm, a web of sectoral rules on telecommunication, energy, financial services and transport.

Coming back to the *Aziz* case, it may be noted that housing, while certainly qualifying as a basic need of European citizens, is missing from this enumeration. An explanation for this is that no specific EU regulatory private law on the topic is yet

[18] On the variety of legal theories concerning the monistic or pluralistic nature of the European legal order, see Mak, 'The One and the Many'. On European constitutional theory, see e.g. N Walker, 'The Idea of Constitutional Pluralism' (2002) *Modern Law Review* 317; M Poiares Maduro, 'Contrapunctual Law: Europe's Constitutional Pluralism in Action' in N Walker (ed), *Sovereignty in Action* (Oxford: Hart Publishing, 2003); M Kumm, 'Who is the Final Arbiter of Constitutionality in Europe? Three Conceptions of the Relationship between the German Federal Constitutional Court and the European Court of Justice' (1999) *Common Market Law Review* 351.

[19] Micklitz, 'Monistic Ideology versus Pluralistic Reality'.

[20] L Niglia, 'Overview of Part One' in L Niglia (ed), *Pluralism and European Private Law* (Oxford, Hart publishing, 2013).

in place. Still, as is confirmed by *Aziz*, this does not mean that EU law does not have anything to say on (the regulation of) national housing markets. The rules on unfair terms in consumer contracts apply to mortgage contracts, too.[21]

Given the topic, housing, the *Aziz* case could, thus, fit into Micklitz's idea of a Market State European private legal order. Policing unfair terms in mortgage and tenancy contracts under Directive 93/13 may be seen as a way to guarantee EU citizens' access to decent housing contracts. To the extent that both national and supranational legal orders play a role in providing for effective remedies against unfair terms, the interaction of these systems fits the normative model of hybridisation that Micklitz applies, inter alia, to capture his view on the European private legal order.[22] 'Hybridisation' here means 'that the legal character of the respective rule is neither European nor national; it bears elements of both legal orders'.[23]

40.5 …and Being Fair

Adding the nuance of hybridisation to the picture painted earlier of how the CJEU interprets national procedural autonomy, however, implies that it becomes more difficult to make a clear-cut theoretical distinction among the competences of EU and national legislature and judiciaries on the topic of unfair terms control in consumer contracts. Moreover, it indicates that EU interference with national law may go further than merely creating access to fair contracts, insofar as the interaction of EU law and national law substantively changes the position of weaker parties within a national legal order. In fact, the CJEU judges seemed to be well aware of the (potential) impact of their ruling in the *Aziz* case on the idea of social justice reflected in Spanish law, when they noted:[24]

> 61 That applies all the more strongly where, as in the main proceedings, the mortgaged property is the family home of the consumer whose rights have been infringed, since that means of consumer protection is limited to payment of damages and interest and does not make it possible to prevent the definitive and irreversible loss of that dwelling.

This assertion highlights a flaw, or at least an omission, in the model of the Market State European private legal order, given that the model seems to assume that: (1) the idea of *access justice* departs from national conceptions of social justice because of its strong market orientation; and (2) national legal orders often resist against EU interference with their own conceptions of social justice.[25] The national, Spanish

[21] See also judgment of 30 May 2013, Case C-488/11 *Asbeek Brusse v Jahani*, not yet reported, in which the CJEU ruled that Directive 93/13's scope is not restricted to sales contracts, but also covers, inter alia, residential tenancy agreements.

[22] Micklitz, 'Monistic Ideology versus Pluralistic Reality', 47–49.

[23] Ibid, 47.

[24] Case C-415/11 *Aziz*, para 61; see also paras 59 and 60, cited above.

[25] Compare Micklitz, 'Monistic Ideology versus Pluralistic Reality', 42 f: 'Conflict and resistance are suggested as one of the possible reactions of the Member States. The perspective is that the

judge handling the *Aziz* case appeared to be of the opposite opinion, namely that, in the first place, Spanish law did not live up to the idea of social justice expressed in the Unfair Terms Directive and, in the second place, EU intervention was necessary to enhance social justice at the national level.

In an interview following his judgment in the *Aziz* case, judge José María Fernández Seijo (Juzgado de lo Mercantil no 3 de Barcelona) explained the reasons for referring a preliminary question to the CJEU.[26] Firstly, according to the judge, between 2000 and 2009 banks did not sufficiently inform clients of the terms of mortgage contracts. Secondly, unlike many other European countries, Spanish law did not grant debtors a second chance, helping them to return to a normal financial situation.

Since Spanish law offered no effective remedies to clients like Mr Aziz, who had accepted the banks unfavourable terms, judge Fernández Seijo sought the help of the CJEU to overcome the impasse in national procedural law—successfully, as we saw in Sect. 40.3 above. In the national judgment in the *Aziz* case, he then concluded that the general terms and conditions imposed on Aziz had to be declared null and void. Consequently, the Catalunyacaixa bank could not claim the full amount of the mortgage, but only the unpaid instalments plus interest.[27]

While the national judge in his judgment emphasises that his task was to assess the *Aziz* case on its legal merits, he is well aware of the economic, social and political context of the dispute:[28]

> From the beginning of the proceedings both the plaintiff and the defendant in their briefs—writ of summons and defence—have introduced elements of an economic, social and legal-political nature that transcend the strictly legal scope of the dispute and of the parties' claims.
> These factors intensified from November 2012 onwards, when the Opinion of the Advocate General at the Court of Justice of the European Union (CJEU) was published, in which she answered the questions referred to the CJEU from the perspective of Community law.
> Without a doubt, the dissemination of this Opinion and the CJEU's judgment of 14 March 2013 have given the proceedings a dimension that by far exceeds the scope of the present case insofar as it coincided with an intense public debate—of a political, legislative, social

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Member States do not give way to the intruding European regulatory private law. Instead, they provoke a clash between the European regulatory private law and the traditional national law, and set limits to where the intruding law ends and where the national laws begin.'

[26] 'Más de 300 reclamaciones por las cláusulas abusivas hipotecarias', *El País—Cataluña* 5/5/2013, http://ccaa.elpais.com/ccaa/2013/05/05/catalunya/1367767343_786819.html.

[27] 'El juez de Barcelona declara abusivas cláusulas del contrato del "caso Aziz", origen de la sentencia del TJUE sobre el sistema de ejecución hipotecaria', *Noticias Judiciales TSJ Cataluña* 16/5/2013, http://www.poderjudicial.es/cgpj/es/Poder_Judicial/Noticias_Judiciales/El_juez_de_Barcelona_declara_abusivas_clausulas_del_contrato_del__caso_Aziz___origen_de_la_sentencia_del_TJUE_sobre_el_sistema_de_ejecucion_hipotecaria. See also 'El juez declara abusiva la hipoteca del "caso Aziz"', *El País—Cataluña* 3/5/2013, http://ccaa.elpais.com/ccaa/2013/05/02/catalunya/1367520137_907887.html.

[28] Juzgado de lo Mercantil no 3 de Barcelona, 2/5/2013, SJM B 21/2013, under the heading 'Consideraciones previas a las alegaciones de las partes', http://www.poderjudicial.es/stfls/SALA_DE_PRENSA/NOVEDADES/J.Mercantil_3_Barcelona.pdf.

> and economic nature—that has prompted a process of legislative reform that has not yet come to an end.
> Regardless of these factors, the truth is that also the parties themselves have brought to the fore those meta-legal elements that without a doubt serve to understand the dispute—it is not without reason that the judiciary's function is to apply and interpret the laws in the context and reality in which they take effect, as is established in Article 3 of the [Spanish] Civil Code: "Legal provisions are to be interpreted according to the proper meaning of their words, in relation to the context, the historical and legislative background and the social reality at the time of their application, serving primarily the spirit and finality of those" (…).

It was against this background that the Spanish national judge referred his questions to the CJEU. The interpretation and application of the relevant rules of procedure in the mortgage execution proceedings had to comply with the criteria for consumer protection introduced in national law through Directive 93/13. The fact that the eventual annulment of the contested general conditions could not provide sufficient consumer protection, as it did not stay the mortgage enforcement proceedings, led the judge to observe that Spanish procedural law might not meet the level of protection required by EU law.[29] An effective way of overcoming this obstacle in national law was to raise the question to the European level.

The CJEU, following the Advocate General, did not lose the opportunity to strengthen the evaluative framework that EU law imposes on national law. While on principle reiterating its earlier case law (CJEU *Freiburger Kommunalbauten*), which left great leeway to national judiciaries when assessing the unfairness of standard terms, the Court went on to give very precise indications as to the factors the national judge had to take into account when assessing the acceleration clause, interest clause and enforcement clause at issue in the *Aziz* case.

In conclusion, a contextual analysis of the *Aziz* judgment shows that the normative framework for the Market State European private legal order proposed by Hans Micklitz can be expanded with another parameter.[30] The interaction of the national judge with the CJEU illustrates that national judiciaries may not only choose to resist against 'Europeanisation' of their laws or to develop new remedies in cooperation with the EU judiciary. They may also seek recourse to the CJEU to resist against the limitations that their own national laws pose on the possibility to reach a certain goal of social justice, in this case the adequate protection of families against being evicted from their homes on the basis of unfair mortgage contracts. As judge Fernández Seijo concludes his judgment:[31]

> The final citation [in the plaintiff's brief], that truth is stranger than fiction, is attributed to William Randolph Hearst (1863–1951), a tycoon of the North-American press and audiovisual industry who inspired the main character of the movie *Citizen Kane*, which was directed by Orson Welles and is considered to be one of the best films in history. (…) These references underline the particular circumstances under which the proceedings evolved and

[29] Ibid, under the heading 'Objeto de la demanda'.

[30] For a schematic overview of the four parameters currently included in the model, see Micklitz, 'Monistic Ideology versus Pluralistic Reality', 51.

[31] Juzgado de lo Mercantil no 3 de Barcelona, under the heading 'Costas'.

> which allowed for the implications, including symbolic ones, of the CJEU's judgment of 14 March 2013 (…) to take shape.

40.6 Imperfect Alternatives

If the amount of Spanish references in unfair terms cases to the CJEU[32] is an indication of the disillusionment of national judges with the idea of social justice reflected in their procedural law, the conclusions of the analysis of the *Aziz* case should not come as a surprise. The preliminary reference procedure offers the domestic judiciary a means to induce the reform of laws that do not, or do no longer, adhere to the ideal of social justice pursued through the legal framework of transactions in society.

The judge in the *Aziz* case admitted that this approach was on the borderline of the task normally assigned to the judge in relation to the legislator, that is to interpret and apply the law, rather than rewrite it. Indeed, the judicial process is a costly alternative to the market and political processes that determine the outcomes of dilemmas of public policy.[33] Still, the choice among such imperfect alternatives may contribute to the further development of a European law on remedies that offers EU citizens access to basic services.

As CJEU judge Sacha Prechal observed in a recent interview, the academic analysis of the dynamics of case law serves to reflect on scenarios for such future developments:[34]

> Sometimes, there may be very detailed problems in cases. In academia work was, at least in the way I did it, much more long term and general in perspective. I am not saying that the Court does not have a more long term perspective. The judgements have to fit in a kind of idea what Union law is, where it stands and how it should develop, but the emphasis is different. The emphasis is on deciding case by case, while in my academic work it was rather the other way around. (…) In any case, I still have quite some contact with academia by being on law review boards, teaching from time to time, supervising PhD theses and attending seminars and conferences. I think it is extremely important to have those contacts. What academics produce may be compared to a mirror for our work in Luxembourg. For similar reasons I find it very important to talk to national judges. Looking in the mirror on a regular basis in order not to get detached from reality serves as a sort of feedback.

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[32] Including: Joined cases C-240/98 to C-244/98 *Océano Grupo Editorial and Salvat Editores* [2000] ECR I-4941; Case C-168/05 *Elisa María Mostaza Claro v Movíl Milenium SL* [2006] ECR I-10421; Case C-40/08 *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira* [2009] ECR I-9579; Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-4785; judgment of 14 June 2012, Case C-618/10 *Banco Español de Crédito SA v Joaquín Calderón Camino*, not yet reported.

[33] Cf N Komesar, *Imperfect Alternatives. Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994); and N Komesar, *Law's Limits. The Rule of Law and the Supply and Demand of Rights* (Cambridge, Cambridge University Press, 2001).

[34] http://europeanlawblog.eu, 18/12/2013.

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Chapter 41
The Right to Refer to the European Court of Justice—Should it be Limited to the Courts of Last Instance?

Hannes Rösler

Abstract This paper speaks against a restriction of the right to reference the European Court of Justice. Lower instance references are essential for the development of Union law. Many important legal policy decisions have been derived from references from lower instance courts. References by lower courts can also counterbalance possible scepticism towards EU law at higher Member States' courts. The current system can intervene at an early stage for false interpretations. It is argued that this is also in the interests of the parties.

41.1 Introduction

In its 60-year history, the Court of Justice of the European Union (CJEU) has had a much more extensive effect on European law[1] than many could have hoped for when the Rome Treaties were first signed. On the one hand the case law of the European Court of Justice (ECJ) has created a constitutional framework, such as with direct effect and the supremacy of EU law, and has also been used to bolster the fundamental freedoms. At the same time the ECJ addresses a constant stream of references for preliminary rulings with detailed minor questions that also require attention. Micklitz, to whom the preliminary ruling procedure lies at the heart of his academic interests[2] and to whom this paper is dedicated, has analysed this in the areas of Sunday trading, equal treatment and good faith in his seminal work *The Politics of Judicial Co-operation in the EU*.

In his book Micklitz uncovered different perspectives: The national vertical problem-solving expectations and the horizontal European legal order building

[1] SA Rosas, E Levits and Y Bot (eds), *The Court of Justice and the Construction of Europe: Analyses and Perspectives on Sixty Years of Case-law* (The Hague, TMC Asser Press, 2012).

[2] H-W Micklitz, *The Politics of Judicial Co-operation in the EU – The Case of Sunday Trading, Equal Treatment and Good Faith* (Cambridge, Cambridge University Press, 2005) 2.

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*,
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_41,

point of view. These different perspectives on the function of the reference perspective have led to some misunderstandings and disappointments in the judicial discourse between the levels.[3] With such differing agendas, the question is raised as to whether such references are sent to the ECJ too early, i.e. at a time when questions that might be solved at a national level have not yet been answered but have been submitted to the ECJ.

The issue is important due to the workload of the CJEU. Almost every year the CJEU discloses record new statistics in its Annual Report.[4] In light of the volume of new EU legislative instruments, such as on international private law and international procedural law, and the large number of Member States with very different legal backgrounds, these figures will continue to rise and may lead to an overload of the ECJ. Therefore, the fundamental question is raised of whether the right of access of lower instance courts should be set aside so as to limit the stream of cases. This issue is addressed in this paper.

41.2 Suggestions from the Literature

While other reform proposals concentrate on the introduction of a filter system at the level of the ECJ, a restricted access by limitations on the reference authorisation[5] would tackle the problem at source.[6] The proposal does not restrict the reference *obligation* of higher courts,[7] but limits the *power of reference* to the court of last instance for the particular case. This means that lower instance courts would no longer be able to refer cases. Undoubtedly the highest civil courts bear a special responsibility for safeguarding European law. It is often posited that the highest courts are 'privileged partners'[8] of the ECJ in judicial federalism.

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[3] Micklitz, *The Politics of Judicial Co-operation,* 41, 446 ff.

[4] Currently the ECJ counts 404 new cases of references for preliminary ruling, see Court of Justice of the European Union, *Annual Report 2012* (Luxembourg, Publications Office of the European Union, 2013).

[5] For a restriction e.g. V Lipp, 'Entwicklung und Zukunft der Europäischen Gerichtsbarkeit' (1997) *Juristenzeitung* 326, 331 f; V Lipp, 'Funktion und Form der Europäischen Gerichtsbarkeit' in T König, T Rieger and H Schmitt (eds), *Europäische Institutionenpolitik* (Frankfurt, Campus, 1997) 404; V Lipp, 'Europäische Justizreform' (2001) *Neue Juristische Wochenschrift* 2657, 2662; H Rasmussen, 'Remedying the Crumbling EC Judical System' (2000) *CML Rev* 1071, 1104 (he further favours *docket control*); J Komárek, 'In the court(s) we trust? On the need for hierarchy and differentiation in the preliminary ruling procedure' (2007) *EL Rev* 467.

[6] See B Wägenbaur, *Court of Justice of the European Union – Commentary on Statue and Rules of Procedure* (Munich, CH Beck, 2013) Art. 23 Statute, margin note 69.

[7] H Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts – Strukturen, Entwicklungen und Reformperspektiven des Justiz- und Verfahrensrechts der Europäischen Union* (Tübingen, Mohr Siebeck, 2012) 315, 324.

[8] FC Mayer, 'Art. 19 EUV' in E Grabitz, M Hilf and M Nettesheim (eds), *Das Recht der Europäischen Union – Kommentar* (München, C.H. Beck, 2013) margin note 77.

Limiting reference powers to the court of last instance would have the effect of considerably strengthening the national higher-instance state courts within the framework of European judicial dialogue. Such an approach would bring the principle of subsidiarity to the fore and is modelled on the reference limitation of the Brussels Convention of September 27, 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters or afterwards the Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters, even if this exception has been repealed by the Treaty of Lisbon. It is also suggested that the EU must accept differences as they are customary within Member States. However, in light of the fact that the majority of references come from lower instance courts, the abolition of the optional right of reference of lower instance courts would lead to a drastic reduction in references estimated at around 25 %. This is now addressed in more detail.

41.3 The Role of Lower-Level and Mid-Level Courts in Reference Rates

The role of lower-level and mid-level courts in the preliminary ruling procedure is controversial. This is due not least to difficulties caused by definitions.[9] In part it is suggested that most references come from lower instance courts, which have proven to be motors of legal integration.[10] Their decentralisation makes it easier to follow ECJ guidelines.[11] This perception is challenged by some claiming that references came mostly from mid-level courts and only a few came from lower-level courts.[12]

[9] As noted by M Broberg and N Fenger (eds), *Preliminary References to the European Court of Justice* (Oxford, Oxford University Press, 2010) 40 ff.

[10] KJ Alter, 'The European Court's Political Power: The Emergence of an Authoritative International Court in the European Union' (2009) *West European Politics* 458 = in KJ Alter, *The European Court's Political Power* (Oxford, Oxford University Press, 2009) 92 (on basis of German and French references); for an economic analysis G Tridimas and T Tridimas, 'National Courts and the European Court of Justice: A Public Choice Analysis of the Preliminary Reference Procedure' (2004) *International Review of Law and Economics* 125, 134; S Voigt, 'Iudex Calculat: The ECJ's Quest for Power' in MJ Holler, H Kliemt, D Schmidtchen and ME Streit (eds), *Jahrbuch für Neue Politische Ökonomie, vol 22: European Governance* (Tübingen, Mohr Siebeck, 2003) 77, 91 ff; approving the commentary H-B Schäfer, ibid, 105, that mentioned the lower instance German Labour Courts, which have a particular affinity for making such references when they disagree with the opinion of the Federal Labour Court (BAG).

[11] Such as JHH Weiler, 'A Quiet Revolution – The European Court of Justice and its Interlocutors' (1994) *Comparative Political Studies* 510.

[12] With statistical material for 1961–1995 A Stone Sweet and TL Brunell, 'The European Courts and the National Courts: A Statistical Analysis of Preliminary References, 1961–1995' (1998) *Journal of European Public Policy* 66; for 1958–1998 see also A Stone Sweet and TL Brunell, 'The European Court, National Judges and Legal Integrations: Guide to the Data Base on Preliminary References in European Law in Context 1959–98' (2000) *European Law Journal* 117;

The majority of references to the ECJ from the United Kingdom come from the High Court, the Court of Appeal and the House of Lords, which an English legal academic categorises collectively as the higher courts.[13]

Statistics provided by the CJEU on the overall development of jurisprudential activities from 1952 or 1961 (first reference) until 2012 breaks down the references for preliminary rulings according to Member States and court. In Germany 66.56% of references came from lower instance courts.[14] The intense and early involvement of the five higher instance federal courts is also striking: the Federal Social Court (BSG) from 1967,[15] the Federal Fiscal Court (BFH) also from 1967[16] (with a particularly large number of references),[17] the Federal Labour Court (BAG) from 1969,[18] the Federal Administrative Court (BVerwG) from 1970[19] and the Federal Court of Justice (BGH) from 1974.[20]

The British House of Lords, which in 2009 was transformed into the Supreme Court of the United Kingdom, did not request a preliminary reference from the Luxembourg court until 1979.[21] The Italian Supreme Court of Cassation (Corte suprema di Cassazione) has been requesting preliminary references since 1976.[22] In the follow-

for 1961–1998 H Schepel and E Blankenburg, 'Mobilizing the European Cort of Justice' in G de Búrca and JHH Weiler (eds), *The European Court of Justice* (Oxford, Oxford University Press, 2001) 33.

[13] D Chalmers, 'The Positioning of EU Judical Politics within the United Kingdom' (2000) *West European Politics* 169; see also LW Gormley, 'References for a Preliminary Ruling: Article 234 EC from the United Kingdom Viewpoint' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 459, 463 f.

[14] References until 2012 (total 1,953): Bundesgerichtshof (Federal Court of Justice): 163, Bundesverwaltungsgericht (Federal Administrative Court): 105, Bundesfinanzhof (Federal Fiscal Court): 285, Bundesarbeitsgericht (Federal Labour Court): 25, Bundessozialgericht (Federal Social Court): 74; State Court of Justice of Hessen: 1; other courts: 1,300. See also MA Dauses, 'P. Gerichtsbarkeit der EU – Einführung' in M Dauses (ed) *Handbuch des EU-Wirtschaftsrechts* (Munich, CH Beck, 2011) margin note 248: it is the 'lower and mid-level courts that have managed to guide European legal development with their references.'

[15] Case C-14/67 *Weichner* [1967] ECR 444.

[16] Case C-17/67 *Firma Max Neumann* [1967] ECR 592.

[17] For a long time the Federal Fiscal Court (BFH) and the Finance Court (FG) Hamburg had the highest reference statistics in the whole of the EU (mainly concerning the law on customs tariffs); Bundesrechtsanwaltskammer, 'Die Zukunft der Europäischen Gerichtsbarkeit – Stellungnahme der BRAK' (2000) *Bundesrechtsanwaltskammer-Mitteilungen* 292, 295.

[18] Case C-15/69 *Südmilch AG* [1969] ECR 363.

[19] Case C-36/70 *Getreide-Import GmbH* [1970] ECR 1107.

[20] Case C-32/74 *Haaga* [1974] ECR 1201; see recently for an overview of company law references by the Second Civil Senate of the BGH H Fleischer, 'Das Rechtsgespräch zwischen BGH und EuGH bei der Entfaltung des Europäischen Gesellschaftsrechts' (2011) *Gesellschafts- und Wirtschaftsrecht* 201, whereby the BGH has overcome its initial reticence about the preliminary ruling reference procedure; see also H Hirte, 'Die Vorlagepflicht auf teilharmonisierten Rechtsgebieten am Beispiel der Richtlinien zum Gesellschafts- und Bilanzrecht' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 553, 570 ff.

[21] Case C-34/79 *Regina/Henn and Darby* [1979] ECR 3795.

[22] See N Trocker, 'Das Vorabentscheidungsverfahren aus italienischer Sicht: Erfahrungen, Probleme, Entwicklungstendenzen' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 417, 435.

ing countries the number of preliminary references from lower instance courts is even higher than in Germany:[23] United Kingdom[24] (79.34%), France[25] (79.12%) and Italy[26] (83.00%). This refutes the theory that in the United Kingdom—due to the judicial hierarchy and the principle of *stare decisis*[27]—preliminary references are submitted mainly from higher instance courts. Therefore, the opinion expressed by Lord Denning[28] that only the House of Lords should request preliminary references (and that only the House of Lords was obliged to request a reference pursuant to what is now Article 267(3) of the Treaty on the Functioning of the European Union—TFEU) has not been followed.[29]

Overall around three quarters of the preliminary references are not submitted by higher instance courts.[30] Advocate General Antonio Tizzano has noted that the number of requests for preliminary rulings by courts of last instance in absolute and in percentage terms "has traditionally been very limited, and this continues to be pertinent today." In the period from 1960 to 2000 Tizzano calculates that only 1,173 from 4,381 requests for preliminary rulings came from courts of last instance. That is only slightly more than one quarter of the total number.[31] This finding correlates with the experience of reference practice in the Brussels I Regulation.[32]

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[23] As example for the Member States: references from the Czech Republic in the area of civil law (and different to administrative law) were mainly from lower courts; see M Žondra, 'References to Preliminary Rulings Lodged by Czech Courts, 2004–2009' (2010) *Czech Yearbook of International Law* 269, 295.

[24] References until 2012 (total 547): House of Lords (since 2009: The Supreme Court): 43, Court of Appeal: 70, other courts: 434.

[25] References until 2012 (total 862): Cour de cassation (Court of Cassation): 100, Conseil d'État (Council of State): 80, other courts: 682. For the division of references from French courts, see the table in F Ferrand, 'Das Vorabentscheidungsverfahren aus französischer Sicht' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 391, 389 and the estimation on 400: 'It can be stated that in France the majority of references in civil cases come from the first instance courts; the appeal courts come in second place' followed by the highest courts ie the Cour de cassation with the Conseil d'État in last place.

[26] References until 2012 (total 1,165): Corte suprema di Cassazione (Supreme Court of Cassation): 111, Corte Costituzionale (Constitutional Court): 1, Consiglio di Stato (Council of State): 86, other courts: 967. See also *Trocker*, 'Das Vorabentscheidungsverfahren aus italienischer Sicht', 428 ff: The lower instances are the driving force behind the reference procedures for preliminary rulings.

[27] Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts,* 193, 195.

[28] *H.P. Bulmer Ltd. v. J. Bollinger S.A*. [1974] 3 W.L.R. 202; Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts,* 193, 195.

[29] L Collins, *European Community Law in the United Kingdom,* 4th ed (London, Butterworths Tolley Limited, 1990) 153; Gormley, 'References for a Preliminary Ruling' 459, 467.

[30] O Due et al. 'Report by the Working Party on the Future of the European Communities' Court System' in A Dashwood and A Johnston (eds), *The Future of the Judicial System of the European Union* (Oxford, Hart Publishing, 2000) 145.

[31] AG Tizzano, Case C-99/00 *Lyckeskog* [2002] ECR I-4839, para 68; see also A Röthel, 'Die Konkretisierung von Generalklauseln' in K Riesenhuber (ed), *Europäische Methodenlehre* (Berlin, de Gruyter, 2010) 395, who talking about the right time to make a reference in her paper says that 70% of references came from instance courts.

[32] J Basedow, 'Die rechtsstaatliche Dimension der europäischen Justizreform: Zur Einführung' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 203, 206: an

The figures are not surprising. They are linked to the strategies of lower instance courts, which may be described as follows from a social science perspective: 'According to the public choice theory, when interpreting the law courts like other organs of government are assumed to have their own set of preferences over policy outcomes. Judicial preferences may, but do not need to be, substantive; they reflect neither calculations of private benefit (like profit maximising firms), nor electoral considerations (like vote maximising politicians). Rather, as legal scholars would argue, judicial preferences are based on notions of justice and the rule of law. Crucially, the preferences of lower national courts regarding policy outcomes may differ from those of higher national courts and/or the national political authorities, leading them to seek opportunities for pursuing their own most preferred policies. The utility of the court is higher, the closer is the actual policy implemented to its most preferred (ideal) policy point.'[33]

In this respect, requests for preliminary references follow preference outcomes[34]. To further cite the aforementioned social science paper: 'Courts will therefore use their judgments to pursue policies which maximise their utility subject to the relevant restrictions, which constrain their freedom of action. A court suffers a twofold loss in utility when its judgment is reversed by a higher national authority (appellate, or supreme court, or the legislature as the case may be). First, because a less preferred policy is pursued in practice (that is, one which serves less well the court's notion of justice). Second, because the failure to uphold a judgment may affect adversely the professional reputation of judges and even, perhaps, jeopardise their future career prospects. National courts will refer to the ECJ and consequently apply its ruling when the expected net utility gains (benefits minus costs) from doing so exceed the utility gains from not referring.'[35]

These findings not only correspond with the decentralised implementation mechanism of EU law.[36] Lower instance courts use the ECJ in a strategic way as a simultaneous method of changing the case law in their own court. The position of the last instance courts of Member States is weakened and, simultaneously, the influence of the lower instance courts is strengthened.[37]

Firstly, lower instance courts can use the ECJ channel to implement value and legal policy strategies that differ from those of higher instance courts. Secondly, they can use the ECJ to check the consistency of their national law with EU law.[38] In Germany, for

evaluation of around 150 references on the Brussels Convention reveals that around a third do not come from higher courts.

[33] Tridimas and Tridimas, 'National Courts and the European Court of Justice', 134 f; Voigt, 'Iudex Calculat', 91 ff.

[34] Which explains the preemptive opinions by some courts requesting a ruling; see A Nyikos, 'Strategic Interaction Among Courts Within the Preliminary Reference Process – Stage 1: National Court Preemptive Opinions' (2006) *European Journal of Political Research* 527.

[35] Tridimas and Tridimas, 'National Courts and the European Court of Justice', 135.

[36] See Stone Sweet and Brunell, 'The European Courts, National Judges and Legal Integration', 66. See for the autonomy of the Member States H-W Micklitz and B de Witte (eds), *The European Court of Justice and the Autonomy of the Member States* (Antwerp, Intersentia, 2012).

[37] For the theory of judicial empowerment see JHH Weiler, 'The Transformation of Europe' (1990/1991) *Yale Law Journal*. 2403, 2483.

[38] Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 199, 202.

example, lower instance courts have requested preliminary rulings on issues such as holiday entitlement during incapacity to work,[39] and state monopolies for sports betting and lotteries[40] and have been successful in contradicting higher instance courts. It should also be noted that as well as the intention of changing the case law of national higher instance courts and eliminating legal uncertainty at a national level, requests for preliminary references that have a strategic ambition also take aim at the national legislature.[41]

41.4 Evaluation of a Restriction

Aptly, prevailing opinion[42] and the Court of Justice of the European Union[43] are responsible for retaining the right of national courts to call on the ECJ regardless of their hierarchical position. The argument that the exemption of ex-Article 68(1)

[39] Cases C-350/06 and C-520/06 *Gerhard Schultz-Hoff v Deutsche Rentenversicherung Bund und Stringer et al.* [2009] ECR I-179, reference from LAG Düsseldorf.

[40] Cases C-316/07, C-358/07 to C-360/07, C-409/07 and C-410/07 *Markus Stoß v Wetteraukreis* [2010] ECR I-8069.

[41] On these three motives see G Thüsing, *Europäisches Arbeitsrecht* (Munich, CH Beck, 2011) § 1, margin notes 66 ff with examples from European labour law.

[42] For example Basedow, 'Die rechtsstaatliche Dimension der europäischen Justizreform', 206 f; Basedow, 'The Court of Justice and private law: Vacillations, general prinicples and the architecture of the European judiciary' (2010) *European Review of Private Law* 443; R Bork, 'Gerichtsverfassung und Verfahrensstrucksstrukturen in Deutschland' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 327, 352; B Hess, 'Rechtsfragen des Vorabentscheidungsverfahrens' (2002) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 470, 489 f (in connection with ex-Art. 68 (1) EEC); G Hirsch, 'Dezentralisierung des Gerichtssystems der Europäischen Union?' (2000) *Zeitschrift für Rechtspolitik* 57, 59; R Streinz and S Leible, 'Die Zukunft des Gerichtssystems der Europäischen Gemeinschaft – Reflexionen über Reflexionspapiere' (2001) *Europäisches Wirtschafts- und Steuerrecht* 1, 10; Dauses, 'P. Gerichtsbarkeit der EU', margin note 248; E Pache and M Knauff, 'Wider die Beschränkung der Vorlagebefugnis unterinstanzlicher Gerichte im Vorabentscheidungsverfahren – zugleich ein Beitrag zu Art. 68 I EG' (2004) *Neue Zeitschrift für Verwaltungsrecht* 16; P Baumeister, 'Effektiver Individualrechtsschutz im Gemeinschaftsrecht' (2005) *Europarecht* 1, 24 f (both in connection with ex-Art. 68(1) EEC); GC Rodríguez Iglesias, 'Der EuGH und die Gerichte der Mitgliedstaaten – Komponenten der richterlichen Gewalt in der Europäischen Union' (2000) *Neue Juristische Wochenschrift* 1889, 1895; CO Lenz, 'Firnis oder Rechtsgemeinschaft – Einschränkung des Vorlagerechts nach Art. 177 EWGV auf letztinstanzliche Gerichte?' (1993) *Neue Juristische Wochenschrift* 2664, 2665; C Kerwer, *Das europäische Gemeinschaftsrecht und die Rechtsprechung der deutschen Arbeitsgerichte* (Köln, O. Schmidt, 2003) 509; K Lenaerts, 'The Unity of European Law and the Overload oft he ECJ – The System of Preliminary Rulings Revisited' in I Pernice, J Kokott and C Saunders (eds), *The Future of the European Judicial System in a Comparative Perspective* (Baden-Baden, Nomos, 2006) 211, 239; FG Jacobs, 'Further reform oft he pre-liminary ruling procedure – towards a "green light" system?' in C Gaitanides, S Kadelbach, M Zuleeg and GC Rodriguez Iglesias (eds), *Festschrift für Manfred Zuleeg* (Baden-Baden, Nomos, 2005) 204, 208; C Barnard and E Sharpston, 'The Changing Face of Article 177 References' (1997) *CML Rev* 1113, 1163 ff.

[43] EuGH, 'Reflexionspapier des EuGH' (1999) *Europäische Zeitschrift für Wirtschaftsrecht* 750, 754; the English version 'The Future of the Judicial System of the European Union (Proposals and Reflections) (May 1999)' can be found in Dashwood, A and Johnston, A (eds), *The Future of the Judicial System of the European Union* (Oxford, Hart Publishing, 2001) 111 ff) also derived from Due et al.

of the EC Treaty should be formalised as a rule is obsolete: As shown,[44] the Lisbon Treaty repealed the restriction of ex-Article 68(1) of the EC Treaty in the interests of implementing EU law and of strengthening judicial protection,[45] by which only higher instance courts could refer questions to the ECJ on issues of freedom, security and justice. This included the conflict of law and civil procedure law of the EU. This has now been normalised in the Treaty in that the area was made subject to Article 267 TFEU. As mentioned, this means that the concept that ex-Article 68(1) of the EC Treaty could also serve as a template for a general restriction of authorisation to request a reference ruling has also failed.[46]

Four groups of arguments speak against the restriction of access. Firstly, lower instance references are essential for the development of Union law. Many important legal policy decisions have been derived from references from lower instance courts. This is highlighted by leading decisions, such as those concerning direct applicability and the primacy of Union law.[47] Also worthy of mention are the decisions that are important for the fundamental rights for the Union legal system,[48] the principles of the fundamental freedoms,[49] government liability for legislative, executive and judicial errors[50] and European Union citizenship,[51] which were all developed as a result of references from first instance courts.[52] Under the current system it can be that—as in the *Köbler* case—the Vienna Regional Court for civil law will turn directly to the ECJ and ask for expert guidance. The important cases of *Schulte*[53] and *Junk*[54] also deserve a mention. By this, the large number of players entitled

'Report of the Working Party' and the Slynn Report (*British Institute of International and Comparative Law* [eds], The Role and Future of the European Court of Justice) 73 f.

[44] Supra Section 41.2 Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 246 ff.

[45] See COM(2006) 346 final, 5 ff.

[46] U Everling, 'Rechtsschutz in der Europäischen Union nach dem Vertrag von Lissabon' (2009) *Europarecht-Beiheft* 71, 79.

[47] Case C-26/62 *Van Gend & Loos* [1963] ECR 3 (referenced from the Tariefcommissie in the Netherlands) and Case C-6/64 *Costa v E.N.E.L.* [1964] ECR 1259 (from the Giudice di Pace of Milan).

[48] Case C-29/69 *Stauder* [1969] ECR 419 (the reference came from the Verwaltungsgericht Stuttgart).

[49] Case C-55/94 *Gebhard* [1995] ECR I-4165 (reference from Consiglio Nazionale Forense, ie Italian Board of Lawyers).

[50] Cases C-6/90 and C-9/90 *Francovich and Bonifaci* [1991] ECR I-5357 (referring courts were the Pretura di Vicenza and the Pretura di Bassano del Grappa) and Case C-224/01 *Köbler* [2003] ECR I-10239 (referring court Landesgericht für Zivilrechtssachen, Vienna).

[51] Case C-184/99 *Grzelczyk/CPAS* [2001] ECR I-6193 (referred by Tribunal du travail de Nivelles in Belgium).

[52] See V Skouris, 'Höchste Gerichte an ihren Grenzen – Bemerkungen aus der Perspektive des Gerichtshofes der Europäischen Gemeinschaft' in R Grote and C Stark (eds), *Festschrift für Starck* (Tübingen, Mohr Siebeck, 2007) 991, 993.

[53] Case C-350/03 *Schulte v Deutsche Bausparkasse Badenia AG* [2005] ECR I-9215 (referred by LG Bonn); similarly Case C-229/04 *Crailsheimer Volksbank eG v Conrads et al* [2005] ECR I-9273 was referenced by the Higher regional Court (OLG) in Bremen.

[54] Case C-188/03 *Junk* [2005] ECR I-885 (reference from ArbG Berlin).

to participate also contributes to the increase of diversity of interests submitting a request and to a strengthening of the joint legal culture.[55]

Secondly, higher instance courts are more likely—not least because of institutional and personnel structures—to have issues about competence, technical scepticism, attempts to impose institutional limits and professional vanity.[56] This resistance is then compensated by the reference practice of the lower courts. In many cases the broad basis of lower instance references currently still remains the true guarantee for uniform interpretation and application of European law. This is why a restriction on the right to request a preliminary ruling would lead to a reduction in the effectiveness of this type of procedure, including for the development of European private law. As the lower courts are the protagonists of the reference procedure,[57] a restriction would tend to have a disadvantageous effect due to the fact that there are relatively few references under private law (varies between states). The opposite view implies a final idealistic responsibility of the higher courts, just as in a system with closely linked stages of appeal.[58]

Problems could also arise as regards the monopoly of the Court to reject illegal provisions of Union law.[59] It is recognised that national courts are prohibited from declaring European law invalid. But lower instance courts may not compensate for national practice, which seeks to challenge the validity of EU law in non-application of that law, by an (early) reference regarding EU jurisdiction if there is a restriction of the right of reference.[60] Furthermore, the right of each court to make a reference underlines that the application of European law is important at all instances.[61] In principle, European law is just as important at first instance as for appeal proceedings,[62] after all, few cases progress to the further instances. The support provided by the preliminary ruling procedure therefore requires a readiness

[55] Dauses, 'P. Gerichtsbarkeit der EU', margin note 248: 'In particular the individualised practice-related adjudication of the national instance court is a central and irreplaceable element of the European legal community.' (Translation provided by the author.)

[56] See MP Maduro, 'Der Kontrapunkt im Dienste eines europäischen Verfassungspluralismus' (2007) *Europarecht* 3, 20 on that still individual national highest-level courts continue to demonstrate a certain resistance to the absolute supremacy of EU law.

[57] Wägenbaur, *Court of Justice of the European Union,* Art. 23 Statute, marginal no 69.

[58] An individual complaint under the European Convention on Human Rights (ECHR) (*nota bene* the differences to the reference procedure under EU law) is subsidiary, so that pursuant to Art 35(1) of the ECHR the European Court of Human Rights (ECtHR) can only consider the issue if all national levels of appeal have been exhausted and then only within six months of the final decision being handed down at national level. For non-acceptance see Art 35(3) ECHR.

[59] M Zuleeg, 'Die Rolle der rechtsprechenden Gewalt in der europäischen Integration' (1994) *Juristenzeitung* 1, 7.

[60] Broberg and Fenger, *Preliminary References*, 34.

[61] P Craig and G de Búrca (eds), *EU Law: Text, Cases and Materials* (Oxford, Oxford University Press, 2011) 478.

[62] In practice this is different. See on first and second instance judges from North-Rhine Westphalia and the Netherlands T Nowak, F Amtenbrink, M Hertogh and M Wissink, *National Judges as European Union Judges – Knowledge, Experience and Attitudes of Lower Court Judges in Germany and the Netherlands* (Den Haag, Eleven International Publishing, 2012).

to have an EU-wide interpretation even *overturning* the existing interpretation of the higher courts.[63]

The third group of arguments concerns the effects of procedural economics and the overall length of proceedings. The ECJ would certainly be able to make a faster decision due to a lighter workload of cases. However, many cases would then have to go through the full time-consuming range of more or less complex national instances only for the highest national court to then make a reference to the ECJ.[64] Although the national appeal procedures and average length of cases diverge greatly, this can lead to disproportionate pressures both for states—in the form of case workload of the higher courts—as well as for the parties. That questions of European law do not currently have to remain open until appeal proceedings, but can be referred directly to the ECJ,[65] is not only advantageous for the current proceedings under discussion. There is also an EU-wide interest in having legal issue determined at the earliest possible time.[66]

This means that the current system can intervene at an early stage for false interpretations: It can prevent a Member State from developing a national law that is not compliant with European law—as the ECJ has formulated this issue in another context as regards the sense and purpose of the preliminary ruling procedure.[67] For this reason the preliminary ruling reference procedure is important in the new areas of EU law and especially for new legal instruments in the area of private law. But even under the current system it normally takes several years after the legal instrument has been adopted or has come into force—for example with the Product Liability Directive 85/374/EEC—until the ECJ can rule on the issue[68] under the preliminary reference procedure.[69] The early avoidance of inaccurate interpretations is therefore not only in the interests of the European Union but also important from the aspect of avoiding legislative or judicial state liability.

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[63] Bundesrechtsanwaltskammer, 'Die Zukunft der Europäischen Gerichtsbarkeit', 295.

[64] See Bork, 'Gerichtsverfassung und Verfassungsstrukturen', 352; J Schwarze, 'Der Rechtsschutz Privater vor dem Europäischen Gerichtshof: Grundlagen, Entwicklungen und Perspektiven des Individualrechtsschutzes im Gemeinschaftsrecht' (2002) *Deutsches Verwaltungsblatt* 1297, 1311; R Voß, 'Trendwende beim Vorabentscheidungsverfahren (Art. 177 EGV)?' (1998) *Zeitschrift für Zölle und Verbrauchssteuern* 116, 117.

[65] EuGH, 'Reflexionspapier des EuGH', 754.

[66] See also Lenaerts, 'The Unity of European Law', 239: efficiency through ECJ 'prejudice' on basis of earlier references.

[67] Case C-107/76 *Hoffmann-La Roche AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH* [1977] ECR 957, para 5.

[68] Case C-203/99 *Henning Veedfald v Århus Amtskommune* [2001] ECR I-3569; see also Case C-183/00 *González Sánchez* [2002] ECR I-3901; Case C-402/03 *Skov Æg* [2006] ECR I-199; Case C-127/04 *O'Byrne* [2006] ECR I-1313.

[69] Apart from cases concerning breach of EU law, e.g. for non-implementation of the Product Liability Directive 85/374/EEC: Case C-293/91 *Commission v Republic of France* [1993] ECR I-1; Case C-300/95 *Commission v United Kingdom* [1997] ECR I-2649.

Fourthly, the interests of the parties in having effective legal protection should be considered.[70] This is linked to the ideal of equality in arguing interests in the EU jurisdiction:[71] Only those parties who have sufficient funds and experience can afford to pursue a case through all instances and then secure access to the ECJ by way of the reference procedure. Also—despite general differences in the appeal rates[72]—it depends on the issue at hand whether it is worth it for the parties to take the case to a second or third instance,[73] so that if there was a restriction on the level at which a case could be referred this would reduce the range of issues which would ever reach the ECJ.

The possibility of legal aid[74] cannot be dealt with here properly,[75] at least with respect to the differences between Member States.[76] The party that has lost its case must bring the appeal, and often this fails to happen. If the possibility of lower instance courts to refer would be restricted, then the assumption of a comprehensive legal system[77] would no longer be fully accurate.[78] The ECJ can only seriously consider itself as providing a comprehensive legal system if there is division of the workload with the an effective national courts.[79] If the important source of references from non-higher-level courts would be removed, this might also be considered as damaging the concept of subjective EU law.[80] It would be different if there was a reorganisation or a development of having exhausted all instances at national level.[81]

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[70] MA Dauses, 'Empfiehlt es sich, das System des Rechtsschutzes und der Gerichtsbarkeit in der Europäischen Gemeinschaft, insbesondere die Aufgabe der Gemeinschaftsgerichte und der nationalen Gerichte, weiterzuentwickeln?' in Deutscher Juristentag (ed), *60. Deutscher Juristentag in Münster: vom 20.-23.9.1994, Bd. I: Gutachten, Teil D* (Munich, CH Beck, 1994) 169.

[71] Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 218 ff.

[72] See E Blankenburg, 'Europäische Justizindikatoren: Budgets der Justiz, Richter und Rechtsanwälte' in M Cottier and J Estermann and M Wrase (eds), *Wie wirkt Recht? Ausgewählte Beiträge zum ersten gemeinsamen Kongress der deutschsprachigen Rechtssoziologie-Vereinigungen, Luzern 4.-6. September 2008* (Baden-Baden, Nomos, 2010) 61, 83 f.

[73] See Blankenburg, 'Europäische Justizindikatoren', 78.

[74] Rasmussen, 'Remedying the Crumbling', 1106.

[75] See Barnard and Sharpston, 'The Changing Face', 1163 f.

[76] Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 165 ff.

[77] ECJ, *Report 1/09* [2011] ECR I-1137, para 70; previously Case C-50/00 P *Unión de Pequeños Agricultores (UPA) v Council* [2002] ECR I-6677, para 40; Case C-131/03 P *Reynolds Tobacco v Commission* [2006] ECR I-7795, para 80.

[78] Wägenbaur, *Court of Justice of the European Union*, Art. 23 Statute, margin note 30.

[79] Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 50 ff.

[80] Zuleeg, 'Die Rolle der rechtsprechenden Gewalt', 7; see also Schwarze, 'Der Rechtsschutz Privater vor dem Europäischen Gerichtshof', 1311: 'The disproportionate procedural burden as a capacity problem should not be solved by restrictions at the cost of the citizen.'

[81] See Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 397 f, for a discussion on the restriction of reference law in the light of the ECJ report 1/09.

41.5 Final Thoughts

Some suggest that first instance courts should hold back with preliminary ruling references and generally leave the reference procedure to the higher courts.[82] Sometimes this suggestion is linked to a proposed national but non-binding reference procedure that is evaluated in brief here. The literature suggests that first instance courts should initially turn to special chambers of their own highest national court of appeal. If the highest appeal court considers that the opinion of the ECJ would be helpful in general terms—such as for guaranteeing uniformity or to develop European law—then that highest national court will request a preliminary ruling from the ECJ. Otherwise it will provide a non-binding answer itself.[83] However, if a party should appeal against the first instance ruling, the appeal court of the ECJ can give a direct preliminary ruling.[84] This represents a filter at national level.

However, this proposal should be rejected: Instead of the ECJ the workload would fall to the highest national court.[85] Such a renationalisation also raises the issue of why national courts should be in a better position to answer questions on EU law than the EU jurisdiction.[86] In many instances the highest national court would spend time on issues that in any case should be considered by the ECJ.[87] Restricting the reference procedure by approval of the highest court or similar would in any case be recommended in particular areas where there is a tendency to overuse or misapply the reference procedure.[88] However, currently there is no evidence of a lack of extensive broad-based practice, which is why such a decentralisation—other than within the CJEU[89]—proves to be unnecessary. Judges at all instances

[82] Cf. M Ottaviano, *Der Anspruch auf rechtzeitigen Rechtsschutz im Gemeinschaftsprozessrecht* (Tübingen, C.F. Müller, 2009) 92.

[83] Derived from the French *avis contentieux*; PJG Kapteyn, 'Reflections on the Future of the Judical System of the European Union after Nice' (2001) *Yearbook of European Law* 173, 183.

[84] Kapteyn, 'Reflections on the Future', 183 ff.

[85] See I Klöckner, *Grenzüberschreitende Bindung an zivilgerichtliche Präjudizien – Möglichkeiten und Grenzen im Europäischen Rechtsraum und bei staatsvertraglich angelegter Rechtsvereinheitlichung* (Tübingen, Mohr Siebeck, 2006) 67 ff.

[86] S Prechal, 'National Courts in EU Judical Structure' (2006) *Yearbook of European Law* 429, 442.

[87] Slynn Report, 75, which briefly discusses an applied model for approval of the reference by the highest-instance court.

[88] Ibid: 'There may […] be certain areas (employment, taxation, social security), where the lower court (or tribunal) may refrain from making the reference and leave the matter to the appellate court that is concerned only with issues of law. In those areas the appellate court would be better placed to make a reference to the ECJ.' See also Judge D Edward, 'Reform of Article 234 Procedure: the Limits of the Possible' in D O'Keeffe (ed), *Judicial Review in European Union Law – Liber Amicorum Lord Slynn Hadley* (The Hague, Kluwer Law International, 2000) 119, 123: 'In the absence of evidence that lower courts are consistently making premature, unnecessary or unsatisfactory references, the merits of maintaining their freedom to refer seem greatly to outweigh the disadvantages.'

[89] For more on the proposal that the Court should be responsible for preliminary rulings, see Rösler, *Europäische Gerichtsbarkeit auf dem Gebiet des Zivilrechts*, 275 ff.

should perhaps be subject to stricter controls in order to only make a reference for a preliminary ruling when the grounds are considered and justified. To sum up: the current system should be maintained since it ensures a flow of incoming cases that significantly help to develop EU law.

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Chapter 42
Procedural Theory in EU Law

Hanna Schebesta

Abstract In this contribution I put forward the argument that (1) the application of the adjudicative principle of 'procedural autonomy' leads to the creation of a European judge-made procedural law. Further, this procedural law exhibits (2) a potentially problematic trans-substantive tendency, as well as (3) a conceptual difficulty as it is applied regardless of a procedural/substance distinction, exemplified, for example, in its treatment of damages. There is therefore the need for a mechanism of differentiation in the application of the principle of 'procedural autonomy', which at the same time articulates procedural justice concerns.

42.1 Introduction

The list of contributors to this *Liber Amicorum* demonstrates Hans Micklitz' esteem within the academic community with immediacy. A versatile scholar, with a deep interest for people and society, he has always been dedicated to the creation of a network of truly European legal scholarship.

Hans Micklitz began in 2007 as Professor for Economic Law at the European University Institute (EUI). As always quite the political figure, he swiftly took on the function of Director of Studies until he was nominated Head of the Law Department in 2012. A versed academic matchmaker, he has attracted countless projects and people for the institution. A great number of his guests, I have no doubt, have pleasant memories of one or the other barbecue and dinner at his house in the hills of Fiesole.

I think Hans Micklitz has a particular talent for spotting the frontiers of a field, and of understanding where academic debates stand and where they are heading. As his supervisee I had the honour of benefiting readily from these insights and his experience. Hans Micklitz' call for an enhanced role for the Court of Justice of the European Union in the development of remedies and procedures under EU

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K. Purnhagen, P. Rott (eds.), *Varieties of European Economic Law and Regulation*, Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_42,

law inspired me in my research on procedural law. He encouraged me to explore the connection between the abstract notion of 'procedural justice' and the EU law concept of 'procedural autonomy' in EU law.

I therefore wish to loosely present, in abridged and partially incomplete form, one of my dissertation's core arguments. For the purpose of this paper, the argument is developed in a four-step structure. In the first part, and on a basic level, some strands of procedural justice theory are presented in order to draw on, and structure, a legal theoretical discussion that is already at a fairly sophisticated stage. The second part lays down a common framework of the state of understanding procedure in EU law. The third part draws the connection between the abstract a priori account of procedural justice, on the one hand, and, on the other, procedure in the EU law context as developed by the legislature and in adjudication by the CJEU. The EU legal discourse has come to neglect important insights of procedural justice theory, which are partially due to procedure's peculiar framing under what is called "procedural autonomy". The main aim is to suggest how to make procedural justice insights fruitful for EU law.

42.2 Part I—Procedural Theory

The following section highlights some of the important and perennial controversies dealt with by procedural justice theory, clustered around the following issues: (a) The '*norm creation' effect* of procedural law, sometimes also termed the ex-ante versus an ex-post perspective, (b) the *separation* between substantive/material and procedural, as well as formal law, and (c) the *purpose* of procedural law.

42.2.1 Distinction Ex-Ante/Ex-Post Perspective[1]

This distinction is incidental to what we perceive to 'be' procedural law, and its function; the fundamental divergences of views on procedural law derive from the adherence to either an ex-post or an ex-ante perspective respective to the effects of procedural law. From an ex-post point of view, the action- or conduct-guiding function of law is inherent in substantive law only. Thereby, 'substantive law regulates primary conduct and procedural law regulates the adjudicative process'.[2] We can visualise this approach as 'ex-post' because the result to which it gives rise is that procedural law always has to look back. Against this, the ex-ante point of view is able to posit that due to several constraints,[3] procedure guides agents' conduct after

[1] LB Solum, 'Procedural Justice' (2004) 78 *Southern California Law Review* 181, 183.

[2] ibid, 225.

[3] ibid, 188, constraints such as for example the problem of imperfect knowledge of law and fact, the problem of incomplete specification of legal norms, and the problem of partiality on behalf of the law abider, ibid, 186.

a judgment is rendered. Procedural law thus conceived inherently carries a future outlook, and serves an intrinsic action-guiding function.

42.2.2 The Procedure—Substance Distinction

Talking about procedural law presupposes that there are two types of legal rules, substantive and procedural, or material and adjective. However, there is a tension between the apparent usefulness of the distinction between substance and procedure[4] in heuristic terms, and the inability to provide a clear line of demarcation and hence a definition of either. This is the issue of separability.

The apparently easy case in favour of separability is in quite exemplary manner made in the following statement: 'Procedure concerns the process or steps taken in arriving at a decision; substance concerns the content of the decision. The two are conceptually distinct, for one can use different procedures for the same substantive issue and the same procedure for different substantive issues. Hence a substantive topic cannot imply a procedure, nor a given procedure imply a particular substantive topic'.[5]

On closer sight, however, it is hard to deny that procedural modalities perform substantive functions. 'The procedures used determine how much substance is achieved, and by whom.'[6] The pervasive,[7] and hence ineliminable connection lies in this characteristic of procedure to 'particularize abstract and general substantive rules' in the 'application of abstract rules to concrete cases'.[8] We are circumnavigating the intricacies of the discussion,[9] and remain with the appraisal that, ultimately, we have to accept a certain degree of entanglement between substance and procedure while recognizing that they remain useful heuristic categories.

42.2.3 Ideal Types of Procedural Fairness or What is the Purpose of Procedural Law?

The last point concerns the 'neutrality' of procedural law, or the role that procedural law plays in relation to substance. Procedural justice distinguishes three ideal types:

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[4] Even this dichotomy is simplified, and the problem can be extended to aspirations distinguishing formal, procedural and substantive legal rules.

[5] MD Bayles, *Procedural justice: allocating to individuals* (Dordrecht, Kluwer, 1990) 3.

[6] FH Easterbrook, 'Substance and Due Process' (1982) 85 *The Supreme Court Review* 112 f.

[7] As opposed to the intentional form referring to legal procedural rules intentionally being instrumentalized by the legislature to achieve substantive goals.

[8] Solum, 'Procedural Justice', 224, 225.

[9] Proposal for separability are for example based on 'intuitionist formalism' or 'outcome determinacy' based on the possibility of influencing the outcome of litigation in its different versions ibid, 194.

The ‘Outcome/Accuracy Model’, the ‘Balancing Model’, and the ‘Participation Model’.[10]

The Accuracy Model is a functional approach based on the idea that the fairness of process depends on the procedure producing correct outcomes, that is, reaching a ‘correct’ result in applying the law to facts.[11] Procedure adopts a servile position in relation to substance, giving truthful and accurate effect to substantive law “without undue waste or friction or consumption of fuel”.[12] Procedure here has no independent effect on the values expressed through the substantive law; it is simply a way of arriving at the ‘truth’ in a process.

The Balancing Model by contrast implies that procedure has a ‘formal’ impact on substance through the balancing exercises it undertakes. It takes into account the fact that procedures are costly, and therefore proposes a balancing between benefits and costs in different variations. The main different ideas within balancing either focus on (i) balancing accuracy with costs, which is an essentially consequential, or utilitarian balancing. Then there is (ii) a rights-based approach that puts deontological constraints on balancing, for example, on “discovery” as a violation of moral rights of parties, i.e. the right to privacy. Rather than balancing the costs of privacy against the benefits in increased accuracy, rights-based approaches look to whether a right has been waived and which right is more fundamental. The idea of the balancing model is that a fair procedure is one which reflects a fair balance between the costs of the procedure and the benefits that it produces.

The third model, the Participation Model, is part of a social-psychological standard and has tremendously varying foundations. It posits that a fair procedure is one that enables those who are affected by a procedure to participate in the making of the decision.[13]

None of the ideal models is alone able to furnish a comprehensive account of procedural justice – theorists therefore usually propose forms of conciliation combining all the elements found that can constitute a necessary (yet not in themselves sufficient) condition for procedural justice. Procedural justice values are therefore defined by a framework extending along the three broad dimensions of (i) accuracy, (ii) cost-benefit balancing, and (iii) participation.

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[10] The categorisation of the following paragraph is based on Solum, ibid, as providing the most global overview of the different models and their various subcategorisations.

[11] Solum, ibid, convincingly discards the pure ‘Accuracy Model’ as it is unable to explain doctrines such as res judicata. Additionally distinguish again the ex-post and ex-ante versions of accuracy: Was a particular case (ex post) correct? Or ex-ante does it produce correct results for all future cases (i.e. systemic accuracy). Ie statutes of limitations may purchase systemic accuracy at the expense of case accuracy.

[12] R Pound, ‘Some Principles of Procedural Reform’ (1909) 4 *Illinois Law Review* 388, 394.

[13] The value of participation (notice and an opportunity to be heard) is based on legitimacy, ‘Because a right of participation must be afforded to those to be bound by judicial proceedings in order for those proceedings to serve as a legitimate source of authority, the value of participation cannot be reduced to [outcomes] or [subjective preference/satisfaction]’. Solum, ‘Procedural Justice’, 224, 286.

42.3 Part II—Procedure in European Union Law

What is striking is the lack of reflection of these fairly general and recognized elements of procedural theory within the treatment of procedure in EU law. Discussion of procedure is at present limited to procedure as concentrated in "procedural autonomy". 'Procedural autonomy' in that sense is a very elusive principle, because what legal scholars *make of it* is so different. Some deny its existence, while equally often any intrusion by the Court on procedural/remedial matters is simply rejected by reference to the very same principle. The doctrine, therefore, is for the moment *highly indeterminate*.

The CJEU approach on procedure found its origins in the famous formulation of the *Rewe/Comet* court rulings:

> In the absence of Community rules on the subject, it is for the domestic legal system of each Member State to designate the Courts having jurisdiction and to determine the procedural conditions governing actions at law intended to ensure the protection of the rights which citizen have from the direct effect of Community law, it being understood that such conditions cannot be less favourable than those relating to similar actions of a domestic nature.[14]

It is this formulation which came to be known as the concept of "procedural autonomy". Its limitations in the form of the principles of equivalence (non-discrimination) and effectiveness (not rendering virtually impossible or excessively difficult the exercise of rights conferred by Community law) were refined in subsequent case law.

Originally, the contours of the "principle" of procedural autonomy, namely effectiveness and equivalence, were what shaped the concept, rather than any self-standing significance of the term itself. The lack of normative significance of the term "procedural autonomy" was mirrored by the attitude of the Court, which continued to refer to and refine the *Rewe/Comet* formula but for many years did not use the notion itself.[15] It was mainly the Advocate Generals, especially AG Darmon and Jacobs (and from time to time parties' submissions), that started to refer to a principle of procedural autonomy. The first time that the CJEU referred to procedural autonomy was in the *Wells*[16] case in 2004 then in a string of consumer law cases. While until 2004 the Court itself had *never* used "procedural autonomy", a search on the curia website for cases by the CJEU now yields around 90 results. This is next to those judgments in which the Court uses the effectiveness/equivalency formulation without calling it 'procedural autonomy'. Therefore, the reception of the concept as such is a clear "success", even though its meaning remains open.

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[14] Case 33/76 *Rewe-Zentralfinanz eG and Rewe-Zentral AG v Landwirtschaftskammer für das Saarland* [1976] ECR 1989.

[15] In 1997 Kakouris was still able to write that the Court had never used the notion. CN Kakouris, 'Do the Member States Possess Judicial Procedural "Autonomy"?' (1997) *Common Market Law Review* 1389.

[16] Case C-201/02, *The Queen on the application of Delena Wells and Secretary of State for Transport, Local Government and the Regions* [2004] ECR I-723.

When faced with a case involving procedural aspects the CJEU has expanded and modified its methods of reasoning. First, it constructed the principle of procedural autonomy. It initially simply required that national procedure meet a standard to give sufficient effect or enforcement to European law. The concept changed with the introduction and proliferated use of the balancing approach, which stipulates that the rationale of the national procedural rule must be taken into consideration. The Court is not consistent in using any one approach, and there is no way of reasoning which can justify all of the case law rendered. We can state, however, that procedural autonomy has moved from a descriptive to a potentially prescriptive concept that could serve as a shield of national rules against requirements of effectiveness from European law.

42.3.1 Effectiveness as a Standard

Under the 'effectiveness' limb, the Court tests respectively that a national rule must not render virtually impossible or excessively difficult the (i) exercise of rights conferred by European law or (ii) the application of European law. These formulations differ from one another as one is geared to the protection of a right, the other towards the protection of the law itself. These two formulations, from which the CJEU seems to choose the 'better fit' to a legal problem, exemplify a subjective or an objective approach respectively. Subjective in this context refers to the specific interest of an individual or group-based test, whereas objective relates to the pure application of law in order to protect a wider common interest of society.

42.3.2 Balancing and Contextualised Effectiveness Test

The test of 'effectiveness' was reshaped in the *van Schijndel/Peterbroeck* cases, by which the CJEU when testing the 'effectiveness' of a national rule created an additional and seemingly cumulative consideration:

> …national procedural provisions […] must be analysed by reference to the role of that provision in the procedure, its progress and its special features, viewed as a whole before the various national instances. [context part] In the light of that analysis the basic principles of the domestic judicial system, such as protection of the rights of the defence, the principle of legal certainty and the proper conduct of procedure, must, where appropriate, be taken into consideration [balancing part].[17]

The structure of the effectiveness test changed from standard to one in which a new emphasis was placed on the national context ('contextualization'), taking into account the purpose of the national rule ('purposive approach'), followed by a subsequent balancing thereof. Generally, the *van Schijndel/Peterbroeck* test is therefore referred to as the 'balancing approach'. It is not only the purpose of the national rule

[17] Case C-312/93 Peterbroeck, Van Campenhout & Cie SCS v Belgian State [1995] I-4599.

that plays, but the context, which is a wider notion including role, progress and various judicial instances. Moreover, the purpose as teleological reasoning is taken into account at both levels, EU and national. Accordingly, the rationale or purpose of a given procedural rule can justify a restriction or limitation on the bringing of a claim based in EU law. The Court referred to rights of the defence, legal certainty, proper conduct of procedure, but we can also think about for example unjustified enrichment.[18] However, the test goes further than a merely 'contextualised' understanding of a national procedural rule, which would only imply a method for determining the 'real' nature of a national rule. In addition, the basic principles upon which these national rules are based must "be taken into consideration". Herein lies the truly fundamental importance of the contextual approach. The balancing aspect is the novelty: national procedural law receives standing. By taking into consideration national procedural rules, these can enter into conflict with EU law requirements. The conflict is not automatically resolved by primacy as a rule but under a balancing exercise.

To summarize, two uses of the principle of effectiveness are distinguished: 'effectiveness as a standard', in which procedural law must meet a standard of accuracy in the transposition of EU substantive law. Then there is the 'balancing use' of effectiveness—which allows for a departure from accuracy and introduces a mechanism of justification. The justification exercise can comprise two dimensions of balancing, namely (i) procedural purpose balancing against accuracy, and (ii) an allocation of the source of the justificatory values: whether they derive from European procedural justice values or stand as exhibited in the national rule, and hence form part of the national level itself.

42.4 Part III—What can EU Law Learn From Procedural Justice Theory?

After this analytical exercise on procedure as it is currently understood at EU level, the following section aims to import some of the insights drawn from procedural theory into EU legal doctrine.

42.4.1 EU Law as Incorporating a Largely 'Accuracy Model' Vision of Procedural Law

Tzankova and Gramatikov first drew attention to the connection between the function of procedural law and procedural autonomy. They argue that 'the principle of

[18] Joined Cases C-295/04 to C-298/04 *Vincenzo Manfredi v Lloyd Adriatico Assicurazioni SpA* (C-295/04), A*ntonio Cannito v Fondiaria Sai SpA* (C-296/04) and *Nicolò Tricarico* (C-297/04) and *Pasqualina Murgolo* (C-298/04) *v Assitalia SpA* [2006] ECR I-6619.

national autonomy ["procedural autonomy"] implicitly recognizes that the main, if not the sole, function of procedural law is to make substantive law effective. Substantive law, thus, comes first.'[19]

Phrased in procedural justice theory vocabulary, the way in which procedural law is dealt with through the CJEU is very highly committed to the 'Accuracy Model' of procedural justice. Tanzkova and Gramatikov argue that because procedural law on European Union level is conceptualised under a classic, that is, servile approach, there is a fundamental disregard of the 'independent virtues and values' *inherent* in procedural law itself.

In other words, the trade-offs between the accurate application of the law, the costs of litigation and the values of participation which procedural laws risk to remain structurally unaddressed if the Court employs only an 'effectiveness' perspective.

This argument is based on a simplified version of what 'effectiveness' has come to stand for, what was previously termed 'effectiveness as a standard' testing. It has been shown above that the principle of effectiveness can be extended to cover a balancing-type test. Within this version of the effectiveness test, procedural principles, such as *res judicata* which arguably belong to the principles of procedural justice, are addressed.

However, reflections on procedural justice often do not take explicit form. It is therefore important to identify procedural justice explicitly as an aspect that must be taken into account in Union law. As demonstrated in Part II, the procedural autonomy reasoning of the CJEU structurally allows for the incorporation of procedural values in the 'contextualised effectiveness' version; but this potential needs to be developed in a stronger understanding and should result in the Court placing greater emphasis on the balancing approach.

42.4.2 Towards the Incorporation of Procedure Specific Values

On the one hand, therefore, the accuracy approach leads to a highly integrated approach between a procedural rule and the substantive European rule. Departing from a view of effectiveness on procedure in its purely servant function took us to recognize independent procedural fairness considerations.

How can these principles be filled with content? One way to approach the substantive values of procedural fairness is by starting off with a taxonomy of traditional principles. To illustrate, Bayles,[20] for example, identifies four broad traditional clusters in his taxonomy: (1) impartiality of the procedure, that is a judge with no own interest or bias, independence, investigation, prosecution, ex parte; (2) the opportunity to be heard characterized by notions of openness, promptness, notice, dis-

[19] I Tzankova and M Gramatikov, 'A Critical Note on Two EU Principles: A Proceduralist View on the Draft Common Frame of Reference (DCFR)' in R Brownsword et al. (eds), *The Foundations of European Private Law* (Oxford, Hart, 2011).

[20] MD Bayles, *Procedural justice: allocating to individuals*, 2.

covery, written/oral/rebut evidence, counsel, record, appeals; (3) grounds for decision, such as mention of findings, reasons, burden of proof, judicial review; and (4) principles of formal justice, such adherence to consistency, precedents, and rules.

Where, in EU law, the principles of procedure justice have been taken into account, this has led to a reliance on a taxonomy of procedural justice principles, such as the right to be heard, a right to a remedy, as notions of human rights under the ECHR and now Charter, as well as general principles. Reliance on for the example the right to effective judicial protection can be expected to increase strongly in the future case law.

By their very nature, under such a perspective the procedural law question is approached across all differing substantive areas of a general nature. This raises—to use the proceduralists' term—the trans-substantivity question,[21] namely, whether the same procedural rules should apply regardless of the substance of the case. The requirement that procedural rules apply equally across substantive categories make it quite difficult for rulemakers to single out deliberately a vulnerable group for a particular procedural burden.[22] Separated from their material context the generalizations can easily become a 'blind application' and lead to results unfit to particular areas.

Factually,[23] the case law of the CJEU exhibits a strong tendency towards trans-substantive reasoning, meaning that procedural and remedial law is applied indiscriminately across substantive areas.

While partially triggered through taxonomies of procedural rights, there is another strong pull: within the case law on procedure, a wild cross-fertilization of judgments and association between different strands of lines of case law has taken place.[24] The CJEU is forced to produce statements, and therefore j law on procedural issues by virtue of being obliged to provide the national courts with an answer to the referred preliminary questions. These are the dynamics of any legal system, including the European one. In the absence of any legislative guidance, the Court, under a system of precedence, or coherency if we want to phrase it more neutrally, relies on similar cases. One pull towards trans-substantivity, for example, on time limits, access to justice, ex-officio and the like lies in the obviously constructive nature of the case law, which grows organically producing more and more judge-made law.

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[21] 'Trans-substantive rules do not privilege any area of law, reflecting, (…) that procedural rules should have no purpose but to implement efficiently policy choices made in the substantive law.' D Marcus, 'The Past, Present, and Future of Trans-Substantivity in Federal Civil Procedure' (2010) 59 *DePaul Law Review* 54.

[22] ibid, 60.

[23] Contrary to the United States experience, it does not seem that trans-substantivity has become a value in and for itself in a normatively guised claim.

[24] This has led most commentators at despair of making sense of the case law rendered, since the case law was neither confined to branches of law such as criminal or administrative, substantive law for example competition or consumer, or procedural rules, for example time-limits or access to justice.

Within the trans-substantive tendencies, EU law needs to find ways of differentiating case types; in other words, a framework in order to answer the question 'When should law require procedural safeguards?'. One way of doing this is through situational categorization. By way of example, such classification could follow Bayles'[25] classification according to context, that is types of decisions, which is essentially based on the varying purposes of contexts. On a very broad level, it can be useful to distinguish between contexts involving group decision making, conflictual adversarial type of situations of litigation and burden/benefit allocating decisions. Bayles, for example, draws a distinction between contexts in which procedural justice is used to resolve conflicts between two or more parties. On the other hand, a context of decision to impose burdens or to confer benefits on individuals as such is not characterized by conflict, but, rather, evaluation against a standard or norm to meet, or compare, individuals against one another. He fleshes these out by providing criteria to distinguish different situations on (a) whether a decision presents itself to an affected individual as a conflict, (b) whether an individual stands only to gain or only to lose, and (c) whether the subject matter and standards involved affect discretion (i.e. are they merely subjective or objective). What develops is the idea that for different decisions, different models of decision-making are appropriate. The point here is not to deliver a definite identification of relevant criteria, but to enable the conclusion that different sets of procedural principles are relevant depending on the type of decision-making process involved.[26]

We therefore advocate a move away from trans-substantive procedural rules spanning across substantive areas, since the factual need for contextualisation of procedural justice is overwhelming. Procedural autonomy should therefore be enriched by an understanding of situational classifications, enabling a differentiation of situations along the spectrums determining the truth (accuracy), minimizing error costs (balancing), and process benefits (participation). For example, the need to take into consideration participation process values are themselves more strongly warranted in Consumer law, whereas Member State liability can be characterized as warranting increased attention to the 'accurate' transposition of law, or taking a rights-based stance, requiring specific considerations in terms of balancing. Enforcement procedures by the Commission, on the other hand, probably warrant a rather strong accuracy measure. Through the neutrality of the situational variables proposed, a transposition into the legal orders is facilitated by circumventing national legal straightjackets such as 'administrative law principles' or 'principles of tort law'.

[25] MD Bayles, *Procedural justice: allocating to individuals*, focusing on burden/benefit types of situations.

[26] ibid, 187.

42.4.3 The Question of Legitimacy

The most powerful argument against a judge-made substance-specific approach to procedure is raised by the objection of the lack of legitimacy of the courts as rulemakers. An argument has been put forward that courts could enhance their legitimacy by limiting themselves to trans-substantive procedural rules as substance-value neutral, while substance-specific departures from the principle should come from legislatures.[27]

Bone, for the United States, observes a 'profound shift in thinking about procedural law'.[28] As an overview of the historical development of ideas about procedural law, despite the different context, his work is illuminating and not without relevance for the EU as it traces the development of different beliefs about procedural law. Furthermore, these differing beliefs ultimately resulted in a shift of the choice of institutions responsible for procedural rule making. In the very beginning stood a pure accuracy approach (which I have outlined above), seeing procedure as normatively distinct and servient to substantive law. This enabled pure process values to 'perfect[ing] administrative machinery',[29] leaving a technical task that was much better performed by the courts.[30] The later conceptualization of the connection between procedure and substance paved the way for the realization that procedure influenced substantive outcomes, in a material way. This facilitated the rise of scepticism which advanced criticism based on the lack of legitimacy of the Courts to create procedural rules.

This critique will have to be evaluated under an institutional choice analysis; for the moment it may be appeased with the pragmatic observation that the CJEU is factually already engaged in procedural rulemaking.

42.5 Conclusion

I have put forward, in abridged form, the argument that (1) the application of the adjudicative principle of 'procedural autonomy' leads to the creation of a European judge-made procedural law. Further, this procedural law exhibits (2) a potentially problematic trans-substantive tendency, as well as (3) a conceptual difficulty as it is applied regardless of a procedural/substance distinction, exemplified, for example, in its treatment of damages. There is therefore the need for a mechanism of differ-

[27] D Marcus, 'The Past, Present, and Future of Trans-Substantivity in Federal Civil Procedure'.

[28] RG Bone, 'The Process of Making Process: Court Rulemaking, Democratic Legitimacy, and Procedural Efficacy' (1999) 87 *Georgetown Law Journal* 887, 889.

[29] ibid, 895.

[30] Bone, ibid, identifies three historical stages of Court rulemaking: 1. The rise of court rulemaking from 1906 with Roscoe Pound's address to the American Bar Association, until the new Federal Rules of Civil Procedure adoption in 1938. 2. The Golden Age of the 50s—70s, followed by growing discontent from 1973 and the decline that continues to the present.

entiation in the application of the principle of 'procedural autonomy', which at the same time articulates prvocedural justice concerns.

In many ways, I owe to Hans Micklitz not only the development of my PhD dissertation, but also of myself as an academic and I would like to hereby express my deep gratitude for that.

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Chapter 43
Social Networks and Liability—the Difficult Triangle Between Network Operators, Users and Third Parties in German Media Law

Gerald Spindler

Abstract This contribution discusses the way the emergence of social networks impacts different legal areas. Whereas social networks have raised many issues of data protection which are addressed in the new proposal for a General Data Protection Regulation (Data protection issues are outside the scope of this article, as well as questions of criminal responsibility) other legal issues are scarcely being discussed, in particular contractual relationships and liability topics. In the following, we will analyse briefly the legal framework according to German media and tort law; however, the general lines can be applied as well to other jurisdictions which usually know similar actions/torts.

43.1 Introduction

Hans Micklitz has always been intrigued by new developments in society and their impact on legal reasoning, in particular the change of traditional paradigms and their evolution towards new norms. Moreover, if these developments influence European legal evolutions as well as consumer protection, one may hope that social networks and their impacts on different legal areas may find the interest of Hans Micklitz.

Social networks are one of the most important forms of new media and play an eminent role in communication for younger generations. Traditional forms of communication, such as E-Mail, have been substituted by social networks. Moreover these networks sometimes replace traditional search engines by integrating content in their own networks and establishing their own form of search engines. Homepages are being transferred to social networks, there launching new 'fan-pages'. Besides Facebook as the most important social network specialized networks, such as Linked-in for professionals, have succeeded in attracting internet users, on the national level networks such as XING in Germany or Sina Weibo or Qzone

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K. Purnhagen, P. Rott, (eds.), *Varieties of European Economic Law and Regulation,*
Studies in European Economic Law and Regulation 3, DOI 10.1007/978-3-319-04903-8_43,

in China. For all networks (and for all communication platforms in general) the triangle between the network operator and communicating users (sender and receiver) is typical. In addition, social networks facilitate the switch from individual communication to mass communication, depending on the preferences of the user (friends, friends of friends, public etc.).[1]

Whereas social networks have raised many issues of data protection which are addressed in the new proposal for a General Data Protection Regulation[2] other legal issues are scarcely being discussed, in particular contractual relationships and liability topics. However, activities of users are not shielded from liability and responsibility by simply using a social network. Typical torts (and upcoming phenomena) include cyber mobbing and bullying as well as infringements of copyrights by users. Issues of security against third party attacks are central for the liability of network operators. However, network operators may also be held liable for activities of their users if they are able to stop their users from continuing infringements. In particular, some jurisdictions allow for actions such as injunctions against platform operators concerning illegal activities of users on platforms, requiring them to establish controls of user activities and to monitor data traffic in order to detect illegal activities. In the following, we will analyse briefly the legal framework according to German media and tort law; however, the general lines can be applied as well to other jurisdictions which usually know similar actions/torts.

43.2 Torts

43.2.1 Users

As activities of users are manifold on social networks, so vary accordingly torts and infringements of different legal provisions:

43.2.1.1 Communication Torts

At first place torts, referring to any kind of communication between users are relevant for social networks, in particular those which are known as cyberbullying pillorying other users. Hence, all torts which are known of classical media suits and actions apply here as well, for instance infringements of personality rights (§ 823 (1) German Civil Code; hereinafter BGB)[3] as well as liability for false factual claims (§ 824 BGB). Moreover, as German tort law refers also to criminal provisions such

[1] cf G Spindler, 'Persönlichkeitsschutz im Internet—Anforderungen und Grenzen einer Regulierung' in Ständige Deputation des Deutschen Juristentages (eds), *Verhandlungen des 69. Deutschen Juristentages* (Munich, CH Beck, 2012) vol 1, F 11.

[2] Data protection issues are outside the scope of this article, as well as questions of criminal responsibility.

[3] For instance OLG Frankfurt, 25/4/2013, (2013) *Gewerblicher Rechtsschutz und Urheberrecht—Praxis* 342, full text: JurPC web-doc 149/2013, www.jurpc.de/jurpc/show?id=20130149.

as defamation (§ 185 German Criminal Code; hereinafter StGB) all these criminal acts related to communication are also included in the range of possible actions for injured users (or third parties). In contrast to a common belief it makes no difference whether the communication is directed just to the (injured) receiver or to third parties or to the public; even a bilateral defamation is sufficient for constituting a tort.[4] However, the fact that an illicit communication has been addressed to the public can influence the amount of damages assigned to the injured party. According to the theory of spheres developed by German courts, the balance between privacy and personality rights on one hand and the freedom of speech has to be assessed along the lines of communication in private spheres or social spheres. In other terms, communication in social spheres benefit more from freedom of speech than in private spheres if the receiver acted himself in the social sphere. Moreover, previous communications by the receiver may play an important role in determining the leeway for reactions of other people.[5]

43.2.1.2 Infringements of Copyright

Besides communication, infringements of copyright play an increasingly more important role in practice of social networks and liability of their users. European copyright law requires for every upload to a social network, a licence or a limitation of copyrights for the user (music, pictures, movies, text, software etc.) as uploading technically results in a copying of the original work. Whereas users in general may benefit from the limitation for private copies (§ 53 German Copyright Act, Article 5(2) Copyright in the Information Society Directive 2001/29/EC) there is no such limitation concerning making available to the public. Crucial for any placement on a social network is thus the determination of the 'public': Do friends of friends still belong to the circle of 'privately' known persons? According to older German court decisions more than 20 persons are already considered as trespassing the threshold towards the 'public'. However, we should note that these rulings were handed down in the 50s when virtual communication and the new opportunities could not be thought of. Hence, it seems that a new notion of 'public' should be conceived in legal reasoning taking into account virtual friends and 'private relations', moreover extending the number of persons being 'privately' connected to according to the common beliefs of people engaged in virtual communication.[6] Thus, personal relationships should be assumed up to 50–70 persons, however, not to 'friends of friends' who still constitute a part of the 'public'.[7] Above the threshold of more than 70 persons it is very likely that (German) courts would assume a 'public' com-

[4] For defamation according to § 185 StGB: K Kühl, '§ 185' in K Lackner and K Kühl (eds), *StGB*, 27th ed (Munich, CH Beck, 2011) margin note 2; T Lenckner and J Eisele, '§ 185' in A Schönke and H Schröder (eds), *StGB*, 28th ed (Munich, CH Beck, 2010) margin note 1.

[5] More details cf Spindler, 'Persönlichkeitsschutz im Internet', F 41 ff.

[6] J v Ungern-Sternberg, '§ 15' in G Schricker and U Loewenheim (eds), *Urheberrecht*, 4th ed (Munich, CH Beck, 2010) margin note 75.

[7] See also PH Heerma, '§ 15' in AA Wandtke and W Bullinger (eds), *Urheberrecht*, 3rd ed (Munich, CH Beck 2009), margin note 19.

munication, even in a virtual surrounding.[8] Moreover, it is still quite uncertain if (German) courts would buy the argument that the connection to a social network may constitute itself the required personal relationship in order to be considered 'private' in the sense of § 53 (1) German Copyright Act (Urhebergesetz; UrhG).[9]

On the other side, making available to the public refers to offering the work itself to a greater circle of people—just to offer a link is still be considered by German courts as an act common to the internet without any real act of publication,[10] which is, however, subject to a revision by the European Court of Justice.[11] Moreover, if a link is embedded in a profile of a social network in such a way that an external party could not really distinguish the external (linked) content from the rest of the content displayed, it can be argued that the external link substitutes a making available to the public, thus constituting an infringement of copyrights. Hence, the German High Federal Court has submitted this issue to the ECJ as well because the court considered embedding links as a new way to use copyright works, not mentioned before in the German Copyright Act.[12] In contrast to usual links, which are considered by the court as just enhancing publication rather than publishing the work directly, an embedded link has to be qualified as an own content of the link-setter,[13] thus resulting in an act of publication which needs to be licensed.[14]

However, it is far from clear that embedding constitutes a publication act on its own. Many authors argue that embedding should be treated as just simple hyperlinks because the function of hyperlinks is not altered if they are placed in the surrounding of the content of the link setting person.[15] Thus, the way in which a link is presented optically (obvious or embedded) should not determine the legal qualification. Only if the embedded link really substitutes own content of the homepage, it should be qualified as own content of the homepage provider, thus constituting an act of publication (as making available to the public, § 19a UrhG).

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[8] T Hoeren, '§ 21' in U Loewenheim (ed), *Handbuch des Urheberrechts*, 2nd ed (Munich, CH Beck, 2010) margin note 24; G Schulze, '§ 15' in T Dreier and G Schulze, *Urhebergesetz*, 4th ed (Munich, CH Beck, 2013) margin note 43; Heerma, '§ 15' in Wandtke and Bullinger (eds), *Urheberrecht*, margin note 20; extreme example: AG Bochum, 20/1/2009, (2009) *Gewerblicher Rechtsschutz und Urheberrecht—Rechtsprechungs-Report* 166, 167: 600 participants of a marriage as personal friends; against v Ungern-Sternberg, '§ 15' in Schricker and Loewenheim (eds), *Urheberrecht*, margin note 75, private relationships excluded by more than hundred persons.

[9] For an online-seminar in eLearning: H Schöwerling, *E-Learning und Urheberrecht an Universitäten* (Vienna, MUR, 2007) 136 ff.; A Dustmann, '§ 15 UrhG' in FK Fromm and W Nordemann (eds), *Urheberrecht,* 10th ed (Stuttgart, Kohlhammer, 2008), margin note 34; v Ungern-Sternberg, '§ 15' in Schricker and Loewenheim (eds), *Urheberrecht*, margin note 76; Schulze, '§ 15' in Dreier and Schulze, *Urhebergesetz*, margin note 43; T Hoeren, '§ 21' in Loewenheim (ed), *Handbuch des Urheberrechts*, margin note 24.

[10] BGH, 17/7/2003, 156 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 1, 18 f-'Paperboy'.

[11] cf Case C-466/12 *Nils Svensson et al v Retreiver Sverige AB* [2012] OJ C 379/19.

[12] BGH, 16/5/2013 (2013) *Gewerblicher Rechtsschutz und Urheberrecht* 818, 820–'die Realität'.

[13] BGH, 'Paperboy'.

[14] BGH, 'die Realität', 820.

[15] See also N Rauer and D Ettig, 'Zur urheberrechtlichen Zulässigkeit des Framing' (2013) *Kommunikation und Recht* 429, 431.

Concerning social networks, users have to acquire licenses if they place links in their profiles and presentations in such a way that other users cannot distinguish between the user profile and the linked content. Sharing content, for instance on a pin board, does not constitute an infringement of making the content available to the public as it just links to the content; instead, sharing is part of a profile on a social network and usually not being considered by other users as own content of the owner of the profile. Moreover, if sharing is limited to friends (or a private circle of contacts) the necessary element of 'public' is missing, so that private sharing (by linking) does not infringe copyright at all. If, however, the European Court of Justice took the stance that inline-linking, embedding, and framing constitute, in general an act of making available to the public[16] most social networks would be affected as users usually place sharing information and links (to music, photographs etc.) on their pin boards.

In case of infringements of copyrights the damage can be calculated in three different ways: be it the actual damage, be it by analogy to licences on the market or be it the profit the infringer has made.[17] This so-called three-folded calculation of damage is enshrined at the European level in the Enforcement Directive.

Closely connected to issues of claims for damage etc. are injunctions and cease and desist letters against infringing users. According to § 97a (2) UrhG, the fees for such letters may not exceed 100 € in simple cases as long as the concerned user is not acting on a commercial basis.[18] However, in practice the assessment of the case as 'simple' and the non-commercial use has turned out to be quite difficult. When users shared more than a dozen files or an entire movie, most of the courts tended to declare these infringements as beyond mere private use.[19] The German legislator recently reacted to these decisions and introduced a new provision in § 97a (3)

[16] BGH, 'die Realität', 819 f.; T Dreier and M Leistner, 'Urheberrecht im Internet: die Forschungsherausforderungen' (2013) *Gewerblicher Rechtsschutz und Urheberrecht* 881, 887; LAF Bentley and E Derclaye et al. 'The Reference to the CJEU in Case C-466/12 Svensson' (2013) *University of Cambridge Faculty of Law Research Paper No. 6/2013*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2220326.

[17] For German law see BGH, 8/5/1956, 20 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 345, 353–'Paul Dahlke'; BGH, 29/5/1962, (1962) *Gewerblicher Rechtsschutz und Urheberrecht* 509, 511 f.—'Dia Rähmchen II', on which see G Wild, '§ 97' in Schricker and Loewenheim (eds), *Urheberrecht*, margin notes 145 ff.

[18] Wild, '§ 97' in Schricker and Loewenheim (eds), *Urheberrecht*, margin note 1; T Dreier, '§ 97a' in Dreier and Schulze, *Urhebergesetz*, margin note 1; G Spindler, '§ 97a UrhG' in G Spindler and F Schuster (eds), *Recht der elektronischen Medien*, 2nd ed (Munich, CH Beck, 2011) margin note 1 ff; concering private users M Malkus, 'Harry Potter und die Abmahnung des Schreckens—Die Höhe von Abmahngebühren bei Urheberrechtsverletzungen auf Tauschbörsen gem. § 97a Abs. 2 UrhG' (2010) *Multimedia und Recht* 382; T Hoeren, '100 Euro und Musikdownloads—die Begrenzung der Abmahngebühren nach § 97a UrhG' (2009) *Computer und Recht* 378.

[19] G Wild, '§ 97a' in Schricker and Loewenheim (eds), *Urheberrecht*, margin note 34; LG Cologne, 30/11/2011, (2012) *Zeitschrift für Urheber- und Medienrecht* 350, 352; LG Berlin, 3/3/2011, (2011) *Multimedia und Recht* 401; J Ewert and N von Hartz, 'Neue kostenrechtliche Herausforderungen bei der Abmahnung im Urheberrecht' (2009) *Multimedia und Recht* 84, 86 f; undecided LG Hamburg, 30/4/2010, (2010) *Zeitschrift für Urheber- und Medienrecht* 611, 612; against AG Hamburg, 16/6/2009, (2010) *Gewerblicher Rechtsschutz und Urheberrecht—Rechtsprechungs-Report* 311.

UrhG by capping lawyers` fees in cease and desist letters on a basis of 1,000 € for a claim[20] if the user has not used the copyrighted work for commercial purposes. Moreover, the cease and desist letter has to comply with formal provisions; such as detailing the infringements and the grounds on which a claim is made. However, fees may exceed the cap of calculation basis of 1,000 € in cases of 'special circumstances'.

Finally, the legislator restricted the choice of forum for the claimant to the court where the infringer has its domicile—however, only for cases of private use of copyrighted works, § 104a UrhG. By these means, private users should be protected against the free forum shopping that had taken place before the law had been reviewed.

43.2.1.3 Other Torts

Not all torts are directly connected to activities on the social network rather than facilitating other people torts in the sense of incitement, aid and abet or participation at torts committed by others. One of these phenomena concern so-called Facebook parties: Users had placed unintentional invitations to parties on their profiles without restricting the invitation to their friends etc. so that thousands of 'followers' showed up at the party, entangling severe damages to neighbours' or parked cars.[21] In a strict sense, placing such an invitation on the pin board of a profile causes the damage done as it is not totally unlikely[22] that the invited 'public' will behave in such a manner like demonstrations etc. Whereas causality would not limit liability of the inviting user it is arguable if the user really is obliged to carefully restrict messages (and invitations) to close friends etc., in particular if it is barely foreseeable that a huge number of people would come to such a party. Nevertheless, if it turns out that such parties become a common phenomenon users may be obliged to control their postings in order to avoid damage to third parties.

[20] Thus, fees are restricted to an amount of about 90-100 €.

[21] A Zand-Vakili, 'Anzeigen nach ungewollter Facebook-Party' (2011) *welt.de*, 6/6/2011, www.welt.de/print/die_welt/hamburg/article13414319/Anzeigen-nach-ungewollter-Facebook-Party.html; see also the overview of the so called 'facebook parties' at Zeit Online, www.zeit.de/2011/27/Deutschlandkarte-Facebook-Party.

[22] In Germany called 'formula of adequance': C Schiemann, '§ 249 BGB' in J v Staudinger (ed), *Kommentar zum BGB* (Munich, Sellier, 2005) margin notes 12 ff; C Schubert, '§ 249' in HG Bamberger and H Roth (eds), *Beck'scher Online-Kommentar BGB*, 28th ed (Munich, CH Beck, 2013) margin notes 51 f; H Oetker, '§ 249' in Saecker and Rixecker (eds), *Münchener Kommentar zum BGB*, margin notes 109 ff.

Moreover, we have to distinguish these cases from real incitement of illegal activities: If users for instance call for a flash-mob action[23] against super markets etc. the inciting user is liable as everyone else who has placed an official call for action.[24]

43.2.2 Torts of Network Operators

43.2.2.1 Security of Social Networks

Security of social networks is crucial for users regarding their personal data as well as their communications to other users. Whereas obligations to guarantee security of social networks are not among the core obligations of contracts concerning the use of networks they can be qualified as important collateral duties, similar to other types of contracts with internet providers.[25] According to German law, one of the important consequence of qualifying those duties as important ('Kardinalpflichten') refers to the absolute prohibition of any clauses that shield the operator from liability. In other terms, the provider of a social network cannot disclaim for violations of his obligation to take care of the security of networks, not even for slight negligence—in contrast to US American law. Moreover, taking into account that these

[23] For flash mobs in labour law: BAG, 22/9/2009, (2010) *Neue Juristische Wochenschrift* 631 with case note U Brötzmann, currently pending before the BVerfG, 1 BvR 3185/09; B Rehder, O Deinert and R Callsen, 'Atypische Arbeitskampfformen der Arbeitnehmerseite' (2013) *Arbeit und Recht* 103; S Krieger and J Günther, 'Streikrecht 2.0– Erlaubt ist, was gefällt!?' (2010) *Neue Zeitschrift für Arbeitsrecht* 20; M Fuhlrott and B Fabritius, 'Zur Zulässigkeit von Flashmob-Aktionen' (2010) *Entscheidungen zum Wirtschaftsrecht* 51; R Richardi and PS Fischinger, 'Vorb. §§ 611 ff' in Staudinger (ed), *Kommentar zum BGB*, margin note 950.

[24] For calls to demonstrations: BGH, 24/1/1984, 89 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 383, 393 ff; LG Hamburg, 30/10/1997, (1998) *Neue Juristische Wochenschrift* 1411 f; G Spindler, '§ 823' in Bamberger and Roth (eds), *BGB*, margin notes 359 f; J Hager, '§ 823' in Staudinger (ed), *Kommentar zum BGB*, E margin note 15; concerning boykotts: BVerfG, 26/2/1969, (1969) *Neue Juristische Wochenschrift* 1161–'Blinkfüer'; BGH, 10/7/1963, (1964) *Neue Juristische Wochenschrift* 29, 30 ff—'Blinkfüer'; OLG Frankfurt, 7/3/1969, (1969) *Neue Juristische Wochenschrift* 2095, 2096; OLG Frankfurt, 29/1/1987, (1988) *Neue Juristische Wochenschrift—Rechtsprechungs-Report* 52; LG Munich I, 20/12/1985, (1988) *Neue Juristische Wochenschrift—Rechtsprechungs-Report* 54; BAG, 4/5/1955, 2 *Entscheidungen des Bundesarbeitsgerichts* 75, 77; BAG, 20/12/1963, (1964) *Neue Juristische Wochenschrift* 883, 884; BAG, 20/12/1963, (1964) *Neue Juristische Wochenschrift* 1291, 1292; BAG, 21/12/1982, 41 *Entscheidungen des Bundesarbeitsgerichts* 209, 222; BAG, 12/9/1984, (1985) *Neue Juristische Wochenschrift* 85; BAG, 5/3/1985, (1985) *Neue Juristische Wochenschrift* 2545; BAG, 21/6/1988, (1989) *Neue Juristische Wochenschrift* 57, 60 f; BAG, 7/6/1988 (1998) *Neue Juristische Wochenschrift* 63; G Wagner, '§ 823' in FJ Saecker and R Rixecker (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, 6th ed (Munich, CH Beck 2012) margin notes 278 ff, 284 ff. all with more references.

[25] For Internet access providers cf G Spindler, *Verantwortlichkeiten von IT-Herstellern, Nutzern und Intermediären* (2007) 273 fn 663, 281 fn 684, www.bsi.bund.de/SharedDocs/Downloads/DE/BSI/Publikationen/Studien/Recht/Gutachten_pdf.pdf?__blob=publicationFile; G Spindler, 'Haftung und Versicherung im IT-Bereich' (2010) *Karlsruher Forum* 48, for E-Mail-Provider: G Spindler (ed), *Vertragsrecht der Internet-Provider,* 2nd ed (Cologne, Dr. Otto Schmidt, 2004) IV, margin note 147; for Access-Providers: G Spindler, ibid, IV, margin note 81.

contracts often contain the consent of users that operators of the social network can use their personal data it can be argued that such contracts do not benefit from the usual privileges of gratuitous contracts[26] concerning liability (such as exoneration from negligence or restriction to gross negligence).

Obligations to protect social networks may also come into play for tort law If third parties have unrestricted access to social networks due to security deficits they may spy out personal data of users. Thus, the negligence of providers of social networks facilitates third party torts and can be qualified as—unintentional—aiding and abetting. Besides contractual liability all grounds of civil tort liability apply, such as § 97 UrhG in case of spying out copyrighted works, or the infringement of personality rights.[27]

However, German tort law does not compensate pure economic loss but requires infringement of certain protected legal interests such as property or personal freedom and similar legal interests. In other terms, German tort law does not know a general liability provision such as in France including all kinds of torts. Hence, concerning personal data it is necessary to determine their quality as protected legal interests, in particular if they can be compared to property or other rights that can exclude others (§ 823 (1) BGB). To some extent data protection provisions such as the European Directive on data protection can bridge the gap as they may be considered as collateral tort liability provisions. In particular, § 9 of the German Data Protection Act (*Bundesdatenschutzgesetz*; BDSG) contains several obligations for data processing providers to secure their equipment against third party attacks, moreover to take care of organizational measures to support safety.[28] It is quite obvious that operators of social networks are obliged to take the same measures as they are processing personal data.[29]

However, if data cannot be qualified as personal data tort liability depends on whether these data have the same characteristics as property, § 823 (1) BGB, for instance commercial data contained in a fan page of a corporation being placed on a social network. As data is stored on the servers of the provider of the social network it can hardly be argued that property of the data owner is being trespassed. Instead, according to German law we have to concentrate on possession rather than

[26] P Bräutigam, 'Das Nutzungsverhältnis bei sozialen Netzwerken—Zivilrechtlicher Austausch von IT-Leistung gegen personenbezogene Daten' (2012) *Multimedia und Recht* 635, 638 ff; see also Spindler, 'Persönlichkeitsschutz im Internet'.

[27] Spindler, *Verantwortlichkeiten von IT-Herstellern, Nutzern und Intermediären,* 281 ff.

[28] See §§ 4, 4a, 5, 6a, 9, 10, 11 BDSG; P Gola and R Schomerus, *Bundesdatenschutzgesetz*, 11th ed (Munich, CH Beck, 2012) § 1 margin note 3; for §§ 19 ff., 33 ff. BDSG for instance S Simitis, *Bundesdatenschutzgesetz*, 7th ed (Baden-Baden, Nomos, 2011) § 4 margin note 68; OLG Hamm, 25/3/1983, (1983) *Zeitschrift für Wirtschaftsrecht* 552, 554; OLG Hamm, 4/4/1995, (1996) *Neue Juristische Wochenschrift* 131; Wagner, '§ 823' in Saecker and Rixecker (eds), *Münchener Kommentar zum BGB*, margin note 424.

[29] However, it is intensively debated whether providers of social networks outside the EU, like facebook, fall under European data protection provisions, in particular whether or not German authorities may require certain standards. OVG Schleswig, 22/4/2013, (2013) *Neue Juristische Wochenschrift* 1977, 1978 f, rejected the applicability of German data protection law to facebook. Instead, Irish law (as being the place of the European representation for facebook) was applied.

property as the owner of data can be qualified as having control about data stored on the servers.[30] Even if data can be qualified in such a manner it is quite arguable to which extent data is being protected. As spying out data does not modify the data itself rather than violating the exclusivity of information/data it is hard to reason that damages should address the loss of confidence (or exclusivity). In other terms, the mere substance of data is not being altered. Taking into account that spying out data is sanctioned by criminal law (§§ 202a, 303a, 303b StGB), however only in case of intentionally committed spying providers of social networks cannot hardly be held liable for facilitating such spying out of data (if they are acting negligent).[31] Hence, breaches of security concerning non-personal data in social networks can only result in claims for damages on contractual grounds.

(Reasonable) expectations of users of social networks are crucial to specify the obligations to secure social networks[32] which however can also be modified by contractual provisions. One of the current problems refers to the question whether a secure connection to social network (https) is a binding obligation of network providers, which encompasses encryption of communication in order to prevent any spying out by third parties. Since the disclosures of activities of secret services by *Snowden* German providers have begun to offer encrypted access to networks as well as a restriction of data traffic to servers in Germany.[33] This may influence the expectations of people in general, also with regard to security measures of social networks.

43.2.2.2 Liability for Tools, Apps, Search Engines

Close to security obligations of operators of social networks are issues of liability for any kind of additional tools, software, in particular games, or functions provided by the social network.

Liability for Own Services

If the operator of a social network offers these services, in particular software and games, as own content it is evident that liability issues are not different from other

[30] Spindler, 'Haftung und Versicherung im IT-Bereich', 48 f; fitting for 'virtual objects': G Spindler, 'Der Schutz virtueller Gegenstände' (2011) 3 *Zeitschrift für Geistiges Eigentum* 129, 147; A Spickhoff, 'Der Schutz von Daten durch das Deliktsrecht' in S Leible, M Lehmann and S Zech (eds), *Unkörperliche Güter im Zivilrecht* (2011) 233, 237; see, however, also BGH, 15/11/2006, (2007) *Neue Juristische Wochenschrift* 2394, 2395: no possession concerning software, only access; M Berberich*, Virtuelles Eigentum* (Tübingen, Mohr Siebeck, 2010) 164 f.

[31] Concerning intentional infringements: Spindler, 'Haftung und Versicherung im IT-Bereich', 57; Spindler, *Verantwortlichkeiten von IT-Herstellern, Nutzern und Intermediären,* 118.

[32] In general BGH, 11/12/1984, (1985) *Neue Juristische Wochenschrift* 1076; BGH, 20/7/1994, (1994) *Neue Juristische Wochenschrift* 3348, 3349; G Spindler, '§ 823' in Bamberger and Roth (eds), *BGB*, margin note 234; Hager, '§ 823' in Staudinger (ed), *Kommentar zum BGB*, E margin notes 27 ff., all with more references.

[33] Initiative 'E-Mail Made in Germany', www.e-mail-made-in-germany.de.

providers of software etc. These are liable for any damages to data and to hardware of their customers, for instance in case of viruses and Trojan horses, be it on grounds of contractual liability or tort liability for defective products (which however does not include liability for functionalities of software, in other terms: that the software fulfils all contractual agreed expectations).[34]

Liability for Third Party Software

If the social network provider just hosts third party software for users of the network (and indicates clearly that it is third party content) he is in general neither contractually nor on a tort basis liable for defects of the software. However, even then the social network provider has to control third party content with regard to viruses or malware (if possible). The degree of obligations to monitor third party content depends once again on the reasonable expectations of users of the platform. If the platform is open to everyone and just acts as a neutral host provider without any restrictions no user may expect thorough security actions taken by the platform provider—in contrast to platforms which require even a fee from third party content provider where users may reasonably expect security actions of the platform provider.[35]

Responsibility for Privacy Design of Tools and Apps

Until now scarcely discussed is the issue whether providers of social networks are responsible for privacy design of apps and tools as well as for compliance with data protection standards, even if the social network providers is not the producer or owner of the apps/tools. Regarding provisions to protect minors, German courts have claimed that providers of auction platforms have to monitor traders on their platforms regarding their compliance with those norms.[36] However, in contrast to legal requirements for the protection of minors, data protection law still does not provide for lists indexing content etc. so that automatic control of third party content is quite difficult for network operators. Moreover, courts have developed that obligation to monitor only in cases of claims for injunctions which requires prior knowledge (by the network operator) of the infringement,[37] usually established by

[34] More details in Spindler, '§ 823' in Bamberger and Roth (eds), *BGB*, margin note 564; F Graf von Westphalen, '§ 47' in U Foerste and F Graf von Westphalen (eds), *Produkthaftungshandbuch*, 3rd ed (Munich, CH Beck, 2012) margin notes 40 ff.; T Littbarski, 'Teil 18' in W Kilian and B Heussen (eds), *Computerrechts-Handbuch*, 31th ed (Munich, CH Beck, 2013) margin note 42.

[35] See also U Baumgartner and K Ewald, *Apps und Recht* (Munich, CH Beck, 2013) margin note 519.

[36] BGH, 12/7/2007, 173 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 188–'Jugendgefährdende Medien bei eBay'.

[37] BGH, 14/5/2013, (2013) *Neue Juristische Wochenschrift* 2348, 2350–'Autocomplete-Funktion'; BGH, 27/3/2012, (2012) *Neue Juristische Wochenschrift* 2345–'RSS Feeds'; BGH, 25/10/2011,

a cease and desist letter. Finally, such obligations have to pass the test of economic and technical reasonableness. One tool which could relieve network operators from any obligation to monitor data protection compliance refers to data protection audits and certifications.

Liability for Search Engines

Last but not least, social network providers have started to implement search engines into their platforms which act in the same manner as 'traditional' search engines, however, restricted usually to search the social network surrounding. At least in Germany it is a common belief that search engines fulfil an important function for modern electronic communication media. Hence, they should be exempted from liability as far as possible when their benefit to communications outweigh the interests of third parties as it has been accepted in many cases by courts.[38] Moreover, the German Federal Supreme Court extended the notion of 'implicit consent' to copyright in cases of search engines, arguing that every user in the internet expects search engines to copy and make use of their consent in order to enhance communications facilities.[39] Concerning social networks, even this notion is not required at all as most contract terms already enshrine provisions referring to transfer of copyrights of users of social networks so that search engines do not have to rely upon implicit consent. However, the German Federal High Court also recently upheld an injunction against a search engine concerning the so-called autocomplete function which violated personality rights of a third party by displaying defaming content and search words.[40]

(2012) *Neue Juristische Wochenschrift* 148–'Blog'; K Anton, '§ 1004 BGB' in Spindler and Schuster, *Recht der elektronischen Medien*, margin note 9; S Jandt, '§ 10 TMG' in A Roßnagel (ed), *Beck'scher Kommentar zum Recht der Telemediendienste* (Munich, CH Beck, 2013) margin note 62.

[38] Liability for Snippets: KG, 4/9/2006, (2006) *Multimedia und Recht* 817; KG, 3/11/2009, (2010) *Multimedia und Recht* 495; OLG Hamburg, 2/3/2010, (2010) *Multimedia und Recht* 490, with a case note by R Kazemi; OLG Stuttgart, 26/11/2008, (2009) *Computer und Recht* 187; regarding autocomplete: BGH, 'Autocomplete-Funktion'; OLG Munich, 29/9/2011, (2012) *Multimedia und Recht* 108; regarding adwords: BGH, 13/12/2012, (2013) *Gewerblicher Rechtsschutz und Urheberrecht* 290–'MOST-Pralinen'; BGH, 13/1/2011, (2011) *Gewerblicher Rechtsschutz und Urheberrecht* 828–'Bananabay II'; BGH, 13/1/2011, (2011) *Multimedia und Recht* 608– 'Impuls II'; Search of pictures: BGH, 29/4/2010, 185 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 291–'Vorschaubilder I'; BGH, 19/10/2011, (2012) *Neue Juristische Wochenschrift* 1886–'Vorschaubilder II'; overview by S Meyer, 'Aktuelle Rechtsentwicklungen bei Suchmaschinen im Jahre 2012' (2013) *Kommunikation und Recht* 221; N Härting, 'Rotlichtgerüchte: Haftet Google?' (2012) *Kommunikation und Recht* 633; S Ott, 'Die urheberrechtliche Zulässigkeit des Framing nach der BGH-Entscheidung im Fall »Paperboy«' (2004) *Zeitschrift für Urheber- und Medienrecht* 357.

[39] e.g. Facebook, www.facebook.com/legal/terms; twitter: twitter.com/tos; LinkedIn: www.linkedin.com/legal/user-agreement; Pinterest: www.de.about.pinterest.com/terms/; but not at Xing: www.xing.com/terms.

[40] BGH, 'Autocomplete-Funktion'.

43.2.2.3 Infringements of Copyrights and Personality Rights of Users

It goes without saying that the social network provider is also liable for any own infringements of copyrights or personality rights of users of the social networks, for instance of using personal pictures of a user without any license or consent of the user. A fortiori, the provider is liable for using content of a former user who has quitted the platform. Thus, most contract terms provide for an explicit consent or for a license of content of users to be used by the platform. However, if these licences etc. are enshrined in standard contract terms it is arguable whether they can be considered as fair and keeping the balance between interests of users and network providers. In most cases, the interest for a network platform to keep for instance pictures and photographs of a user is quite opaque if they are used just for marketing intentions. Only if the former content of the user is indispensable to understand connecting content, for example in discussions forums, such general clauses may pass the fairness test.

43.3 Safe Harbour Rules for Liability

Providers of social networks may benefit from European and German safe harbours privileges enshrined in Articles 12–15 of the E-Commerce Directive (and §§ 7 to 10 German Telemedia Act; TMG). Whereas these safe harbour rules apply to all kind of liability and responsibility of operators of social networks, in particular injunctions are exempted from these privileges, § 7 (2) TMG—what the European Court of Justice[41] as well as the German high federal court[42] affirmed. [43] As providers of social networks act like host providers § 10 TMG (Article 14 E-Commerce-Directive) applies, exonerating them from any liability if they do not have any knowledge of illegal activities or of related circumstances and, once having the knowledge, act immediately to block access to the content or remove the content.

[41] Case C-324/09 *L'Oréal v Mulliner* [2011] ECR I-6011.

[42] Leading case: BGH, 11/3/2004, 158 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 236, 246 ff.—'Internetauktionen I'; confirmed by BGH, 19/4/2007, 172 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 119–'Internet-Versteigerung II'; BGH, 30/4/2008, (2008) *Gewerblicher Rechtsschutz und Urheberrecht* 702–'Internet-Versteigerung III'; BGH, 17/8/2011, 191 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 19-'Stiftparfüm'; BGH, 25/10/2011, 191 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 219–'Blog-Eintrag'; BGH, 23/6/2009, 181 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 328–'spickmich.de'; BGH, 30/6/2009, (2009) *Multimedia und Recht* 752; BGH, 27/3/2007, (2007) *Neue Juristische Wochenschrift* 2558–'Meinungsforum'.

[43] More details and summary by M Leistner, 'Grundlagen und Perspektiven der Haftung für Urheberrechtsverletzungen im Internet' (2012) *Zeitschrift für Urheberrecht und Medienrecht* 722; M Leistner, 'Störerhaftung und mittelbare Schutzrechtsverletzung' (2010) *Gewerblicher Rechtsschutz und Urheberrecht* suppl 1 (for copyright liability); see especially: G Spindler and C Volkmann, 'Die zivilrechtliche Störerhaftung der Internet-Provider' (2003) *Wettbewerb in Recht und Praxis* 1; C Volkmann, *Der Störer im Internet* (Munich, CH Beck, 2005) 100 f.

43.3.1 Provider

The safe harbour rules only apply for providers of information society services who could be any natural or legal person which offers own or third party 'telemedia' services or providing access to them—without regard if the service is for free or not.

Whereas it is evident that providers of social networks can be qualified as providers of information services it is far from being clear if the same applies to users of the networks. If users store content of third parties like photos, text, or any other material, for instance of 'friends', it can be quite of importance if they also benefit from safe harbour privileges. Moreover, comments of third parties being pinned on the board of a user may be deemed as third party content thus relieving the user of any responsibility.

At first glance, users cannot be treated in the same way as host providers (or social network providers) as they are not using own tools or own storage space rather than utilizing the technological framework provided by operators of social networks. However, neither the European Directive nor the TMG require the use of own software or hardware in order to benefit from safe harbour privileges. In contrast, every homepage and every hosted 'profile' may serve also as a host provider for third party content. Even more, the privileges do not require directly a control of the user concerning the third party content; however, in the case of third party postings and comments on the pin board of a user some networks apparently have not provided for any means to block or remove the postings. Thus, the user cannot comply with the requirement of § 10 TMG (and Article 14 E-Commerce Directive) concerning the instant action to remove or block access to illegal content. Moreover, a user may be confronted with injunctions which he cannot really comply with—creating doubts whether injunctions in those cases really can be handed down.[44]

43.3.2 Providers of Social Networks

43.3.2.1 Third Party Content and Hosting

The qualification of content as third party content is crucial for the application of safe harbour privileges for social network operators. Only if content (or activities) are related to third parties and are not be categorized as own content of the provider of social networks, Article 14 E-Commerce Directive or § 10 TMG can shield the provider from any responsibility.

German courts have transferred categories stemming from media law to the safe harbour privileges, in particular the notion of 'adopting third party content as own content'. Thus, even if the provider has not contributed anything to the third party content it may be qualified as own content (thus excluding safe harbour principles)

[44] In this respect correct T Stadler, 'Haftungsrisiko Facebook?', www.internet-law.de/2012/04/haftungsrisiko-facebook.html.

if the provider does not distinguish clearly between his own content and activities and the third party content. A mere and general disclaimer is not sufficient for these purposes. German courts use a bundle of criteria in order to assess the quality of third party content, for instance the transfer of (copy) rights to the provider, the embedded nature of third party content like designing the framework for the third party content, own trademarks etc. placed near the third party content, as well as controlling the content.[45] It may not be sufficient that a user can easily see that third party content is being provided as long as other circumstances plead for an 'adoption' of the third party content.[46]

In contrast, however, to these German criteria the European safe harbour rules take a more technical stance, stressing in particular the degree of control and supervision exercised by the provider concerning the content of the third party.[47] The ECJ recently affirmed this more technical perspective by emphasizing the 'neutral' role of a host provider.[48] According to the criteria used by the ECJ the activities of the provider are crucial for the qualification of the role of the provider. If, for instance, the provider has actively supported the third party by designing the content or promoting the content by advertising campaigns/measures, thus gained knowledge of data and content, he can no longer be qualified as neutral to the third party content.[49] However, it is far from clear what a neutral role really means, which activities are harmful for the safe harbour privileges, for instance whether creating certain categories for users to store their third party content already leads to an active role of a provider.[50] In particular for social networks, offering sharing tools or news etc. that can be linked to would not result in an active role of a provider as this would reduce safe harbour privileges to mere technical hosting platforms. On the other

[45] BGH, 12/11/2009, (2010) *Multimedia und Recht* 556–'marions-kochbuch.de'.

[46] ibid.

[47] G Spindler, 'Die Verantwortlichkeit der Provider für „Sich-zu-Eigen-gemachte" Inhalte und für beaufsichtigte Nutzer' (2004) *Multimedia und Recht* 440, 441; consenting H Hoffmann, '§ 7 TMG' in Spindler and Schuster (eds), *Recht der elektronischen Medien*, margin note 20; Jandt, '§ 7 TMG' in Roßnagel (ed), *Beck'scher Kommentar zum Recht der Telemediendienste*, margin notes 35 f; A Berger and R Janal, 'Suchet und Ihr werdet finden?—Eine Untersuchung zu Störerhaftung und Auktionshäusern' (2004) *Computer und Recht* 917, 918 f; probably also S Sobola and K Kohl, 'Haftung von Providern für fremde Inhalte Haftungsprivilegierung nach § 11 TDG—Grundsatzsatzanalyse und Tendenzen der Rechtsprechung' (2005) *Computer und Recht* 443, 445; against JD Roggenkamp, 'Anmerkung' (2010) *Kommunikation und Recht* 499; S Leible and O Sosnitza, '"3… 2… 1… meins!" und das TDG—Zur Haftung von Internetauktionshäusern für rechtswidrige Inhalte' (2004) *Wettbewerb in Recht und Praxis* 592, 595; U Matthies, *Providerhaftung für Online-Inhalte* (Baden-Baden, Nomos, 2004) 143.

[48] Case C-324/09, *L'Oréal v Mulliner*.

[49] ibid.

[50] Against this G Spindler, 'Europarechtliche Rahmenbedingungen der Störerhaftung im Internet—Rechtsfortbildung durch den EuGH in Sachen L'Oréal/eBay' (2011) *Multimedia und Recht* 703, 704 f; similarly HP Roth 'Verantwortlichkeit von Betreibern von Internet-Marktplätzen für Markenrechtsverletzungen durch Nutzer: L'Oréal gegen eBay Gleichzeitig Anmerkungen zum EuGH-Urteil vom 12.07.2011 (Rs. C-324/09)' (2011) *Wettbewerb in Recht und Praxis* 1258, 1264; A Wiebe, 'Providerhaftung in Europa: Neue Denkanstöße durch den EuGH (Teil 1)' (2012) *Wettbewerb in Recht und Praxis* 1182, 1186.

hand, active marketing for fan pages embedded in a social network should certainly be deemed harmful to safe harbour privileges,[51] as well as influencing or actively monitoring content, even it is being done on quality purposes.[52]

Thus, if providers actively control and monitor software or apps they leave their role as passive hosting providers. However, such a rigid distinction between active and passive roles may interfere with obligations of providers concerning safe systems and software. Hence, these monitoring activities which aim at enhancing the security of systems should not be deemed harmful to the passive role of a hosting provider. In contrast, if a social network operator advertises third party software or apps (for instance, for games as it seems to be quite common on social networks) the provider actively supports the third party. The same applies if the provider reserves his right to remove software from his platform or formulates certain criteria which the software has to comply with in order to be launched on his platform.[53]

43.3.2.2 Search Engines, Hyperlinks, and Transmitting Private Communication

Some of the functions and tools being offered by social networks are neither regulated by the E-Commerce Directive nor by the TMG. One of these services refers to search engines in general which had been exempted from safe harbour privileges in Article 12–15 E-Commerce Directive as well as in §§ 7 to 10 TMG. In contrast to some authors who still claim that safe harbour privileges can either directly or per analogy be applied to search engines,[54] the European as well as the German legislator abstained from any regulation. Nevertheless, applying general principles of liability result in similar criteria and solutions for search engines as the safe harbour privileges, because operators of search engines are not obliged to monitor thoroughly the search findings etc. Due to the automated functions of search engines, ex-ante control of the search findings is nearly impossible and could only being done if automated filters can be used. Moreover, search engines fulfil a necessary

[51] Case C-324/09, *L'Oréal v Mulliner*; not if the provider reserves adwords of search engines, see Wiebe, 'Providerhaftung', 1188; M Roessel, 'Filterpflichten des Providers im Lichte des EuGH—Eine Entlastung des I. Zivilsenats' (2011) *Computer und Recht* 589, 591.

[52] G Spindler, 'Anmerkung' (2012) *Juristenzeitung* 311, 312; C Volkmann, 'Anmerkung' (2011) *Computer und Recht* 607.

[53] Different Baumgartner and Ewald, *Apps und Recht*, margin notes 477 ff, particularly 505 ff, who still state that there is an alien content, but assume reduced requirements to the awareness.

[54] See especially U Sieber and FM Höfinger, in T Hoeren, U Sieber and B Holznagel (eds), *Handbuch Multimedia-Recht*, 34th ed (Munich, CH Beck, 2013) part 18.1 margin notes 107 ff; see also U Sieber and M Liesching, 'Die Verantwortlichkeit der Suchmaschinenbetreiber nach dem Telemediengesetz' (2007) *Multimedia und Recht—Beilage 8* 1, 11 ff. Following this opinion also J Wimmers and C Schulz, in J Heidrich, N Forgó and T Feldmann (eds), *Heise Online-Recht—Der Leitfaden für Praktiker & Juristen*, 3rd ed (Hannover, Heise, 2011) B.III.87; against this: G Spindler, 'Das neue Telemediengesetz—Konvergenz in sachten Schritten' (2007) *Computer und Recht* 239, 245; K Altenhain, 'Vorb. §§ 7 ff.' in W Joecks and K Miebach (eds), *Münchener Kommentar zum Strafgesetzbuch*, 6th ed (Munich, CH Beck, 2012) margin note 51.

and widely acknowledged function to find information on the web.[55] These general arguments can be transferred to search engines on social networks, given the size of typical networks which require the use of search engines as well.

Hyperlinks have not been regulated either by European or German legislators. Nevertheless, courts do apply the same reasoning as for search engines, thus recognizing the socially desired function of these tools in order to navigate in the Internet. Again, these arguments are true also for social networks when hyperlinks are used to find other content or other profiles. However, we have to distinguish between the moment when the link has being set and the time afterwards: at the time the user is setting a link he has knowledge of the linked content. Afterwards, however, he has scarcely any control of changes being made to the linked content, so that only very rudimental monitoring obligations would apply.[56]

The tools to transmit private messages to one or multiple users in social networks usually consist of a mix of E-Mail services and chat rooms. The messages transmitted are not privileged by Articles 7–14 of the E-Commerce Directive unlike the act of transmission itself which falls under Article 12 E-Commerce Directive and § 8 TMG.[57] In contrast, the automated hosting of messages for a longer time (in order to be read by a user) is privileged by Article 14 E-Commerce Directive and § 10 TMG.[58]

[55] BGH, 'Vorschaubilder I'; BGH, 'Paperboy'; Sieber and Liesching, 'Suchmaschinenbetreiber', 3; O Spieker, 'Verantwortlichkeit von Internetsuchdiensten für Persönlichkeitsrechtsverletzungen in ihren Suchergebnislisten' (2005) *Multimedia und Recht* 727; G Spindler, 'Vor § 8 TDG' in G Spindler, P Schmitz and I Geis (eds), *Teledienstegesetz* (Munich, CH Beck, 2004) margin note 61.

[56] D Gabel, 'Die Haftung für Hyperlinks im Lichte des neuen UWG' (2005) *Wettbewerb in Recht und Praxis* 1102, 1117; G Spindler, 'Hyperlinks und ausländische Glücksspiele—Karlsruhe locuta causa finita?' (2004) G*ewerblicher Rechtsschutz und Urheberrecht* 724, 728; G Spindler, 'Verantwortlichkeit und Haftung für Hyperlinks im neuen Recht' (2002) *Multimedia und Recht* 495, 499 f, 502; T Stadler, *Haftung für Informationen im Internet*, 2nd ed (Berlin, Erich Schmidt Verlag, 2005), margin note 188a; R Mann and JF Smid, 'Presserecht im Internet und „elektronische Presse"' in Spindler and Schuster (eds), *Recht der elektronischen Medien*, margin notes 59 ff; case law: BGH, 14/10/2010, (2011) *Neue Juristische Wochenschrift* 2436–'AnyDVD' with case note by D Bölke; BGH, 1/4/2004, 158 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 343–'Schöner Wetten'; BGH, 'Paperboy'; LG Frankfurt, 20/4/2010, (2010) *Multimedia und Recht Aktuell* 302790; LG Munich I, 7/10/2004, (2005) *Kommunikation und Recht* 184.

[57] G Spindler, '§ 8 TMG' in G Spindler and P Schmitz (eds), *Telemediengesetz* (Munich, CH Beck, 2014) forthcoming; Sieber and Höfinger in Hoeren, Sieber and Holznagel (eds), *Handbuch Multimedia-Recht*, part 18.1 margin note 62; OLG Brandenburg, 9/5/2012, (2012) *Zeitschrift für Urheber- und Medienrecht* 691, 692.

[58] Altenhain, '§ 8 TMG' in Joecks and Miebach (eds), *Münchener Kommentar zum StGB*, margin note 13; Sieber and Höfinger in Hoeren, Sieber and Holznagel (eds), *Handbuch Multimedia-Recht*, part 18.1 margin note 66.

43.3.3 User

With regard to liability, users benefit from the same safe harbour privileges as providers of social networks—however, to a much lesser extent as usually they do not host third party content. In practice, third party content is relevant for comments to posting and for sharing other content. In general, posts of other users can clearly be distinguished from the content of the profile owner so that Article 14 E-Commerce Directive can be applied (§ 10 TMG). Moreover, the profile owner has no influence and little control of the third party content; usually he can only remove the third party content (postings etc.). However, he gains knowledge as soon as he logs in to the social network so that his own profile and all postings are displayed. After having obtained knowledge the user has to act, as Article 14 E-Commerce Directive requires instant action.

By contrast, if the user has modified third party content or has embedded the third party content in his own profile in such a way that other users cannot distinguish it any more from the profile of the user (for instance mash-ups and remixes) safe harbour privileges do not apply any more as the user has left the role of a neutral 'provider'.

Concerning actions of sharing and recommendations of third party content the user can benefit from the general principles developed for hyperlinks—but not from safe harbour privileges. At the moment in time when he has set the recommendation or has shared the content he aids and abets the distribution of the third party content so that he may be held liable for illicit content. Whereas for normal hyperlinks the user is in general not considered to be liable as he cannot continuously control modifications of the linked content, the situation for social networks is different in some aspects: shared content will always be shown in the current version on the profile of the user whereas recommendations follow (depending on the technology of the social network) the normal rules for hyperlinks.

43.4 Injunctions

As noted, injunctions are out of scope of safe harbour privileges, even though a lot of details are still intensively debated, for instance the relationship between specific monitoring duties and the prohibition of general monitoring duties.[59] In general, injunctions are, according to German law, accessory to tort law (and related legal areas such as unfair competition law etc.). However, liability in the area of injunctions may go far beyond simple aiding and abetting (§ 830 BGB); courts tend to

[59] BGH, 15/8/2013, (2013) *Neue Juristische Wochenschrift* 3245–'File-Hosting-Dienst'; BGH, 12/7/2012, 194 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 339–'Alone in the Dark'; BGH, 12/7/2007, (2007) G*ewerblicher Rechtsschutz und Urheberrecht* 890–'Jugendgefährdende Medien bei eBay'; BGH, 11/3/2004, (2004) *Multimedia und Recht* —'Internetauktionen I', with case note by T Hoeren.

declare everybody liable on grounds of injunctions (not claims for damages!) who has set a cause or 'helped' to injure the protected legal interest.[60] As in theory everybody could be held liable according to such a vast theory of causality, courts have introduced, in particular for cases concerning internet intermediaries, the notion of 'reasonable duties to monitor and control' other activities and content,[61] in order to take into account the characteristics of automated business models which are acknowledged by jurisdiction.[62]

43.4.1 Providers of Social Networks

In general, social networks are business models which are accepted by society—with the exception of 'specialized' networks that serve primarily illegal activities as hacking communities or other illicit purposes. Injunctions against (legal) social networks depend on several factors:

Injunctions require knowledge of the provider concerning illegal activities or content of third parties; preventive actions for injunctions cannot be reconciled with Article 14 E-Commerce Directive or § 10 TMG as they would not require any prior knowledge (which is, however, necessary to file actions for damages).[63] German courts have acknowledged this kind of relationship by accepting that injunctions

[60] BGH, 'File-Hosting-Dienst'; BGH, 'Internet-Versteigerung III', para 50; BGH, 'Alone in the Dark', para 19; BGH, 12/5/2010, 185 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 330 para 19–'Sommer unseres Lebens'—all with further references; BGH, 'Autocomplete'; case notes by N Härting, 'Allgegenwärtige Prüfungspflichten für Intermediäre—Was bleibt noch nach "Kinderhochstühle" und "Autocomplete" von der Störerhaftung übrig?' (2013) *Computer und Recht* 443, 444; G Spindler, 'Verantwortlichkeit eines Plattformbetreibers für fremde Inhalte' (2005) *Juristenzeitung* 37, 39; G Spindler, 'Das Gesetz zum elektronischen Geschäftsverkehr—Verantwortlichkeit der Diensteanbieter und Herkunftslandprinzip' (2002) *Neue Juristische Wochenschrift* 921, 925; Sieber and Höfinger in Hoeren, Sieber and Holznagel (eds), *Handbuch Multimedia-Recht*, part 18.1 margin notes 56 ff.

[61] Leading case: BGH 'Internet-Versteigerung I', confirmed by BGH 'Internet-Versteigerung II'; BGH, 'Internet-Versteigerung III'; BGH, 'Sommer unseres Lebens', para 19; BGH, 18/11/2010, (2011) *Gewerblicher Rechtsschutz und Urheberrecht* 617 para 37–'Sedo'; BGH, 'Stiftparfüm'; BGH, 'Alone in the Dark', para 19.

[62] BGH, 22/7/2010, (2011) *Gewerblicher Rechtsschutz und Urheberrecht* 152 para 38 ff—'Kinderhochstühle im Internet'; G Spindler, 'Präzisierungen der Störerhaftung im Internet—Besprechung des BGH-Urteils „Kinderhochstühle im Internet"' (2011) *Gewerblicher Rechtsschutz und Urheberrecht* 101, 104 f.

[63] G Spindler, 'Störerhaftung des Host-Providers bei Persönlichkeitsrechtsverletzungen—Impulse aus dem VI. Zivilsenat des BGH—zugleich Anmerkung zu BGH, Urt. v. 25.10.2011–VI ZR 93/10' (2012) *Computer und Recht* 176, 178; Spindler and Volkmann, 'Störerhaftung der Internetprovider', 3 f; Jandt, '§ 10 TMG' in Rossnagel (ed), *Beck'scher Kommentar zum Recht der Telemediendienste*, margin note 71; OLG Zweibrücken, 14/5/2009, (2009) *Multimedia und Recht* 541, 542; see also BGH, 'Internet-Versteigerung II', 507 with critical comments G Spindler; OLG Hamburg, 4/2/2009, (2009) *Zeitschrift für Urheber- und Medienrecht—Rechtsprechungsdienst* 317, 324–'Kochbuch—Mettenden'; OLG Hamburg, 4/2/2009, (2006) *Zeitschrift für Urheber- und Medienrecht* 414, 419–'Software für Pay-TV-Empfang im Internet'.

presume a prior knowledge of providers of networks.[64] Hence, the operator of a network has to be informed about the illegal activity specifically, a general message indicating that something 'wrong' is going on would not be sufficient as the operator should be able to identify the content and the activity easily in order to remove the content or block access, Article 14 E-Commerce Directive.

On the other hand, the message (notice) to the operator does not have to contain evidence such as licences or legitimation of right holders (whose rights had been infringed, for instance)—except in cases when there are doubts concerning the legitimation of the sender of the message or concerning the allegations.[65] Even then the operator has to inform the user about the assertions.[66] Whether or not the infringement is obvious depends on the specific circumstances; the sender of the message notifying the illegal activity (or content) does not have to provide profound legal assessments of the alleged infringement.[67] However, a lot of details of notice-and-action procedures are still a matter of European harmonization currently discussed.[68]

Even though a message may be clear and substantial and the provider is obliged to take action to block access to the content, he may not be held liable concerning injunctions in order to monitor similar infringements in the future. Such injunctions presume that it is reasonable to oblige the provider to monitor his social networks, in particular if automated business models allow for such controlling devices in order to prevent future infringements. According to the German High Federal Court a whole range of criteria and factors have to be taken into account, also if the provider has established a system to handle complaints by users.[69] On the other side, the German High Federal Court held that a file-sharing host could be obliged to control manually so-called (external) lists of links that led users to illegal copies hosted on the servers of the provider.[70] Even more, the provider has to make use of external search engines in order to control these sources.[71]

Concerning social networks it is hard to assess in advance and in general which monitoring duties can be reasonable. With regard to evident and obvious infringements operators of social networks may be obliged to a higher degree of control than regarding complex personality rights which always require a complex balancing of interests of sender and receiver of a communication. In those cases (of personality right injuries) it can be sufficient that the provider of social networks makes use of the notice-and-take-down procedure acknowledged by the BGH by sending the complaint to the sender (user) of the incriminated message. Hence, the sender can react to the complaint, if he does not react in due time the provider can

[64] BGH, 'Alone in the Dark', para 22.

[65] BGH, 'Stiftparfüm', para 31.

[66] Ibid, para 32.

[67] Ibid, para 36.

[68] See www.ec.europa.eu/internal_market/e-commerce/notice-and-action/index_en.htm

[69] BGH, 'Kinderhochstühle im Internet'.

[70] BGH, 'Alone in the Dark'.

[71] BGH, 'File-Hosting-Dienst', para 36.

take down the communication (posting, content shared etc.). If the sender rejects the complaint it is up to the user who has complained to take up the case; if the claimant does not react either, the provider is allowed to do nothing and to keep the incriminated content online. In case the claimant reacts in due time the provider then has to decide to take down the content or not.[72] In these rare cases it is unavoidable that the provider has to opt for one side, the claimant or the user, thus risking being liable for violating his contractual duties on either side.

Moreover, we have to distinguish these cases from the obligation of providers to monitor similar injuries of personality rights in the future: With regard to the complex balance of rights, providers can only be held liable on grounds of injunctions for evident and obvious defamations etc., which can easily be easily monitored even by automated systems; all other monitoring obligations would be unreasonable.[73] The same applies for rights to one's own picture, §§ 22, 23 UrhG, which stem from personality rights too, thus also requiring a complex balancing of interests of the public and of individuals.

Concerning injunctions against Facebook parties or calls to form flash-mob, providers of social networks are barely able to assess the quality of such an invitation or call as they do not have any (automated) knowledge of the background of these messages. Hence, an injunction could only be handed down concerning identical calls or invitations rather than extending the liability to similar calls etc., as well in general concerning messages (boycotts etc.) against one enterprise. Providers lack the knowledge of facts as well as of involved interests to make any assessment of the legitimacy of these communications.

In contrast, monitoring duties are stronger concerning infringements of copyrights if the legitimation of a right holder could by determined easily, moreover if automated systems for complaints and checks of legitimation of right holders are established.

Last but not least it may be discussed whether operators of social networks may be held liable on grounds of injunctions concerning protection of minors. Once again, even if we assume such monitoring duties in general they would be limited to check identical content in the future. Furthermore, it is not resolved whether (administrative) provisions to protect minors could be invoked also by their parents and could result in actions on grounds of private law (tort law claims) against providers. However, even though claims for damages on grounds of tort law are hardly conceivable, parents may have contractual claims if they had engaged in a contract with a social network enabling the juvenile to use the social network.

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[72] BGH, 'Blog-Eintrag', para 25 ff; on this see G Spindler, 'Störerhaftung des Hostproviders'; T Feldmann, 'Anmerkung' (2012) *Kommunikation und Recht* 113.

[73] No monitoring duties: A Kartal-Aydemir and R Krieg, 'Haftung von Anbietern kollaborativer Internetplattformen—Störerhaftung für User Generated Content?' (2012) *Multimedia und Recht* 647, 651; for autocomplete function in search engines: G Engels, 'Anmerkung' (2013) *Multimedia und Recht* 535, 539 f; for internet fora H Nieland, 'Störerhaftung bei Meinungsforen im Internet—Nachträgliche Löschungspflicht oder Pflicht zur Eingangskontrolle?' (2010) *Neue Juristische Wochenschrift* 1494, 1497: unreasonable; see also OLG Düsseldorf, 7/6/2006, (2006) *Multimedia und Recht* 618, 620.

43.4.2 User

Besides providers of social networks, the user may also be held liable on grounds of injunctions: With regard to third party content he will usually be obliged to remove illicit postings etc. as he will get knowledge of this content every time he logs into his account. Moreover, in contrast to the provider of social networks he is able to assess the quality of communications knowing the background of messages. Hence, he is more likely to balance the different interests of persons involved in communications than a provider.

However, every obligation for the user presumes that there are technical means for the user to act, in particular to remove or block third party content. If he is not able to influence the content on his profile due to technical restraints he cannot be held liable on grounds of injunctions.[74]

43.5 Other Liability Privileges

43.5.1 Contractual Exonerations of Liability

As usual contracts may provide for exoneration of liability, in particular in standard contract terms, in order to limit or restrict liability.[75] According to German law, these standard clauses are subject to rigid judicial control, in particular a fairness test (§ 307 BGB). Liability for essential contractual duties cannot be restricted to gross negligence[76] or to certain caps of damages, in particular not for any duties to secure the network against attacks of third parties.

Concerning the relationship between users such liability clauses can be invoked as all users share the same contractual terms, so that according to the principles developed by German courts in other platform-cases,[77] users have to comply with these terms even though they have not directly concluded a contract between them.

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[74] Correctly T Stadler, 'Haftungsrisiko Facebook?', www.internet-law.de/2012/04/haftungsrisiko-facebook.html.

[75] e.g. Facebook: no 16.3 terms and conditions, www.facebook.com/terms/provisions/german/index.php; Twitter: no 11 terms and conditions, www.twitter.com/tos; LinkedIn: nos 5 and 6 of the user agreement, www.de.linkedin.com/legal/user-agreement?trk=hb_ft_userag; Xing: no 9 terms and conditions, www.xing.com/terms.

[76] G Christensen, '§ 309 Nr. 7 BGB' in P Ulmer, E Brandner and H Hensen (eds), *AGB-Recht*, 11th ed (Cologne, Dr. Otto Schmidt, 2011) margin note 39; BGH, 24/9/1985, (1986) *Neue Juristische Wochenschrift* 1610; BGH, 17/1/1989, (1989) *Neue Juristische Wochenschrift* 582; BGH, 4/11/1992, (1993) *Neue Juristische Wochenschrift* 326; BGH, 12/10/1995, (1996) *Neue Juristische Wochenschrift* 1407.

[77] See BGH, 8/6/2011, (2011) *Neue Juristische Wochenschrift* 2643; T Wagner and R Zenger, 'Vertragsschluss bei eBay und Angebotsrücknahme: Besteht ein „Loslösungsrecht" vom Vertrag contra legem?' (2013) *Multimedia und Recht* 343, 346 f.; A Wiebe in G Spindler and A Wiebe, *Internetauktionen und elektronische Marktplätze*, 2nd ed (Cologne, Dr. Otto Schmidt, 2005) ch 4

Other liability privileges such as § 708 BGB limiting liability amongst partners in a partnership cannot be applied as there is no partnership contract between users and the network provider. Nevertheless, common practices and, for instance, language (use of certain terms etc.) have to be taken into account when assessing the liability standards amongst users.

It goes without saying that contractual disclaimer clauses cannot reduce liability towards third parties which are not part of the contractual relationship.

43.5.2 Minors

Furthermore, given the fact that often minors are participating in social networks, the usual liability privileges for minors can be applied, in particular concerning the legal culpability in tort law according to §§ 827 to 829 BGB. Hence, only if minors are capable to understand their doing and the consequences they can be held liable for their actions. Under § 828 (3) BGB there is a rebuttable presumption that a minor between 7 and 18 years can assess and understand his actions.

43.6 Liability of Parents and Custodians

Besides minors, parents (and custodians) can be held liable for damage done by minors if parents have omitted their obligations to supervise their children, § 832 BGB. However, specifically concerning internet cases parents often are not able to cope with technical issues. Moreover, they cannot control the actions of their children day and night. Hence, the German High Federal Court decided that supervision duties may not be overextended.[78] Besides the specific circumstances, in particular the character and properties of a child,[79] it is in general sufficient to control a 13-year old child from time to time and to instruct it concerning respect of rights of other people. Controls have to be intensified if there are reasons to suspect illegal actions such as music piracy etc.[80] It would be detrimental to the evolution of a child if parents were obliged to shadow their child every minute during internet activities.[81] Nevertheless, if there is a reasonable suspicion parents must control

margin notes 120 ff; G Spindler, 'Vertragsabschluß und Inhaltskontrolle bei Internet-Auktionen' (2001) *Zeitschrift für Wirtschaftsrecht* 809; LG Bonn, 5/6/2012, 18 O 314/11.

[78] BGH, 15/11/2012, (2013) *Neue Juristische Wochenschrift*, 1441–'Morpheus'.

[79] Emphasising this: R Schaub, 'Anmerkung' (2013) *Gewerblicher Rechtsschutz und Urheberrecht* 511, 516.

[80] BGH, 'Morpheus', para 24; K Hilbig-Lugani, 'Anmerkung' (2013) *Kommentierte BGH-Rechtsprechung Lindenmaier-Möhring* 347217.

[81] BGH, 'Morpheus', para 26; S Brüggemann, 'Anmerkung' (2013) *Computer und Recht* 327, 328.

the minor.[82] However, many details still have to be clarified, for instance whether intensified monitoring duties come into play at the very first infringement[83] or only after frequent infringements.[84]

These principles can easily be transferred to social networks: Parents can only be obliged to instruct and control on a case-by-case basis the activities of their children. A general ban of participating in social networks for minors would neglect the overwhelming significance for communication in social networks amongst minors today.[85]

43.7 Conflict of Laws and Country-of-Origin Principle

With regard to the global scale of social networks like Facebook[86] it is quite obvious that conflict of laws play a significant role for determining liability risks. However, social networks follow the same rules as other internet services and providers. Hence, the determination of jurisdiction depends on the criteria developed in the relevant legal area which can only be called into mind briefly:

Regarding copyright infringements of the right to copy a work, the place where the copy has been made determines the applicable jurisdiction. However, concerning social networks (in particular networks in the 'cloud') the place of copy cannot be easily assessed, as it is not predictable where the copy is exactly located (in contrast to usual downloads taking place at the personal computer at home). Instead the place where the copying process is being controlled and managed should be relevant.[87] In contrast, for infringements of the right to make a work available for the public it is important to whom offers to use (and download) the work are being made: If a website (and profile) is directed to users in a specific country (for instance, using the specific language) only the jurisdiction of that country should be relevant to assess infringements.[88]

Regarding personality rights the European Court of Justice used the same criteria: The centre of main interests of the injured person is relevant to determine the

[82] BGH, 'Morpheus', para 25; P Gooren, 'Internetnutzung und elterliche Aufsichtspflicht' (2013) *Zeitschrift für Urheberrecht und Medienrecht* 479, 481.

[83] F Drücke, 'Eine Warnung für Eltern?' (2013) *Kommunikation und Recht* 326, 327; Gooren, 'Internetnutzung und elterliche Aufsichtspflicht', 481.

[84] N Rauer and F Pfuhl, 'Anmerkung' (2013) *Wettbewerb in Recht und Praxis* 802, 804.

[85] Brüggemann, 'Anmerkung', 328; CM Thora, 'Anmerkung' (2013) *Zeitschrift für Versicherungsrecht* 868, 869.

[86] For instance, facebook does not establish any territorial restrictions even though facebook uses different languages according to the country of login.

[87] T Dreier, 'Vorb. § 120 ff.' in Dreier and Schulze, *Urhebergesetz*, margin note 33; P Katzenberger, 'Vor §§ 120ff' in Schricker and Loewenheim (eds), *Urheberrecht*, margin note 145; with a different opinion T Hoeren in Hoeren, Sieber and Holznagel (eds), *Handbuch Multimedia-Recht*, part 7.8 margin note 16.

[88] Judgment of 18 October 2012, case C-173/11 *Football Dataco*, not yet reported.

competent court according to Art. 5 (3) of the Brussels I Regulation,[89] as the tortfeasor usually knows this place and hence the applicable jurisdiction.[90] The centre of main interests will coincide in most cases with the domicile of the injured person, except when the person is working in other countries and the infringements are related to his professional reputation.[91] Only at the place of centre of main interests of the injured person or at the place of the action the whole damage can be claimed; at all other places (states) merely the part of damages related to the reputational damage occurred there can be claimed.[92]

Moreover, this concentration upon two places to determine the competent court (and implicitly the applicable jurisdiction) should also be used for any kind of injunction relieves.[93] Thus, Article 5(3) Brussels I Regulation should be interpreted in a narrow way in order to restrict the potential places to file injunctions.[94]

Finally, concerning the conflict of laws between Member States of the European Union, the applicable law for infringements of personality rights (not copyright!) is modified by the country-of-origin-principle enshrined in Article 3 E-Commerce Directive, one of the most opaque provisions in the E-Commerce Directive. According to this principle the most favourable jurisdiction for the provider applies, be it the jurisdiction of the origin or of the receiving Member State.[95] However, the country-of-origin-principle is only applicable for commercial services, and not for private users. As most torts like cyberbullying etc. in social networks are based upon actions of private users, the country-of-origin-principle has little significance to most infringements.[96]

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[89] Reg (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, [2001] OJ L 12/1.

[90] Joined cases C-509/09 and C-161/10 *eDate Advertising* [2011] ECR I-10269; see also G Spindler, 'Kollisionsrecht und internationale Zuständigkeit bei Persönlichkeitsrechtsverletzungen im Internet—die eDate-Entscheidung des EuGH' (2012) *AfP—Zeitschrift für Medien- und Kommunikationsrecht* 114, 116; WH Roth, 'Persönlichkeitsschutz im Internet: Internationale Zuständigkeit und anwendbares Recht' (2013) *Praxis des Internationalen Privat- und Verfahrensrechts* 215, 221.

[91] ECJ, *eDate Advertising*, para 49; Roth, 'Persönlichkeitsschutz im Internet', 221.

[92] ECJ, *eDate Advertising*, para 52; Spindler, 'Die eDate-Entscheidung des EuGH', 116 f; Roth, 'Persönlichkeitsschutz im Internet', 221 f.

[93] Spindler, 'Die eDate-Entscheidung des EuGH', 117; Roth, 'Persönlichkeitsschutz im Internet', 223.

[94] See Roth, 'Persönlichkeitsschutz im Internet', 223; see also G Wagner, 'Art. 5 EuGVVO' in F Stein and M Jonas, *Kommentar zur Zivilprozessordnung*, 22nd ed (Tübingen, Mohr Siebeck, 2011) margin note 169 and S Leible, 'Art. 5 Brüssel I-VO' in T Rauscher (ed), *Europäisches Zivilprozess- und Kollisionsrecht* (Munich, Sellier, 2011) margin note 92: Art. 5(3) Brussels I Regulation not applicable to injunction relief.

[95] ECJ, *eDate Advertising*, para 68; Spindler, 'Die eDate-Entscheidung des EuGH', 119 f; Roth, 'Persönlichkeitsschutz im Internet', 226.

[96] Altenhain, '§ 3 TMG' in Joecks and Miebach (eds), *Münchener Kommentar zum StGB*, margin note 9; T Pfeiffer, M Weller and F Nordmeier, '§ 3 TMG' in Spindler and Schuster (eds), *Recht der elektronischen Medien*, margin note 5; R Gitter, '§ 3 TMG' in Roßnagel (ed), *Beck'scher Kommentar zum Recht der Telemediendienste*, margin note 17.

43.8 Procedural Issues—Burden of Proof and Rights to Information

Finally, no claim for damages or injunctions can be enforced without adequate procedural rules. However, social networks follow the same rules as all other internet-specific cases; thus, everybody has to prove facts that are favourable for his claims—in contrast to US law there is no institution in continental European civil procedure law that is comparable to the pre-trial discovery.[97] Courts have developed some reversals of the burden of proof in only some specific areas, mostly due to information asymmetries and inabilities for the claimant to substantiate what has happened on the side of the tortfeasor, for instance concerning product liability for defective products. These principles could be applied also to social networks when users do not have any information about security measures and actions of social network providers.[98]

Last but not least the injured person may not be able to identify the tortfeasor: Even though most social networks require users to use their real name (like Facebook)[99] there is scarcely any control of the identity of participants of social networks. Unfortunately, there is no obligation for social network providers to check the identity of their users so that injured persons are confronted with severe problems to trace back the identity of a tortfeasor. Even though injured persons have a right to information directed to internet intermediaries, for instance access providers, in order to disclose the relevant data according to § 101 (2) UrhG[100] (and

[97] BGH, 10/3/2010, (2010) *Neue Juristische Wochenschrift—Rechtsprechungsreport* 1378, 1379; BGH, 18/5/2005, (2005) *Neue Juristische Wochenschrift* 2395, 2396; BGH, 14/1/1991, (1991) *Neue Juristische Wochenschrift* 1052; BGH, 11/12/1991, (1992) *Neue Juristische Wochenschrift* 683; H Prütting, '§ 286 ZPO' in T Rauscher, P Wax and J Wenzel (eds), *Münchner Kommentar zur Zivilprozessordnung mit Gerichtsverfassungsgesetz und Nebengesetzen*, 4th ed (Munich, CH Beck, 2013) margin note 111; U Foerste, '§ 286' in HJ Musielak (ed), *Kommentar zur Zivilprozessordnung*, 10th ed (Munich, CH Beck, 2013), margin note 35; I Saenger, '§ 286' in I Saenger (ed), *Zivilprozessordnung*, 5th edn (Baden-Baden, Nomos, 2013) margin note 58.

[98] For IT products: Spindler, 'Haftung und Versicherung im IT-Bereich', 39 f; see also regarding the reversal of the burden of proof in general: G Spindler, '823' in Bamberger and Roth (eds), *BGB*, margin notes 552 ff; Wagner, '§ 823' in Saecker and Rixecker (eds), *Münchener Kommentar zum BGB*, margin note 684; BGH, 17/3/1981, 80 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 186, 196 f, confirmed by BGH, 11/6/1996, (1996) *Neue Juristische Wochenschrift* 2507, 2508; BGH, 2/2/1999, (1999) *Zeitschrift für Versicherungsrecht* 456.

[99] Facebook: no 4 terms and condotions: www.facebook.com/legal/terms; LinkedIn: no 2 C user agreement: www.de.linkedin.com/legal/user-agreement?trk=hb_ft_userag; Xing: no 2.2 terms and condotions: www.xing.com/terms; Spindler, 'Persönlichkeitsschutz im Internet', F 59.

[100] For Host-Provider: OLG Munich, 17/11/2011, (2012) *Zeitschrift für Urheber- und Medienrecht—Rechsprechungsdienst* 88; OLG Cologne, 25/3/2011, (2011) *Zeitschrift für Urheber- und Medienrecht—Rechsprechungsdienst* 350; G Spindler, '§ 101 UrhG' in Spindler and Schuster (eds), *Recht der elektronischen Medien*, margin note 7; T Dreier, '§ 101' in Dreier and Schulze, *Urhebergesetz*, margin note 10; MP Weber, *Die Umsetzung der Enforcement-Richtlinie ins deutsche Recht* (Frankfurt, Lang, 2010) 109 ff, 340 ff; G Spindler and MP Weber, 'Die Umsetzung der Enforcement-Richtlinie nach dem Regierungsentwurf für ein Gesetz zur Verbesserung der

the Enforcement Directive 2004/48/EC) this right to information presumes that the provider has stored the relevant data such as the IP address.

Moreover, the right to information is restricted to copyright infringements; concerning infringements of personality rights there is still no comparable right to information. The only way to cope with this quite unsatisfactory situation is to extend the right to information by way of an analogy to personality rights as they are usually much stronger protected by constitutional law than copyrights.[101]

43.9 Conclusion

The tour d`horizon showed in a nutshell that social networks are not a mystery to legal theory and practice as most of the issues can be handled along the well-known lines of liability criteria. Whereas in detail some categories have to be modified in order to take into account the characteristics of internet communication, in particular social networks, the general lines of civil liability remain untouched. The real challenge to liability is the adaptation of duties to automated business models, to strike the balance between legally complex defined rights and legal interests such as defamation or personality rights on one hand and new business models built upon automated, binary 'yes' or 'no' working algorithms on the other. In addition, enforcement and the balance between identification of tortfeasors and anonymity in the internet are of crucial importance to any kind of liability which shall not be just law in the books. Thus, old categories may be 'reloaded' in the light of new media.

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[101] Spindler, 'Persönlichkeitsschutz im Internet', F 58, F 111 f; BGH, 17/5/2001, 148 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 26, 30–'Entfernung der Herstellernummer II'; BGH, 24/3/1992, 125 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 322, 331–'Cartier-Armreif'; BGH, 23/2/1995, (1995) *Neue Juristische Wochenschrift* 1965, 1966–'Schwarze Liste'; OLG Dresden, 8/2/2012, (2012) *Zeitschrift für Urheber- und Medienrecht—Rechtsprechungsdienst* 536, 538 f.; LG Berlin, 10/11/2005, (2006), *Zeitschrift für Urheber- und Medienrecht* 430; W Seitz in Hoeren, Sieber and Holznagel (eds), *Handbuch Multimedia-Recht*, part 8 margin notes 71 ff.; negative for telemedia: OLG Hamm, 3/8/2011, (2011) *Zeitschrift für Urheber- und Medienrecht—Rechtsprechungsdienst* 684, 685; AG Munich, 3/2/2011, (2011) *Multimedia und Recht* 417.

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