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THE PRIVATE LAW SYSTEMS IN THE EU: DISCRIMINATION ON GROUNDS OF NATIONALITY AND THE NEED FOR A EUROPEAN CIVIL CODE

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THE PRIVATE LAW SYSTEMS IN THE EU:

DISCRIMINATION ON GROUNDS OF NATIONALITY AND THE NEED FOR A EUROPEAN CIVIL CODE

Comparative study of the systems of private law of the EU Member States with regard to discrimination on grounds of nationality and on the scope and need for the creation of a European Civil Code

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Preface

This report, commissioned by the Directorate-General for Research of the European Parliament, examines, on the basis of a comparative study of legal provisions, the scope and need for the creation of a European Civil Code and the competence of the European Union to create such a code. At the same time, it investigates any forms of discrimination on grounds of nationality that may still be permissible under the private law and private procedural law of the EU Member States.

The comparative inventory of legal provisions reviews the main differences between the national systems of property and procedural law that are currently represented in the European Union, as well as their common features. Admittedly, in many respects this could only be a fairly crude survey. We were unable to follow up specific details for sheer lack of time and because of the limits on the scope of such a study. We also had to confine ourselves to property law. Work on a European Civil Code, if it is to have any chance of political acceptance, must begin in the economically related domains of private law; harmonisation of family law and the law of succession remains a *cura posterior* for the time being. Accordingly, the term 'property law' as used in this study excludes these branches of private law. It stands as a general term covering both the law relating to land and chattels and the law of obligations, to use a distinction that applies in some countries, particularly Germany. This also means that we do not use the term 'Civil Code' in this report in the same way as it is used in the civil-law countries of continental Europe. The fact is that we are not yet talking about a complete codification of all private law but rather about the creation of a European legal framework covering a limited range of subject matter; this framework must be designed with a view to seeking out the traditions and principles that are common to the various national systems of property law, developing them sensitively in cases where they need further development and ensuring that they, at least, are enshrined for the first time in European law.

Even this is a formidable task; in chapter 3 we discuss why it should be undertaken and how it could be tackled. The report concludes with an analysis of the legislative powers of the EU. It is several years now since the European Parliament first called on scholars of private law to devote themselves to the general theme of this study.[1]

[1] The first resolution to this effect dates from 26 May 1989 (for the wording, see for example *Rabels Zeitschrift für ausländisches und internationales Privatrecht (RabelsZ),* Vol. 56 [1992], p. 320, and *Zeitschrift für europäisches Privatrecht (ZEuP)*, 1993, p. 613); the resolution was repeated and reaffirmed on 6 May 1994 (*Europäische Zeitschrift für Wirtschaftsrecht (EuZW)*, 1994, p. 612; *ZEuP*, 1995, p. 669; Official Journal of the European Communities (OJ) C 158/400-401).

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Chapter I

Summary of the main differences between the various systems of property law and civil procedural law in the European Union and their common features

Salient features of European contract law

Ole Lando, Copenhagen

I. Introduction

1. ***On the way to a uniform European system of contract law***
   Although their systems of contract law are still highly disparate, the States of the European Union have yet to create a uniform system of general contract law. Efforts have been made in that direction. These are reflected in the Principles of European Contract Law (hereinafter referred to as the PECL), the basic rules of European contract law that were formulated by the Commission on European Contract Law.[1] In their present version, these rules relate to the conclusion of contracts, the authority of agents, substantive validity, interpretation, content, breach of contract and the rights of parties affected by a breach of contract. The work that is still being undertaken relates to rules governing majorities of creditors and debtors, the assignment of claims, the assumption of debts, set-offs, the right to charge compound interest and the statute of limitations.

2. The rules governing the conclusion of contracts, breach of contract and legal remedies for breach of contract are, to a considerable extent, consistent with the United Nations Convention on Contracts for the International Sale of Goods (CISG). In these and other domains, after conducting a comparative review of the autonomous European legal systems, the Commission based its principles on the national rules which, in its opinion, merited precedence. One example is the authority of agents, the rules governing which were inspired by the concept of *Vollmacht* in German law. Innovative provisions also exist here and there. The following paper relates the main decisions underlying the Principles of European Contract Law to the leading autonomous legal systems of the Member States.

[1] Lando and Beale (ed.), *Principles of European Contract Law, Part I: Performance, Non-performance and Remedies* (1995). A German translation can be found in Drobnig and Zimmermann, 'Die Grundregeln des Europäischen Vertragsrechts, Teil I, der Kommission für Europäisches Vertragsrecht', in the *Zeitschrift für europäisches Privatrecht* (ZEuP), 1995, pp. 864-875. The first part of the Principles has also been published in French, edited by de Lamberterie and Tallon, as *Les principes du droit européen du contrat* (1997). The second Commission's findings are set out in Lando and Beale (ed.), *Principles of European Contract Law, Parts I and II*, The Hague, 1999. The article numbers referred to in the present text are based on that version. The third Commission is expected to complete its work in the year 2001.

II. The binding effect of a party's promise

3. ***Pacta sunt servanda***
A party to a contract must be able to rely on the other party keeping his part of the bargain. The binding character of contracts is therefore a basic principle in all countries. All the legal systems in the European Union vigorously uphold this principle. The obligation to comply with the terms and conditions of contracts is implied in Article 1:102 of the PECL, which proclaims freedom of contract, and in other articles, such as Article 6:111 on changes in circumstances, which provides that a party is bound to fulfil his obligations even if performance becomes more onerous (see below).

4. ***The desire to become legally bound***
The legal systems seem to concur in the view that an agreement only becomes a binding contract if the parties have intended to become *legally* bound. Even when it has been accepted, a dinner invitation is morally but not legally binding. Further, the parties must have agreed on terms which are *sufficiently definite*. This also seems to be a common core of all European systems of contract law and is prescribed in Article 2:101 of the PECL.

5. ***Good faith***
However, under common law as well as German, Dutch and Nordic law, it is not what a party intends in his inmost mind that binds him. People are bound by what they say, not by what they think. For this reason, Article 2:102 of the PECL provides that the intention of a party to be legally bound by contract is to be determined from the party's statements or conduct as they were reasonably understood by the other party. The decisive point is the reasonable expectation of the recipient of a declaration of intent.

6. This principle of good faith is also behind the rules on the authority of agents. In accordance with German and Nordic law, Article 3:201 of the PECL provides that the principal's authorisation of an agent to act in his name may be express or may be implied from the circumstances. A person is to be treated as having granted authority to an apparent agent if the person's statements or conduct induce a third party reasonably and in good faith to believe that the apparent agent has been granted a power of attorney.

7. ***Form and cause***
Several of the systems based on Roman law require writing as a condition for the validity of contracts and stipulate that the contract must have a *cause*. However, in German and Nordic law, neither a specific form nor a cause are recognised as prerequisites of a valid contract. The Commission on European Contract Law has associated itself with the more liberal position adopted by the latter systems.

8. ***Consideration***
The same holds true of the *consideration.* In English and Irish law, a promise by one party which is not supported by a consideration, i.e. a *quid pro quo*, is generally not binding. A promise, even if seriously meant and accepted by the promisee, will not be binding unless the promisee gives or does something ('unilateral' contract), or promises

to give or do something ('bilateral' contract), in exchange for the promise. Failure to honour a gratuitous promise is consequently non-actionable.

9. The Commission on European Contract Law took the view that in the business world there are promises, such as promises to pay for work or services already done, which should be enforced even in the absence of a consideration.The same applies to promises to make a gift or donation. A wealthy industrialist who announces in public that he will pay a million euros into a fund for the benefit of the wives and children of soldiers killed when serving in the peacekeeping forces in the former Yugoslavia should be held to his promise. For these reasons the Commission decided to follow the continental rule which does not require a consideration. Article 2:101 of the PECL states explicitly that the contract is considered to have been concluded "if the parties intended to be legally bound and have reached a sufficient agreement, *without any further requirement*". This means that the validity of a contract does not depend on its form or on a cause or consideration.

10. ***Can an offer be revoked before it has been accepted?***
In German law an offer is binding when it reaches its recipient and in Nordic law when it comes to his knowledge. Unless the offer itself indicates that it is revocable it cannot then be revoked. However, most laws of the Union will allow a party to revoke his offer before it has been accepted. This is also the rule in Article 16 of the CISG, and the Commission on European Contract Law decided to follow suit; see Article 2:202 of the PECL.

    But there are exceptions. Offers which indicate that they are irrevocable and offers which state a fixed time for their acceptance will lead their recipient to expect that they will not be revoked. This expectation is to be protected. And if in other cases it is reasonable for the recipient to rely on the offer being irrevocable, and if the recipient has acted on the basis of his reliance on the offer, it should not be revocable either. If, for instance, a subcontractor submits an offer to the contractor which the latter then uses in his bid for a construction contract, the subcontractor should not be permitted to revoke his offer.

11. ***Derogations from the UN law on sales contracts***
Article 2:202 of the PECL follows Article 16 of the CISG, but with one important exception. Article 16(2)(a) of the CISG provides that an offer cannot be revoked if it indicates, *whether by stating a fixed time for its acceptance or otherwise*, that it is irrevocable. An reader of this provision might conclude that the fixing of a time limit for the acceptance of an offer would always make it irrevocable, but that is not certain. On this issue there was disagreement among the delegates who drafted Article 16 of the CISG in Vienna. The delegates from the common-law countries did not agree that the fixing of a time for acceptance should make the offer automatically irrevocable. The delegates of the civil-law countries thought it should. The outcome of the debate, although not very clear, seems to have been that the revocability or irrevocability of the offer depends upon the way in which its recipient would reasonably be expected to understand the intention of the party making the offer. This rule could give rise to legal uncertainty, and it has not been adopted by the Commission on European Contract Law.

Article 2:102(3) of the PECL simply provides that the revocation of an offer is ineffective if a fixed time was stipulated for its acceptance.

III. The claim to performance

12. ***The issue***
Most contracts contain a promise of performance. One party undertakes to provide goods, rights or services, and the other side undertakes to pay a sum of money in return. If one party reneges on his promise, however, the problem arises as to whether that party can be sued for specific performance or only for damages arising from non-performance.

13. ***The basic rule governing monetary payments***
The continental legal systems allow a creditor to require performance of a *contractual obligation to pay money*. In common law too, an action to enforce payment of an agreed sum of money is often possible, although this remedy is limited in certain respects, and such an action may be brought only when the price has been "earned" by performance; see the British and Irish Sale of Goods Acts, section 49(1). Nevertheless, in both types of legal system the creditor can tender his performance to the other party and can subsequently claim payment of the price. This is also the main rule in the PECL (see Article 9:101(1)).

14. ***Exceptions***
But should it always apply, even though a buyer of goods or services does not want them and is unwilling to receive and pay for them?. Experience gained from common law and Scottish cases seems to indicate that there should be exceptions from the main rule. In cases other than sale of goods the rule in common law and in Scots law now appears to be that if a party repudiates a contract, and if at the date of the repudiation the other party has no legitimate interest in performing, he is confined to an action for damages, and his recovery will be subject to his obligation to mitigate his loss. The onus is on the repudiating party to show that the other party has no legitimate interest in performing.

15. Most continental systems do not recognise restrictions upon a claim for payment of the price. The forerunner of the CISG, the Uniform Law on Contracts for the International Sale of Goods (ULIS) of 1964 provides in Article 61(2) that a seller shall not be entitled to require payment of the price by the buyer if it is in conformity with usage and reasonably possible for the seller to resell the goods. In that case the seller may only claim damages. The CISG however, has not imposed this restriction on the seller's right to perform and claim the price.

It has been reintroduced in the PECL. The underlying consideration is that a debtor should not have to pay for a performance which he does not want in cases where the creditor can easily make a cover transaction or in other cases where it would be unreasonable to oblige the debtor to pay the price.

16. ***Non-monetary obligations***
In common law, specific performance of a non-monetary obligation is a discretionary remedy based on equity. However, the discretion exercised by the courts is not an arbitrary discretion but one which is governed by rules. One is that specific performance will only be granted where damages are inadequate. The sale of land is a prime example. In the civil-law countries the aggrieved party's right to specific performance is generally recognised. In German law this right is regarded as axiomatic.

17. However, civil law makes exceptions too. On the Continent specific performance is not available when performance has become *impossible or unlawful.* In several civil- and common-law countries, specific performance will also be refused if it would be *unreasonable* to grant it, if, for instance, the cost of raising a ship which has sunk after it was sold would considerably exceed the value of the ship. Nor is performance available for contracts which consist *in the provision of services or work of a personal character,* and in several countries a performance which *depends upon a personal relationship* such as an agreement to establish or continue a partnership; in such a case, the defaulting partner cannot be legally compelled to play an active role in the partnership. These exceptions show that the difference between civil and common law is ultimately far smaller than might appear at first sight. Furthermore, even in the civil-law countries an aggrieved party will generally pursue an action for specific performance only if he has a particular interest in performance which damages would not satisfy.

18. ***The CISG formula***
In spite of the many points of resemblance in results, the civil and the common lawyers did not agree on common rules when the CISG was drafted. Article 46 states that "The buyer may require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with this requirement". Article 28, on theother hand, stipulates that, "If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by the Convention". In other words, the lawyers agreed to differ. Thus Article 46 of the CISG reflects the position of the civil-law countries of continental Europe, while Article 28 reflects the common-law position.

19. ***The PECL formula***
This partition was unnecessary. The civil-law countries could have allowed the possibility of restricting specific performance to the situations for which this remedy is needed in pratice. The common-law countries could have conceded that in these situations specific performance as a genuine right, rather than a discretionary remedy (see above), is the appropriate solution. This compromise forms the basis of the formula adopted in Article 9:102(1) and (2) of the PECL.

Article 9:102(2) provides that "Specific performance cannot, however, be obtained where
(a) performance would be unlawful or impossible, or
(b) performance would cause the obligor unreasonable effort or expense, or
(c) the performance consists in the provision of services or work of a personal character or depends on a personal relationship, or
the aggrieved party may reasonably obtain performance from another source".

The commentary on these provisions states that that the exception defined in item (c) is explained by the consideration that an order to perform personal services or work would severely restrict a party's personal freedom. Further, such performance rendered under duress would often be unsatisfactory and, finally, it would be difficult for a court to supervise the proper enforcement of the order. The exception defined in item (d) is explained by very similar considerations. The rules governing the means and procedure for enforcing a judgment for performance are left to the national legal system. These rules differ between the civil-law and the common law-countries, and this may render the common-law phrase "specific performance", as used in Article 9:102, somewhat dubious. Nevertheless, it is used for want of a better and generally comprehensible term.

IV. Legal remedies in the event of non-performance

20. ***Non-performance***
The PECL rules governing breach of contract are close to those enshrined in the CISG, common law and the Nordic legal systems but in their systematic intervention they differ in some respects from the German system. In the PECL, breach of contract is called *non-performance.* Under the PECL system, non-performance occurs when a party fails to perform any one of its obligations under the contract. The non-performance may consist in a defective performance or in a failure to perform at the due time, whether the debtor fulfils his obligation too early, too late or not at all. It includes a violation of an accessory duty such as the duty not to disclose the other party's trade secrets. Where a party has a duty to receive or accept the other party's performance a failure to do so will also constitute non-performance.

21. ***Remedies***
The *remedies* available for non-performance essentially depend upon whether the non-performance is not excused, is excused or results from the other party's behaviour (see PECL, Article 8:101[2]). A non-performance which is not excused may give the aggrieved party the right to claim performance,[3] to claim damages, to withhold his own performance, to reduce his own performance or to terminate the contract. A non-performance which is excused does not give the aggrieved party the right to claim damages or performance. However, the other remedies mentioned above may be available to him. Non-performance is excused if the defaulting party proves that it is due to an impediment which is beyond his control and that he could not reasonably have been expected to take the impediment into account when concluding the contract or to have avoided or overcome the impediment or its consequences (see Article 8:108 of the PECL). If the non-performance is caused by the obligee's act - or omission - he may not resort to any of the remedies. He has no remedies against the obligor if he is unable to receive the performance, even when this is due to an impediment beyond his control. His failure to receive performance may in itself be a non-performance which may give the other party remedies such as the right to terminate the contract.

22. ***Termination for fundamental non-performance***
Like the CISG and several of the Member States' systems of contract law, the PECL requires fundamental non-performance as a condition for termination of the contract by an aggrieved party (see Articles 8:103 and 9.301). Article 8:103 of the PECL defines

[2] The text reads as follows: "(1) Whenever a party does not perform an obligation under the contract and the non-performance is not excused under Art. 8:108, the aggrieved party may resort to any of the remedies set out in Chapter 9. (2) Where a party's non-performance is excused under Art. 8:108, the aggrieved party may resort to any of the remedies set out in Chapter 9 except claiming performance and damages. (3) A party may not resort to any of the remedies set out in Chapter 9 to the extent that its own act caused the other party's non-performance."
[3] See points 11 to 18 above.

fundamental non-performance.[4] Article 9:301(1) provides that a party may terminate the contract if the other party's non-performance is fundamental. Article 8:103(a) gives effect to an agreement between the parties that strict adherence to the terms of the contract is essential and that any deviation from the obligation goes to the root of the contract so as to entitle the other party to be discharged from his obligations under the contract. Thus, if in a commercial leasing transaction it is stipulated that the object leased *has to* be made available on a certain date, when the lessee will come and pick it up, delivery on that day is of the essence of the contract, and any delay will constitute a fundamental non-performance. However, the principle of good faith enshrined in Article 1:201 may come into operation. If the non-performance is so slight that it would be unreasonable for the aggrieved party to terminate the contract, he shall not be entitled to do so.

23. Article 8:103(b) lays emphasis on the gravity of the consequences of the non-performance for the aggrieved party. It is the importance of the detriment which he suffers that matters. The model Article 25 of the CISG, which defines fundamental breach as a breach which "results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract". Art 8:103(c) applies to an intentional non-performance which gives the aggrieved party reason to believe that he cannot rely on the other party's future performance.

24. ***Other grounds for termination of a contract***
A party's fundamental non-performance is not the only reason for termination. Article 9:301(2) provides that, in the event of a delayed performance by the other party, the aggrieved party may terminate the contract after having given notice fixing an additional period of time of reasonable length and if, at the end of that period, the other party has not performed his obligations (see Article 8:106(3)). In his notice the aggrieved party may provide that, if the other party does not perform within the period fixed by the notice, the contract shall terminate automatically. The model for this procedure is the CISG (Articles 49(1)(b) and 64(1)(b); see also Articles 47 and 63). The CISG procedure, for its part, has its origin in the *Nachfrist* (grace period) principle in German law.

V. Release from liability in the event of a significant change of circumstances.

25. ***Vis major***
In most European countries a party is bound to perform his obligations under the contract even though it has become more onerous for him to do so. An exception to this rule, the *pacta sunt servanda*, is made in the case of *vis major* (i.e. *force majeure*), which is the term used here to denote supervening events that make performance impossible or quasi-impossible. In a case of *vis major* the obligor will be excused for his non-performance.

[4] The text reads as follows: "A non-performance of an obligation is fundamental to the contract if: (a) strict compliance with the obligation is of the essence of the contract; or (b) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract, unless the other party did not foresee and could not reasonably have foreseen that result; or (c) the non-performance is intentional and gives the aggrieved party reason to believe that it cannot rely on the other party's future performance."

Although the rules are not exactly the same in all the legal systems, most of them display the following main features:
The obligor is relieved from his obligations only if performance has become impossible in law or in fact. Most legal systems also accept quasi-impossibility, where performance, though possible in fact, has become an economically unreasonable requirement. Furthermore, the legal systems require that the obligor could not reasonably be expected to take the impossibility into account at the time of the conclusion of the contract and that the impossibility of performance was due to factors beyond the control or influence of the obligor.

In most legal systems *vis major* ends the contract. There is no room for modification of its terms and no scope for the parties to renegotiate the contract with a view to such modification. The *vis major* rule, however, is not mandatory. It is negotiable and in practice is often waived in standard contract terms. Article 79 of the CISG and Article 8:108 define the legal position that has been outlined here.

26. ***Hardship***
In contracts for the performance of a continuing or recurring obligation, such as cooperation agreements, long-term construction contracts and contracts for a continuous supply of goods or services, unforeseen contingencies may make performance excessively onerous for one party, especially in times of depression or unrest. These contracts need a hardship clause which goes beyond the *vis major* rule. Many contracts do actually contain such a clause, but often the parties forget to provide them, or they do not find them necessary. It has been argued that a party who is then exposed to hardship must bear the consequences. However, the hardship which a party may suffer in these case is often too hard a penalty for his forgetfulness or improvidence. Many national legal systems already take this factor into account, either by means of explicit rules or by invoking the principle of good faith, as in Germany, and the rules developed from that principle concerning frustration of contract (*clausula rebus sic stantibus*). Such rules are unknown in common law and, as far as civil contracts are concerned, in French law too. Nor has the CISG any separate provision on hardship (see Article 79).

27. ***Article 6:111 of the PECL***
The Commission on European Contract Law considered a hardship rule to be necessary and inserted it in Article 6:111 of the PECL.[5] As in the case of the *vis major* rule, the

[5] The text reads as follows: "(1) A party is bound to fulfil its obligations even if performance has become more onerous, whether because the cost of performance has increased or because the value of the performance it receives has diminished. (2) If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating it, provided that (a) the change of circumstances occurred after the time of conclusion of the contract, (b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract, and (c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear. (3) If the parties fail to reach agreement within a reasonable period, the court may: (a) terminate the contract at a date and on terms determined by the court; or (b) adapt the contract in order to distribute between the parties in a just and equitable manner the losses and gains resulting from the change of circumstances. In either case the court may award damages for the loss

hardship rule is not mandatory. The two rules differ in a number of respects. A party may seek relief if performance has become excessively onerous; it is not required that it has become impossible. Thus, there was hardship when a company which in 1929 had undertaken to deliver water at a fixed price to a hospital in 'times ever after,' had to continue to deliver the water after 1978, when the agreed price had become derisory as a result of inflation. There was also hardship when a gas company which in 1908 had promised to deliver gas for a period of 30 years at a fixed tariff, had to continue delivery at that price when, during the First World War, a severe shortage of the coal that was used to produce gas quadrupled its price. The PECL, however, do not provide for automatic termination of the contract in all cases. The contract may be adapted to the new conditions by negotiation between the parties (the preferable option) or, if necessary, by the competent court. Details are contained in paragraphs 2 and 3 of Article 6:111 of the PECL.

VI. The principle of good faith

28. ***German law***
There are considerable differences in European attitudes towards good faith as a legal principle. This is most graphically illustrated if one compares German law with the common law of England. Section 242 of the German Civil Code provides that the obligor must perform his duty in accordance with the requirements of good faith and fair dealing. This provision is the kingpin, as it were, of the German law of contract Civil Code. It has been used in all areas of German law as an overriding moral imperative and has influenced the interpretation of other statutory provisions as well as tempering the rigorous individualism of the original contract law of the Civil Code. It has been used as a device for adapting the law to changes in social and moral standards.

29. The principle has operated in many fields of the law; it governs the interpretation of contracts and gives relief to a party in case of changed circumstances. On the basis of section 242, the German courts have set aside unfair contract terms, and the provision has given rise to a number of contractual obligations to observe the principles of fair play, such as a duty to cooperate, to look after the other party's interests, to provide information and to submit accounts. Other examples are forfeiture and abuse of rights, which may take many forms. Some such forms are expressed in the formula *Dolo facit qui petit quod statim redditurus est*, the rule which lays down that a party may not rely on a form of behaviour which is inconsistent with his own earlier conduct or impose penalties that are disproportionate to the extent of the breach by the other party. The principle of good faith is also enshrined in the other European legal codes but, apart from the Netherlands, no country has assigned to it the status it is accorded in Germany.

30. ***Common Law***
Common law, by contrast, does not recognise any general obligation to act in accordance with good faith and fair dealing. English courts have held an obligor to a contractual

suffered through a party refusing to negotiate or breaking off negotiations contrary to good faith and fair dealing."

undertaking even though the obligee had no good reason to insist on performance. Furthermore, English law does not, in general, recognise unreasonableness and unfairness as grounds for the invalidity of contract terms. This rather rigorous approach adopted by English law towards observance of contractual obligations has been explained by reference to the need for predictability. It is necessary in a commercial setting that businessmen should know where they stand. Vague concepts of fairness that are liable to make judicial decisions unpredictable are to be avoided. However, we must not overlook the fact that common law often applies specific rules, which are becoming more and more numerous, to obtain the same results that other legal systems achieve with the aid of the general good-faith clause.

31. ***The PECL***

The PECL also operate with a general good-faith clause. Article 1:201 of the PECL expressly states that each party "must act in accordance with good faith and fair dealing". Practical applications of this rule appear in several provisions of the PECL. The concept, however, is broader than any of these specific applications. The purpose of the good-faith clause is to enforce Community-wide standards of decency, fairness and reasonableness in commercial transactions. It ultimately takes precedence over specific Principles. So even though Article 8:103(a) of the PECL states that strict compliance with obligations is of the essence of a contract, a party would not be permitted to terminate because of a trivial breach of obligation.[6] "Good faith" means an honest and fair attitude of mind. It is contrary to good faith to pursue a remedy for no reason but to harm the other party. It is an objective test, designed to ensure that each party shows due regard for the other's interests. Good faith is to be presumed. Where bad faith is alleged, the onus of proof is on the accusing party. The purpose of the principle of good faith is to strike a balance between law and equity. A law or contractual condition which is normally valid may sometimes lead to an inequitable result. There is no general rule as to whether law or equity should take precedence. It all depends on the circumstances of the individual case. Thus, strict compliance with the terms of a contract may be of the essence when the obligor knows that those of the obligee's employees who are entrusted with the control of the obligor's performance are able to see whether there is strict compliance or not but unable to judge the gravity of any deviation, however slight, from the terms of the contract. In such a case, the law takes precedence over equity.

[6] See footnote 4 above.

VII. Unfair contractual conditions

32. ***General remarks***

Standard contracts are the result of modern mass contracting. Standard contracts make individual contract negotiations superfluous, thereby reducing transaction costs. They frequently serve as a more convenient vehicle than the terms for which the law implicitly provides. But standard terms tend to be one-sided; one party (the *stipulator*), who is often the seller of goods or services, will impose his terms upon the other party (the *adhering party*) and let the latter carry as many of the risks involved in the transaction as possible. Such contracts may provide, for example, that the stipulator is not bound by promises and statements which he or his agents have made during the contract negotiations unless they have been put down in writing and signed by the stipulator. They may enable the stipulator to raise the price of his performance between the conclusion of the contract and the delivery of the goods or services in question or provide that the adhering party remains bound by the contract, while the stipulator may postpone his performance as he sees fit; they may also contain clauses exempting the stipulator for liability for breach or imposing severe penalties on the adhering party in the event of his non-performance.

33. ***Consumer protection***

The consumer epitomises the weaker party. Many contemporary legal systems afford the weaker party special protection against unfair conditions in standard contracts. German law has played a leading role in the development of protective mechanisms. In the fifties, the German courts, invoking section 242 of the German Civil Code, began to deliver judgments invalidating unfair clauses in consumer contracts and in contracts relating to other business transactions. The General Conditions of Business Act 1976 (*Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen*) consolidated the case law that had developed in this domain. Section 9 of the Act introduced a general clause, laying down that clauses in standard contracts are null and void if they infringe the principle of good faith. Sections 10 and 11 of the Act then list clauses which are automatically null and void (the 'black list' in section 11) and those which courts may review (the 'grey list' in section 10). These catalogues of clauses are only applicable to consumer contracts; section 9, on the other hand, applies to all business transactions. The grey and black lists in sections 10 and 11 do, however, influence judicial interpretations of section 9 in cases concerning general business transactions. The *Gesetz über Allgemeine Geschäftsbedingungen* has been a source of inspiration for many other European legal systems.

34. ***European Community Law***

The same applies to the 1993 EEC Directive on unfair terms in consumer contracts.[7] The Directive, however, protects only consumers. A consumer is defined in Article 2 as any natural person who, in contracts covered by the Directive, is acting for purposes which are outside his trade, business or profession. Consumers in this sense are individuals who buy goods or services for their personal or household needs. Contracts between private individuals and contracts between business enterprises and charities and other non-

[7] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ L 95 of 21 April 1993, p. 29).

business organisations fall outside the scope of the Directive. Nor are contracts concluded by large and powerful enterprises with small and medium-sized traders, artisans, farmers and fishermen covered by the Directive, although their bargaining experience and skill and their position *vis-à-vis* the enterprise are not very different from those of the consumer. So no action has been taken yet in this domain to harmonise the European legal systems, which differ widely in their treatment of such 'weak-party contracts'.

35. ***The PECL***

In the chapter on the validity of contracts and contract clauses of the PECL, Article 4:110 sets out rules on unfair contract terms.[8] These rules follow the Directive in several respects. Article 4:110(1) provides that a party may avoid a term which has not been individually negotiated if, contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of that party, taking into account the nature of the performance to be made under the contract, all other terms of the contract and the circumstances at the time the contract was concluded. These rules are supplemented by a commentary, which sets out an indicative and non-exhaustive list of terms which may be regarded as unfair and which is reproduced in an Annex to the Directive. Unlike the Directive, however, the PECL are not limited to contracts between the enterprise and the consumer. Article 4:110 applies to all weaker parties to a contract, such as owners of small businesses, farmers, fishermen, artisans, etc. Moreover, the protection afforded by the PECL is not even confined to the archetypal weak party and may also be invoked by a large and powerful enterprise. Experience shows that such enterprises may also inadvertently subject themselves to unfair terms. Article 4:110 is, of course, mandatory; a party cannot waive its application when negotiating a contract. However, the party who is disadvantaged must take the initiative to have the clause set aside or modified.

Like Article 4(2) of the Directive, Article 4:110 of the PECL does not permit a court or an arbitrator to assess whether the main performance or the price specified in the contract is unfair. However, the rules in chapter 4 on "procedural" unfairness may be applied to protect a disadvantaged party, notably the rules on mistake, misrepresentation, fraud,

[8] The text reads as follows: "(1) A party may avoid a term which has not been individually negotiated if, contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of that party, taking into account the nature of the performance to be rendered under the contract, all the other terms of the contract and the circumstances at the time the contract was concluded. (2) This article does not apply to: (a) a term which defines the main subject matter of the contract, provided the term is in plain and intelligible language; or to (b) the adequacy in value of one party's obligations compared to the value of the obligations of the other party."

duress and excessive or grossly unfair advantage. These rules are mostly in accordance with the rules of the national legal systems of the Union. As the case law of the Member States shows, the courts tend to assume such “procedural” unfairness in cases where inequality of bargaining power between the contracting parties has resulted in gross disparity between performance and consideration.

The law governing service contracts

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I. Introduction

1. *Background*

Services have long been the engine of modern economies. In today's societies, such as our modern European society, new types of service are constantly emerging, and with them come new forms of contractual agreement. Current civil law, however, scarcely seems able to develop suitable norms for these new contracts. Legal experts in all the Member States conceive new rules for each new form of service, apparently without being aware of the connections between the various services and without reference to any type of general system. We certainly feel that this state of affairs is partly due to the fact that jurists do not know how service contracts should be incorporated into the system of private law. There are not even any national instruments defining the general characteristics of service contracts. Some European codes of civil law have a few provisions that could usefully serve as a basis for a general set of national rules on the provision of services (e.g. section 675 of the German *Bürgerliches Gesetzbuch*, Article 1779 of the French *Code civil* und Article 7:400 *et seq.* of the Dutch *Burgerlijk Wetboek*). These legal provisions, however, are rudimentary as well as being restricted to services that are not the subject of other legislation. In some Member States, the legislature or the judiciary has developed special rules for particular forms of service, as in the cases of the laws governing construction and insurance contracts. The existence of these special fields of private law, however, has done little to promote the development of a cohesive, overarching system governing service contracts.

This lack of a general system not only applies to the legislature or the judiciary; the formulators of legal doctrine have not undertaken a systematic review and analysis of current law on service contracts either. Academics also tend to focus exclusively on the individual types of contract to which the legislators occasionally accord legal recognition.

2. *General matters relating to the law on service contracts*

To put it briefly, it is regrettably impossible to avoid the conclusion that the only major point that the legal systems of all EU Member States definitely have in common in the field of service contracts is the total absence of a legal framework for the assessment of services. One consequence of this situation has been the development of autonomous special provisions of private law. So there is no uniformity within the individual national legal systems at the present time, which makes harmonisation on a European scale seem

like a pipe dream. This does not mean, of course, that it would be impossible to make statements about essential differences and similarities between national systems of private law in the domain of service contracts. Many types of service provision are simply covered by general contract law, the application of which will normally produce a satisfactory result. In our view, however, some forms of service provision have particular characteristics which make special rules indispensable. In the following study we shall examine five examples of such characteristics, namely information requirements (section II below), criteria for the assessment of service quality (section III), liability for the actions of third parties (section IV), entitlements of third parties (section V) and the termination and adaptation of contracts for the performance of a continuing or recurrent obligation (section VI).

II. Information requirements

3. *The contractor's duty to provide information*

One major problem affecting relations between the natural or legal person offering a service (the contractor) and the recipient of the service (the customer) concerns the duty of the contractor to provide adequate information. Adequate information is essential to a prospective customer, since it enables him or her to select the most appropriate contractor and service. A shortage of adequate information is by no means unusual. For that reason, the contractor's duty to provide adequate information has emerged as one of the main areas of service provision on which courts are asked to rule. About a quarter to a third of all published judgments on services relate directly or indirectly to an obligation to provide information.[1] A doctor, for example, must inform patients of the risks that are involved if a proposed or requested treatment is administered and if it is not administered. Some rules governing the provision of information may be enshrined in public law, such as the Community laws on the labelling of foodstuffs and on the presentation of certain insurance products. The potential of private law in this field is considerable, but it has been far more fully developed in some countries than in others. In German law, information requirements have been particularly well developed on the basis of the theory of *culpa in contrahendo*. This basis is of little assistance, however, when it comes to establishing the criteria for distinguishing between adequate and inadequate information. Some situations are covered by specific legal provisions, such as those concerning the obligation of a notary public to inform clients of their legal rights and duties in connection with the use of notarial services.[2] These provisions are normally general clauses, the finer points being left for the judiciary to fill in, and an all-embracing system can scarcely be gleaned from case law. In France too, an obligation to provide adequate information is generally recognised.[3] In English law, however, it remains a general principle that one party to a contract is under no obligation to provide the other party with information.[4] Moreover, general principles such as good faith and *culpa in contrahendo* are not explicitly enshrined in the English law of contract. Nor is there any

[1] Cf. Haug (1997), point 401.
[2] In particular, see sections 17-21 of the Notarial Authentication Act (*Beurkundungsgesetz*) and section 14 of the Federal Notaries Act (*Bundesnotarordnung*).
[3] Cf. Ghestin (1993), point 623.
[4] Cf. Treitel (1995), p. 361.

legal basis at all for an obligation to provide information. Section 13 of the Supply of Goods and Services Act 1982 merely lays down that the professional contractor is bound to provide the service with due care and competence. In exceptional cases in which the judge assumes a duty to provide information, this assumption is based on specific constructs which make the relevant English case law even more casuist than those of the other Member States.

III. Criteria for the assessment of service quality

4. *Liability for breaches of contract*

In a service contract, the parties often rely on each other. As long as such a contract is fulfilled by both parties without any problems, the law takes a back seat. Legal issues only arise when one party has defaulted on his obligation and there is consequently no longer a mutual desire to cooperate. The law of liability is therefore one of the most important aspects of the law governing service contracts.

5. *Defining the general precept of due care*

The customer's main obligation is generally to pay for the contracted service. In legal terms, this obligation scarcely poses any problems. The contractor's main obligation is to provide the service. The question whether this obligation has been badly fulfilled is often difficult to answer. The general rule is that the contractor must act like a diligent meber of his trade or profession. For doctors, for example, this rule implies that they must act in accordance with the current state of scientific knowledge in their profession, even in cases in which their patient is not primarily seeking treatment.[5] The basic rule requiring compliance with professional standards applies in most countries, although little importance seems to attach to the question whether liability for non-compliance falls under breach of contract, tort/delict or some other branch of the law.[6] This general clause, however, is only an initial reference point. The question arises as to which rules can be used to test ***how*** a diligent member of a particular trade or profession would act. More narrowly defined quality standards of this type are in short supply. And if the current state of scientific knowledge is the criterion, how can the current state and the state at the time of the alleged breach of professional standards be established? Sometimes, especially in cases involving medical contracts, specialists are called in, and their reports virtually assume the status of official evidence of the state of scientific knowledge. It is also questionable whether account should be taken of opinions that have come to be recognised as right by the time a case is heard but were only shared by a minority of contributors to specialised literature when the service was provided. In English law

[5] For a graphic example, see Cour d'Appel, Paris, 30 September 1993, *D.* 1995, Somm.98, a case in which the patient was motivated by purely aesthetic considerations.

[6] For Germany, see Kötz (1996), point 97; for England, *Bolam v. Friern Hospital Management Committee* [1957], 2 All ER 118, 121, *Sidaway v. Bethlem Royal Hospital Governors* [1985], 1 All ER 643, 658, and section 13 of the Supply of Goods and Services Act 1982; for France, Cass. civ. I of 25 February 1997, *Bull. civ. I*, point 72, *Resp. civ.* 1997.Comm.; for the Netherlands, HR 9.11.1990, *NJ* 1991, 26 (Speeckaert v. Gradener), HR 20.9.1996, *NJ* 1996, 747 (Beurskens v. B. Notarissen) and Article 7:401 of the *Burgerlijk Wetboek.*

governing the liability of physicians, such statements of opinion are inadmissible. A doctor acting in accordance with a respectable school of thought in medical literature is not acting negligently.[7] In German law, on the other hand, the opinion of respected medical scientists will suffice to establish at least an obligation to investigate potential problems.[8] Although the legal systems have more or less the same general clause, the ways in which this clause has been interpreted do vary. There is, in any case, a shortage of more specific quality standards for most services. Although case law contains examples of the way in which the general obligation to exercise due care has been enforced in a number of particular situations, the 'transactional obligations' that have emerged from such judgments are formulated in different degrees of detail from one Member State to another, relate to diverse areas of activity and contain loopholes, which are either coincidental or derive from the differences in the occupational cultures of the various Member States.

IV. Liability for the actions of third parties

6. ***Involvement of third parties in services***

Another problem is that service contracts often involve various persons. In every field of the law governing the provision of services, the position of third parties has its own particular effect on the contractual and legal relationship between the contracting parties. Many contractual situations require three or more persons to cooperate in order to achieve the desired outcome. Few problems are posed by a situation in which a contractor involves employees in the performance of the service. The fact that contractors are liable for defects caused by their employees is undisputed. Things become slightly more difficult when a contractor uses the services of an independent subcontractor, but even in this case it may be assumed that the contractor will be liable for the subcontractor's mistakes. The real problem arises when the involvement of the independent third party has come about at the instigation of the customer, and the most difficult question of all concerns the contractor's liability if the customer has taken the initiative to involve a third party but has selected the third party on the basis of a suggestion or recommendation made by the contractor.

7. ***First example: construction contracts***

In some service contracts, all the parties maintain extremely close relations. In the case of a conventional building project, for example, a customer commissions an architect to draw up the plans, and a building contractor is then engaged to execute the plans. The first difference to emerge here between the legal systems of the EU Member States is that customers in France and Belgium, for example, are legally bound to involve an architect if they wish to erect a building, whereas Dutch and German customers are not subject to the same requirement under their national legal systems. They are consequently able to build at a lower cost. But even in the Netherlands and Germany, customers often conclude a contract with an architect, especially if the projected building exceeds a

[7] *Bolam v. Friern Hospital Management Committee* [1957], 2 All ER 118, 121.
[8] Federal Court of Justice (BGH), 21 November 1995, *Neue Juristische Wochenschrift (NJW)*, 1996, 776.

certain size.[9] In practice, three independently operating contractual parties are normally involved in conventional building projects. It would therefore be logical if each legal system were attuned to this triangular relationship. However, the relationship between the architect and the building contractor is regulated neither in law nor in the standard contracts which are in general use. This causes problems if, for instance, the architect makes a mistake which renders the building plans defective, and the builder does not notice the mistake, although he should have noticed it. In such a case, is the builder, possibly together with the architect, fully liable? In France and Belgium, and perhaps in the Netherlands too, this appears to be the case. Under German and English law, on the other hand, the prevailing opinion is that there is contributory negligence on the part of the customer, because the customer is accountable to the contractor for mistakes made by the architect.[10]

8. ***Second example: operations***

Several persons are involved in an operation. Besides the surgeon, a nurse and an anaesthetist are generally on duty in the operating theatre. The question arises as to who is deemed to have concluded a contract with the patient for the surgical treatment. The hospital will normally be the contractor, in which case it is liable for mistakes made by its staff.[11] However, German law also recognises so-called 'split hospital contracts' in which the patient contracts with the hospital for admission to the clinic as well as concluding a treatment contract with the consulting physician. In such cases, German law prescribes that the hospital bears no liability for mistakes made by the doctor when treating the patient, which are the sole personal responsibility of the doctor.[12] A different rule has been established in the Netherlands, where a patient sustaining injury in a hospital can always claim damages from the hospital, either as a contracting party or – and this is an innovation - ***as if*** the hospital were a contracting party.[13] As far as the liability of the hospital is concerned, it is therefore irrelevant whether the hospital is a contracting party.[14] Moreover, neither a doctor nor a hospital can disclaim or limit their contractual or civil liability.[15] Whereas the German law of contract assigns liability to either the hospital or the doctor, depending on whether the patient has concluded a split

[9] Cf. Jansen (1998), pp. 141-142.
[10] Cf. Jansen (1998), pp. 519-520.
[11] Cf. BGH, 18 July 1985, *Bundesgerichtshofs-Entscheidungssammlung für Zivilrecht (BGHZ)*, 95, 6.
[12] Cf. BGH, 14 February 1995, *BGHZ* 129, 6. In such cases, doctors are also liable for mistakes made by the staff assigned to them; cf. Oldenburg Higher Regional Court (OLG Oldenburg), 11 November 1997, *Versicherungsrecht (VersR)* 1998, 1421.
[13] Cf. Article 7:462 of the Dutch Civil Code (*Burgerlijk Wetboek*).
[14] Contractual relations do become relevant, of course, when it comes to a right of recourse against the doctor. If the doctor has concluded a contract of employment with the hospital, recourse is not normally possible (see Article 6:170(2) of the Dutch Civil Code); otherwise it is permissible in principle (see Articles 6:10 and 6:102 of the Code).
[15] Article 7:463 of the Dutch Civil Code.

contract, in Dutch law the hospital is always liable, and in some cases the doctor is liable too.[16]

V. Entitlements of third parties

9. ***Basic principle***

The question whether a third party who is not involved in the contract is entitled to damages for non-fulfilment of a service contract is another matter entirely. Most of the legal systems do not rule out such a claim. In some countries the legislature has adopted a special set of provisions. A German notary public, for example, has many official duties. According to the case law of the Federal Court of Justice (*Bundesgerichtshof*), everyone whose protection is at least part of the purpose of an official duty is entitled to redress if that duty is not performed.[17] In most other countries, however, there is no comparable basis for such an entitlement. In any event, it does not apply to occupations outside the public service.

10. ***Contractual third-party liability***

A *contractual* basis for a claim by third parties may be provided by a contract in which rights are granted to third parties. This is essentially another form of contractual liability, because the third party accedes to the agreement by accepting the offer of these rights and thereby becomes a contractual partner. The French *Cour de cassation*, for example, assumes that such a contract exists in the domain of passenger transport.[18] The third-party beneficiary contract is a recognised entity in many Member States of the EU, but it is not yet recognised in English law.[19] In French and Dutch law, and probably in Belgian law too, it is even possible to impose an obligation on the third-party beneficiary.[20]

11. ***A special case: contracts with a protective effect in favour of third parties***

It is more difficult to define the legal nature of a third-party entitlement where there is neither a contractual relationship with the third party nor a relevant legal provision. In Germany and Portugal, the instrument of the contract with a protective effect in favour of third parties has been developed in a bid to solve this problem. The underlying theory is that, in certain circumstances, an obligation arises to protect not only the contracting party but also those third parties who are in the 'same camp' as the contracting party. The device of the contract with a protective effect in favour of third parties is used throughout

[16] Dutch law also lays down that, even if the contract has been concluded with the hospital, a doctor is held personally liable if found guilty of a tort. Under Article 7:463 of the Civil Code, a doctor cannot disclaim civil liability.

[17] BGH, 26 June 1997 (*Monatsschrift für deutsches Recht (MDR)* 1997, 985); BGH, 30 April 1998 (*MDR* 1998, 1185).

[18] Cf. Cass. civ., 6 December 1932 and 24 May 1933, *D.* 1933.1.137, per Josserand, *D.* 1934.1.81, per Esmein (Mme Noblet): a traveller died as a result of a railway accident. The *Cour de cassation* ruled that his widow was entitled to damages. The fact that the traveller had a legal obligation to maintain his wife was probably decisive in the eyes of the court, because in another case on 24 May 1933 the same court ruled that the sister of another traveller was not entitled to damages (Cass. civ. 24.5.1933, *D.* 1933.1.137, per Josserand, *D.* 1934.1.81, per Esmein.

[19] Cf. Du Perron (1998), pp. 321-322

[20] Cf. Du Perron (1998), p. 322.

private law,[21] but is of particular importance in the law governing the provision of services. This legal device has been used by the German Federal Court of Justice, for example, in such varied domains as the law governing legal practice,[22] travel[23] and medical practice.[24] Exemption clauses excluding or limiting liability may, however, be invoked to curtail the rights of the third party.[25] In French law on the sale of goods, the legal device of the *groupe de contrats* fulfils the same function to a certain extent, because the injured party can bring an *action directe*. According to the case law of the *Cour de cassation*, however, this device may only be used if the 'links in the contractual chain' are supposed to provide the same service. The theory cannot therefore be applied as a rule to cases involving the provision of services.[26] In most other legal systems, however, the law of tort or delict rather than the law of contract is used to deal with such cases.[27] But the change of legal base does not normally imply any major substantive differences.[28] In English law, for instance, the key question is whether the contractor has committed a tort by failing in his duty to protect the third party.[29] When the court has to decide whether such a duty applies, the crucial point is whether a 'special relationship' exists between the contractor and the third party. For this condition to be satisfied, a consultant, for example, must be aware of the purpose of his report and must know that third parties will rely on the consultant's report to fulfil that purpose without the need for further investigations of their own.[30] If, on this basis, it is concluded that the contractor has a duty to protect the third party, the substance of the applicable liability rules will be no different to those derived from the law of contract.[31]

12. ***Problems concerning the burden of proof***

So there are usually no additional substantive requirements for claims by third parties. Be that as it may, the position of a third party is sometimes more difficult than that of a party to the contract. The onus of proving a breach of duty is normally on the plaintiff. It is sometimes harder for a third party to furnish the requisite proof than it is for a contractual party. How, for example, are third parties to prove that a testator intended to bequeath his estate to them? Witnesses are normally called to give evidence, but in many testamentary cases this is no longer possible.[32] This problem exists in all Member States of the Union, and we believe it to be inherent in the role of a third party as such.

[21] Cf. Larenz (1987), pp. 224 *et seq.* For Portuguese law, see Da Rocha e Menezes Cordeiro (1997), pp. 619 *et seq.*, as cited in Hesselink (1999), p. 277.
[22] BGH, 6 July 1965, *NJW* 1965, 1955 (testamentary case); BGH, 24 January 1995, *NJW* 1995, 1618.
[23] BGH, 12 May 1980, *BGHZ* 77, 117.
[24] BGH, 18 March 1980, *BGHZ* 76, 259.
[25] Cf. Du Perron (1998), p. 324.
[26] Cf. Cass. Ass. plén., 12 July 1991, *D.* 1991.Jur.549, per Ghestin, *JCP* 1991.II.21743, per Viney (a case concerning planning and building law).
[27] Cf. Giesen (1999), pp. 42-43, and Hesselink (1999), p. 277.
[28] See also von Bar (1980), p. 225.
[29] Cf. Giesen (1999), pp. 42-43.
[30] Cf. Lord Oliver in *Caparo Industries plc v Dickman* [1990] 1 All ER 568, 589.
[31] Cf. Giesen (1999), p. 42.
[32] Giesen (1999), p. 42, with further references.

VI. Termination and adaptation of contracts for the performance of a continuing or recurrent obligation

13. ***General remarks***

In service contracts each party often relies on the cooperation of the other. Sometimes the parties are so closely attuned to each other that they are virtually interdependent. This applies to long-term contracts, especially contracts for the performance of a continuing or recurrent obligation, in which the contractual relationship may last for years.[33] In the general part of the law of contract, however, scarcely any provisions have been designed specifically to cover continuing or recurrent obligations. The necessary rules have therefore been developed by the courts.

14. ***Open-ended contracts***

Despite – or perhaps even thanks to – the lack of a statutory regime, and although the legal systems sometimes approach the issue from various different angles, most legal systems have developed similar rules on the termination of open-ended contracts. In France, for example, it is *d'ordre public* that contracts must not be concluded in perpetuity. This means that in French law both parties have the mandatory right to unilaterally terminate contracts for the performance of continuing or recurrent obligations.[34] According to the rulings of the *Cour de Cassation*, a party to a contract need not even have a 'legitimate interest' in termination, as long as he does not infringe the principle of good faith (*bonne foi*).[35] He must, however, give due notice of termination, so that the other party can adapt to the new situation and has enough time to look for a new partner.[36] Failure to give adequate notice, the length of which is determined by good faith, customary law or statute, makes the terminating party liable to pay damages.[37] In some areas of contract law, the right of termination has always been combined with an entitlement to compensation in order to protect socially vulnerable parties. In some types of statutory contract, the need to afford such protection is reflected in the requirement that the terminating party must have a legitimate interest in termination, in derogation of the principle referred to above.[38] It is not possible, however, to exclude the right of termination from a contract. The only possibility consists in contractual limitations, such as agreed clauses on compulsory termination procedures and minimum periods of notice.

15. Although the prohibition of obligations in perpetuity does not always apply as strictly as in France and is even absent from some legal systems, all systems basically prescribe

[33] These might include contracts with insurers, banks and telephone service providers and could extend to contracts with schools and even with solicitors and doctors.

[34] See for example Ghestin, Jamin and Billiau (1994), points 239 *et seq.*, with further references. See also Cass. com., 15 December 1969, *Bull. civ. IV* point 384, *Juris classeur périodique (JCP)*, 1970.II.16391, per J.H.; Cass. com., 19 July 1971, *Bull. civ. IV*, point 213; Cass. civ., I 5.2.1985, *Bull. civ. I* point 54, p. 52, *Revue trimestrielle du droit civil (RTDCiv)*, 1986, p. 105, per Mestre.

[35] Cass. com., 15 December 1969, *Bull. civ. IV*, point 384, *JCP*, 1970.II.16391, Anmotastion by J.H.; Cass. com., 19 July 1971, *Bull. civ. IV*, point 213.

[36] Cass. com., 8 April 1986, *Bull. civ. IV*, point 58.

[37] Ghestin, Jamin and Billiau (1994), point 246.

[38] In the case of an agency agreement, for example; cf. Ghestin, Jamin and Billiau (1994), point 241.

fairly similar rules: termination is possible in principle, contractual restriction of the right of termination is permissible, but exclusion of the right is not. Statutory and judicial restrictions on the right of termination generally amount to the imposition of a minimum period of notice for the purpose of protecting the weaker party.[39] If the terminating party has good reason to terminate the contract, he can usually terminate immediately without having to comply with a minimum period of notice.[40] The right of termination therefore seems to be organised along similar lines in the various legal systems. Whether this really leads to legal uniformity in practice, however, remains questionable. There is still a great deal of harmonisation to be done in this domain.[41] Nevertheless, harmonising the relevant legal provisions does not appear to be an impossible task.

16. ***Adaptation of contracts***

There is, however, a lack of consistency in the solutions adopted by the Member States when it comes to determining whether and how contracts can be adapted or terminated in response to changed circumstances. The starting point, i.e. the fact that the parties are free to include provisions in their contract which relate to possible changes in the prevailing circumstances and/or to adapt or terminate the contract by mutual consent because of such changes, is, of course, the same everywhere. What is questionable, however, is whether a judge is permitted to amend or set aside a contract in the absence of any such contractual provisions, in other words at the request of only one of the parties. The European legal systems vary considerably on this point. In the United Kingdom and Ireland, the contract is set aside on the basis of the *frustration* theory if circumstances have changed to such an extent that the performance of the parties' contractual obligations has become radically different to what they had originally intended.[42] Winding up a contract that has been partly or sometimes wholly fulfilled may have the effect of entitling one party to repayment in order to make the consideration commensurate with the performance, which often implies a retroactive adaptation of the contract.[43] It is not possible, however, to amend an ongoing contract for the performance of a continuing or recurrent obligation. In practice, such a contract will be terminated and a new contract offered on different terms and conditions.[44] The same change of circumstances in Germany will not, as a rule, result in the termination of the contract but to its adaptation on the basis of the theory of *Wegfall der Geschäftsgrundlage* (fundamental change of circumstances, or *clausula rebus sic stantibus*). According to this theory, the adverse effects arising from the fact that fulfilment of the original contract has become an unreasonable expectation should be distributed between the two parties.[45] By

[39] For Germany, see for example Horn (1981), pp. 564 and 571-572, and Larenz (1987), p. 30; for England, Atiyah (1995), pp. 395 *et seq.*; for Austria, Koziol and Welser (1995), pp. 196-197 and Supreme Cout of Justice (OGH), 25 March 1980, *EvBl.* 1980/175; for the Netherlands, Asser-Hartkamp II (1997), points 310-311.
[40] See for example Larenz (1987), p. 32 for Germany and Koziol and Welser (1995), p. 197, for Austria.
[41] It seems to us that the situation in English law in particular could deviate from the norm, since Atiyah (1995, p. 397) states that there is no obligation to act in good faith in this matter either and that the parties are essentially free to exercise the right of termination as they please.
[42] Cf. Tallon (1998), pp. 329-330.
[43] Cf. Atiyah (1995), pp. 243-244.
[44] Cf. Atiyah (1995), pp. 395-396.
[45] Cf. Larenz (1987), pp. 321 *et seq.*

and large, the German solution has been adopted in Greece, Austria, Italy and the Netherlands.[46] The French, Belgian and Luxembourg civil codes, however, have not embraced the theory of *imprévision*. The consequence of the principle of adherence to a contract in those countries is that the parties must fulfil the contract if possible, even if fulfilment has become more difficult and disadvantageous for one of the parties.[47] Setting aside or termination of the contract (possibly combined with the offer of a new contract) in the common-law countries, adaptation of the contract in the countries influenced by German law and simple fulfilment of the original contract in the Member States whose provisions are based on those of the French *code civil* – a more diverse range of solutions to these problems is scarcely conceivable. Particularly in the domain of service provision, where, as we observed above, contractual relations are often maintained over a period of years, this sort of legal diversity is undesirable. We shall return to this point later.[48]

[46] Cf. Tallon (1998), pp. 329-330.

[47] Cf. Tallon (1998), pp. 329-330. In France, judicial intervention in a contract is only possible if, through the act of a public authority (*fait du prince*), the basis and substance of a party's obligation are partly nullified but the partial fulfilment of the contract remains possible. In such a case, the parties are released from some of their contractual obligations but remain bound by the contract in all other respects. Even in these circumstances a proper revision of the contract is not undertaken; cf. Ghestin, Jamin and Billiau (1994), point 282.

[48] See below in chapter III of the present study.

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The law governing insurance contracts

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I. Introduction

1. *Financial services*

The concept of financial services has come into European law from the world of economics. The term is not comprehensively defined in Community law but is explained by the enumeration of examples. In Annex II of Directive 97/7/EC on distance contracts, the following services are listed as financial services: investment services, insurance and reinsurance operations, banking services, services of collective investment undertakings and operations relating to dealings in futures and options; in order to further define these individual categories, the annex then goes on to refer to other legal instruments of the Community.[1] Nor is there any established comprehensive interpretation of financial services in the national legal systems of the Member States. In particular, the concept does not relate to any sort of standard contract. So the search for differences between the national legal systems of the Member States in this domain can only serve a useful purpose if it focuses on individual statutory contract types. The insurance contract lends itself particularly well to this sort of examination, because it is recognised as a separate form of contract in all the legal systems of the Member States.

2. *The law governing insurance contracts*

On closer inspection, however, the situation with regard to the sources of the law governing legal contracts in the Member States is actually highly complex. Although the national legal systems concur in so far as they apply the general provisions of the law of contracts to insurance contracts, these provisions are often overridden in many respects by special laws on insurance contracts, laws which contain numerous peremptory and semi-peremptory rules. The only countries without such special legislation – apart from a few narrowly defined exceptions – are the United Kingdom and Ireland, where the courts try to solve the particular problems of insurance contracts with the instruments of the general law of contracts. The following remarks cannot provide a full-scale comparison of the general law of the EU Member States in the realm of insurance contracts. Instead, they highlight some specific problems relating to the general law of insurance contracts, problems which are of particular relevance to the actual development of a single

[1] European Parliament and Council Directive 97/7/EC on the protection of consumers in respect of distance contracts (OJ L 1997 144/19), Annex II.

European insurance market on the one hand and which reveal considerable disparities between national approaches on the other.

II. Freedom to contract

3. *Compulsory insurance*

The parties to an insurance contract will normally have been free to decide whether to conclude the contract at all and whether to conclude it with a particular partner. The principle of freedom to contract is not, of course, absolute. In the Member States, for example, there are various numbers of compulsory insurance schemes. In the case of third-party motor insurance, indeed, the obligation to insure is even laid down in Community law.[2] Compulsory insurance does not necessarily imply that insurers are compelled to contract with every applicant. In a competitively organised insurance market, however, there is every reason to assume that all those who are subject to compulsory insurance will find an insurance company that is willing to cover their respective risks, though not always on the same terms and conditions. Be that as it may, some countries do have compulsory contracting. The German Compulsory Insurance Act (*Pflichtversicherungsgesetz*) provides expressly for compulsory motor insurance with third-party cover in section 5(2).[3] Although French law does not provide for this type of compulsory contracting, it does drastically curtail the right of insurers to cancel any form of compulsory insurance policy in the event of a claim.[4]

4. *Consumer insurance (Sweden)*

Legislatures seldom curb freedom to contract outside the realm of compulsory insurance. The statutory obligation to contract that applies to consumer insurance in Sweden, however, is a notable exception.[5] This provision, like the entire Consumer Insurance Act (*Konsumentförsäkringslag*), applies to six types of insurance that are listed in section 1 of the Act, namely house contents insurance, buildings insurance, holiday homes insurance, travel insurance, motor insurance and boat insurance. The contours of this contracting obligation are so blurred that any foreign insurance company would be taking a great risk

[2] Article 3 of Council Directive 72/166/EEC of 24 April 1972 on the approximation of the laws of Member States relating to insurance against civil liability in respect of the use of motor vehicles and to the enforcement of the obligation to ensure against such liability (OJ 1972 L 103/1); for more details, see Bernhard Rudisch, 'Europäisches Kfz-Haftpflichtversicherungsrecht: Grundlagen, Bestand und aktuelle Entwicklungen', in *Zeitschrift für Verkehrsrecht* 43 (1998), p. 219.

[3] As promulgated in the Federal Law Gazette (BGBl) of 5 April 1965 (BGBl. I, p. 213) and last amended by the Act of 21 July 1994 (BGBl I, p. 1630); the version currently in force is reproduced, for example, in Prölss and Martin, *Versicherungsvertragsgesetz* (26th edition, 1998, pp. 1445 and 1471.

[4] See Article A 211-1-2 of the *Code des Assurances*; cf. Yvonne Lambert-Faivre, *Droit des assurances*, 10th edition, 1998, point 519.

[5] Section 9 of the *Konsumentförsäkringslag* (1980:38); the English translation of this provision is as follows: "An insurance company may not refuse to enter into a contract of insurance with a consumer where the insurance is of a type which the company normally offers to the general public. The first paragraph shall not apply if the insurance company, taking account of the risk of the occurrence of the insured event, the probable extent of the damage or other circumstances, has special reasons not to provide the insurance." Cf. Bertil Bengtsson, *Försäkringsrätt* (4th edition, 3rd impression), 1997, p. 35.

if it offered insurance cover in Sweden unless it had many years' experience in dealing with this provision.

III. Maximum term of contracts

5. ***Statutory minimum and maximum terms***
A distinction has to be made between the period of insurance as the basis for the actuarial assessment of premiums and the duration of the contractual relationship. In the Member States, the term of an insurance contract is traditionally fixed by the parties exercising their freedom of contract. Since it is the insurer's prerogative to formulate the terms and conditions of an insurance policy, there is a danger at this point that insurers will draw up one-sided contracts, protecting their own interests at the client's expense.

6. Studies in the field of comparative law highlight two problem areas. In the United States, the periods for which insurance contracts are concluded are tending to become shorter, with some buildings policies being concluded for only one year and the odd motor policy even being restricted to three months. In this way the insurers seek to maximise their premium-setting flexibility in such a way that they can adapt their own investment policy rapidly to interest and yield fluctuations in the financial markets.[6] To curb excesses in this direction, some state legislatures in the United States have adopted laws laying down a minimum term for various types of insurance policy.[7]

7. There are no indications anywhere in Europe of insurers trying to insist on insurance periods of less than one year or even wishing to do so. On the contrary, in some Member States they have traditionally been more interested in the lengthiest possible commitment to their policies in order to finance their marketing systems. In countries such as Spain and the United Kingdom, where the sale of insurance policies is largely in the hands of independent middlemen (insurance brokers), annual contracts have become established in practice;[8] the annual renewal of policies gives the brokers considerable influence. Where companies, on the other hand, market most of their policies through their own network of agents, their desire for long-term customer commitment is reflected in the nature of the contracts they have concluded. In some cases the stipulated contractual periods have been so lengthy that they seriously restricted the insured parties' purchasing power and led to vociferous calls for government intervention. As long as the terms and conditions of insurance policies were subject to the approval of regulatory authorities, the clause stipulating the period of insurance was the main target of state control, but since prior

[6] Katrin Kühnle, *Die Bindung an den Versicherungsvertrag*, 1998, p. 29.

[7] Kühnle, *op. cit.*, p. 31, footnote 6.

[8] For the United Kingdom, see Ray Hodgin, *Insurance Law*, 1998, p. 125, and Malcolm Clarke, *The Law of Insurance Contracts* (3rd edition), 1997, p. 292; for Spain, see Olaf Polster, *Das spanische Privatversicherungsrecht*, 1998, p. 136, which contains references to Spanish sources.

authorisation was abolished by the third generation of European directives,[9] mandatory provisions of private law are increasingly filling the vacuum.

8. ***Maximum periods of insurance and inalienable rights of termination***
National laws differ in this respect, not only in the effective length of the maximum period of insurance but also in the technical detail and scope of their rules. In some Member States the legislature explicitly lays down maximum periods of insurance, which means that clauses stipulating longer periods are illegal and hence null and void; whether such a clause renders the entire contract null and void is not specified in the laws governing insurance contracts and is a matter for the general law of contracts. Maximum periods are laid down by law in Belgium, Spain and Sweden, for example.[10] In other Member States, however, the law normally respects the contractual agreement regarding the period of insurance but imposes an inalienable right of termination, which takes effect once the contract has run for a precisely defined length of time; this approach has been adopted by France, Italy, Germany and Austria, for instance.[11] The two regimes are functionally equivalent, at least in so far as they both permit the dissolution of the contract after a certain period of time, irrespective of the terms and conditions agreed in the contract.

9. ***Time limits***
These maximum periods of insurance, however, vary widely between Member States. While Italy and Spain permit ten-year contracts,[12] the legislation of the last decade reveals a tendency to harmonise laws in this domain by introducing shorter maximum periods and even one-year contracts. One-year limits are already enshrined, at least for private policies, in Sweden, France and Belgium and probably in Greece too.[13] In Austria, if the insured is a consumer, he or she may terminate the contract after three

[9] Article 29 of Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive) - OJ 1992 L 228/1 - and Article 29 of Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive) - OJ 1992 L 360/1.

[10] For Belgium, see the first sentence of Article 30(1)(1) of the Land Insurance Contracts Act of 25 June 1992, promulgated in the *Moniteur belge* of 20 August 1992; for Spain, see the first sentence of Article 22(1) of Law No 50/1980 of 10 October 1980, promulgated in the *Boletín Oficial del Estado* No 250 of 17 October 1980; for Sweden, see section 10 of the Consumer Insurance Act (footnote 5 above).

[11] For France, see the first sentence of Article L. 113-12(2) of the *Code des Assurances*; for Italy, see the second sentence of Article 1899(1) of the *Codice civile*; for Germany and Austria, see the first sentence of section 8(3) of each country's Insurance Contracts Act (*Versicherungsvertragsgesetz*).

[12] See the references in footnotes 10 and 11 above; on the Italian rules, see also Antigono Donati and Giovanna Volpe Putzolu, *Manuale di diritto delle assecurazioni* (5th edition), 1999, p. 139; on Spanish practice, see the reference in footnote 8 above.

[13] For Sweden, see section 10 of the Consumer Insurance Act (footnote 5 above); for France, see Article L. 113-12 of the *Code des Assurances*; for Belgium, see the first sentence of Article 30(1)(1) of the Insurance Contracts Act (footnote 10 above); for Greece, see Article 8(1) and (6) of Law No 2496 of 16 May 1997, of which I have an English translation, produced privately by Manessiotou and Murray of Rokas and Partners, a firm of solicitors in Athens.

years,[14] while Germany grants the right of termination to all insurers and insured after five years.[15]

10. ***Privileged categories of people***

When it comes down to detail, these rules diverge considerably. This applies especially to their scope. Although the various laws show that the protection afforded by statutory restriction of contract periods is primarily designed to benefit insured individuals, the way in which this aim is pursued differs somewhat from one Member State to the next. In Austria, only consumers are entitled to terminate insurance contracts, whereas insurers and other types of client are not. The Swedish law also ultimately favours the consumer alone; the right to terminate does not apply to other policyholders, and the insurer, as was mentioned above, is subject to compulsory contracting. The maximum period of insurance under Belgian law applies in principle to all insurance contracts, but the main forms of commercial insurance policies are excluded, which reduces the scope of this protection to policies for private purposes, albeit by a process of negative selection.[16] In French law too, termination is open to both parties to an insurance contract, including policyholders of all types; the right to terminate, however, is subject to the disposition of the parties, except in cases where the cover relates to private risks. In German law, all policyholders – not just consumers – enjoy an inalienable right of termination after five years.[17] The Greek law of 1997, with its maximum period of one year, seems to benefit all policyholders rather than consumers only.[18]

11. ***Résumé***

This brief summary must suffice. It amply demonstrates that, as far as the maximum term of an insurance contract is concerned, only one-year policies are suitable for use on a European scale. If, however, an insurer from a country in which policies with longer periods of insurance are essentially recognised by the law – even though they may be subject to a right of termination – has the idea of offering these policies in countries such as Belgium, Sweden or Greece, that insurer is running a twofold risk: the first is that, depending on the type of insurance cover the policy provides, the clause in which the period of insurance is stipulated, or even the entire policy, may be null and void, and the second is that a situation may arise in which the policyholder is able to terminate the policy at any time, whereas the insurance company is bound by the longer contract term

[14] See footnote 11 above.

[15] See footnote 11 above.

[16] The list of the excepted insurance categories is reproduced in Marcel Fontaine, *Droit des assurances* (2nd edition), 1996, p. 187, point 329 and footnote 232.

[17] Under section 15a of the German Insurance Contracts Act, it is possible to derogate from section 8(3) in favour of the insured party in such a way that the insurer remains bound to continue providing cover beyond the mandatory five-year period.

[18] Under Article 33 of Law No 2496 (see footnote 13 above), contractual derogations in favour of the policyholder can prevent an insurer from invoking the maximum term of one year if the parties have agreed on a longer term in the insurance contract.

as stipulated. This constitutes a flaw in the single market, a flaw that is made all the more regrettable by the fact that most of the national rules discussed here have only been adopted in the last twenty years, in other words at a time when the integration of the insurance markets covered by the market regulations proper had already begun.

IV. Behavioural obligations of policyholders between conclusion of the contract and occurrence of the event

12. ***The three phases of a contract***

Insurance contracts generally require policyholders to fulfil behavioural obligations which relate to three phases in the life of a contract: (1) the requirement to provide all relevant information when the contract is being concluded, (2) behavioural obligations during the period prior to the occurrence of the event, and (3) obligations after the event. The following paragraphs focus on the second group of obligations, which serve to maintain the contractual balance between the premium and the insured risk.

13. ***Opportunism***

The regulation of these behavioural obligations is at the heart of the law governing insurance contracts in all Member States; this regulation partly concerns the breach of these obligations as such and also relates in part to the more general aspect of increased risk. To effect this regulation, the national legal systems essentially avail themselves of the same elements: obligations to notify the insurer of relevant changes, scope for adjustments to the contract, termination rights and the possibility of non-liability for the insurance company all interact, but in widely diverse combinations from one country to another. The legal position is therefore far from easy to digest.[19] The significance of these problems in terms of the law governing insurance contracts and market practice must not be underestimated. It follows from the danger of opportunistic behaviour which is inherent in a risk-related contract for the performance of a continuing obligation such as an insurance contract.[20] Risks of opportunism arise when, in an incomplete contract relating to future eventualities, one side is more firmly bound than the other. There is then a great incentive for one party to adjust the contractual balance subsequently at the other party's expense by restrictive interpretation of its own obligations.

14. Opportunism in terms of subsequent alteration of the risk can come from either party. Trusting in the existing cover they are buying at the agreed premium, policyholders tend not to give any further thought to the insured risk as they go about their everyday lives and are oblivious to unavoidable increases in that risk, even if these increases are ascribable to their own conduct. On the other side of the coin, insurance companies seek

[19] See the highly sophisticated treatment of the subject in Reimer Schmidt, 'Einfluß des Verhaltens des Versicherten auf die vertraglich zugesagte Gefahrtragung (warranty, misrepresentation, concealment; réticences, déchéances; Obliegenheiten)', in *Materialien des zweiten Weltkongresses für Versicherungsrecht der Internationalen Vereinigung für Versicherungsrecht IV* (1967), pp. 13 *et seq.* and especially pp. 29 *et seq*.

[20] See for example Deregulierungskommission (German Deregulation Commission), *Marktöffnung und Wettbewerb*, 1991, point 48.

to minimise the risk they have incurred. To that end, they may effect what amounts to an adjustment of the cost-performance ratio to their own advantage without altering the premium.

15. The legal resolution of this problem constitutes a special form of the *clausula rebus sic stantibus*[21] which is reflected in the general civil law of the Members States. The fact that the Member States have seen fit to create a special set of rules for insurance contracts alongside their general codes of civil law demonstrates the importance of this issue in relation to the functioning of insurance markets. In this context, the lack of uniformity of national rules that is highlighted when the various legal systems are compared raises the question whether a European insurance market can develop at all without a harmonisation of these rules.

16. ***Risk limitation and obligations***
The risk-related behavioural requirements that are imposed on policyholders vary in terms of legal technicalities. In some cases they are treated as exceptions to the insured risk or as risk limitations, as in the example of a policyholder whose accident cover excludes accidents sustained in the pursuit of a dangerous sport such as parachuting or mountaineering. Other insurers try to achieve the same effect by contractually engaging policyholders to refrain from such dangerous sports. The term used in German legal language for this type of obligation is *Obliegenheit* rather than *Pflicht*, because failure to comply with such a requirement is not of itself actionable, nor does it give rise to an entitlement to compensation; by breaking this type of behavioural rule, the policyholder will only forfeit certain benefits, notably his or her entitlement to insurance cover.

17. Whether the insured risk is restricted or whether the policyholder undertakes to refrain from a particular type of behaviour should not actually make any difference in terms of legal implications, but that is not the case everywhere. English common law in particular draws a clear distinction between *exceptions* and *warranties*. In the case of an exception, the insurer is only exempt from liability for damage in so far as it resulted from the occurrence of the high risk that is excepted from the insurance cover; a breach of warranty, on the other hand, has the legal effect of terminating the insurance contract, irrespective of causality.[22] This legal consequence highlights another important difference, namely that insurance cover continues in the event of an exception, whereas the contract only survives a breach of warranty if there is clear circumstantial evidence that the insurance company does not wish to invoke the termination clause.[23] Because of the severe sanctions that common law imposes for breach of warranty, English courts are somewhat reluctant to regard a contractual obligation as a warranty.[24] In other Member

[21] Reimer Schmidt, *op. cit.* (see footnote 19 above), p. 8.

[22] See Clarke, *op. cit.* (see footnote 8 above), pp. 530-531, which contains numerous examples from case law, and p. 546.

[23] This is the principle of *estoppel*; for details, see Clarke, *op. cit.* (see footnote 8 above), p. 552, which contains numerous examples from case law.

[24] See Clarke, *op. cit.*(see footnote 8 above), pp. 526-527.

States, the distinction between risk restriction and behavioural obligations seems to mean little in terms of legal implications, but here too the nature of the subject makes it difficult to draw a clear dividing line.

18. ***Notification requirements***

In the event that a breach of obligation causes an increase in the insured risk, the continental legal systems all require the policyholder to notify the insurer of the increased risk.[25] Not all countries have such a statutory notification requirement, but in any case it is regularly imposed on policyholders through the insurance contract.[26] Be that as it may, the insurer is not generally notified of an increased risk until the event has occurred and the insured submits a claim on his or her policy. In this situation, two questions arise: one concerns the fate of the contract, and the other concerns the insurer's obligation to pay. In the following paragraphs, we shall confine ourselves to an examination of the second question.

19. ***The insurer's freedom from liability***

The legal systems of the Member States agree that the breach of a behavioural obligation by the policyholder influences the extent of the insurance company's obligation to pay out, but this principle is put into practice in a number of widely divergent ways.

20. ***Common Law***

The one extreme is common law, in which a breach of warranty, as was mentioned above, results in the immediate and automatic termination of the contract; this means that the insurer is released from liability whether or not the policyholder acted culpably and whether or not the breach of warranty actually caused the damage in question; these effects ensue even if the insurance company des not terminate the contract.[27] Although this draconian sanction has attracted criticism from the Law Commission for England and Wales, which proposes a *de lege ferenda* solution whereby the insurer would only be free from liability if the breach of warranty had been instrumental in the occurrence of the damage,[28] the situation in English law, unlike some other common-law systems, has remained unchanged.

21. ***Sweden***

The other extreme in this European comparison may be found in the Swedish Consumer Insurance Act, which lays down in principle that the insurer remains liable in the event of a breach of obligation by the policyholder, even if the breach is intentional, although it does provide for the possibility of a reduced payout. The amount of this reduction is determined on the one hand by the degree of culpability of the insured and on the other

[25] With regard to France, for example, see Article L. 113-2(1)(3) of the *Code des Assurances*; for Belgium, Article 26(1) of the Land Insurance Contracts Act (footnote 10 above); for Spain, Article 11 of Law No 50/1980 (footnote 10 above); for Italy, Article 1898(1) of the *Codice Civile*; for Germany, section 23(2) of the Insurance Contracts Act (VVG); for Austria, section 23(2) of the Insurance Contracts Act (VersVG).

[26] For the situation under common law, see Clarke, *op. cit.* (footnote 8 above), pp. 526 and 536.

[27] *The Good Luck*, 1992, 1 AC, pp. 233 and 262; cf. Clarke, *op. cit.* (footnote 8 above), pp. 545-546.

[28] See The Law Commission, *Insurance Law: Non-Disclosure and Breach of Warranty*, (Law Com. No 104) Cmnd 8064 (1980); see also the annotated version in Hodgin, *op. cit.* (footnote 8 above), pp. 320-322.

hand by the extent to which the damage or its severity is ascribable to the breach of obligation.[29] In German and Austrian law too, freedom from liability is not automatically prescribed by the law but must be specifically stipulated in the contract,[30] which is often the case in practice.

22. ***The other systems***

The legal systems that lie somewhere between these extremes also differ considerably among themselves with regard to the causal relationship between the behavioural breach and the occurrence of damage, the significance of culpability and, thirdly, the extent of freedom from liability. Several European legal systems do not treat breaches of contractual behavioural obligations by policyholders as a separate issue but as part of the problem of increased risk. In the event of damage, they ask what adjustment to the premium would have been agreed if the insurer had known in good time of the increase in the risk and the contract had been altered. The performance for which the insurer is liable should then be in the same ratio to the sum insured as the hypothetical premium is to the actual premium paid.[31] The situation is therefore treated as if the hypothetical insurance contract included a subpolicy providing cover against the breach of obligation. Seen in this light, the increase in the risk is tantamount to an objectively established fact, which renders the culpability of the policyholder irrelevant.

23. Since these legal systems identify the basic problem as the imbalance between the increased risk and the agreed premium, the question of the extent to which risk-increasing behaviour, i.e. a breach of obligation, has caused the damage or influenced its severity is not asked by the law.[32] Be that as it may, some specialised literature and court rulings in those countries too have contained calls for the proportional reduction of insurance payouts to be limited to cases in which the increase in the risk has been conducive to the occurrence of the insured event.[33] In Germany, on the other hand, the law lays down that, in the event of either a breach of obligation or an increase in the risk,

[29] For more details, see section 31(1) of the Act referred to in footnote 5 above; this provision states that "If an insured has intentionally or negligently failed to fulfil his obligations to the insurance company pursuant to the terms of the insurance, the amount of the cover may be reduced with regard to him. The reduction shall be made on the basis of that which is reasonable taking into account the effect which the failure had upon the occurence of the insured event and the extent of damage, as well as to the insured's intent or negligence, and other circumstances". See also auch Bengtsson (footnote 5 above), pp. 66-67.

[30] For Germany, see Wolfgang Römer in Wolfgang Römer and Theo Langheid, *Versicherungsvertragsgesetz*, 1997, section 6, points 13 and 100; for Austria, see Helmut Heiss in Helmut Heiss and Bernhard Lorenz, *Versicherungsvertragsgesetz* (2nd edition), 1996, section 6, point 42.

[31] For France, see for example Article L-113-9(3) of the *Code des Assurances*; for Italy, Article 1898(5) of the *Codice Civile*; for Spain, the third sentence of Article 12(2) of Law No 50/1980 (footnote 10 above); for Belgium, Article 26(3)(1)(b) of the Land Insurance Contracts Act (footnote 10 above); for Greece, Article 4(2) of Law No 2496 (footnote 13 above) in conjunction with Article 3(5) ofthe same Law.

[32] This is explicitly stated in relation to France in Lambert-Faivre, *op. cit.*(see footnote 4 above), point 337, and in relation to Italy by Donati and Volpe Putzolu (footnote 12 above), p. 123, but see also footnote 33 below.

[33] This is characterised as the dominant view in Italy by Antonietta Bianchi Pitter in Giorgio Cian and Alberto Trabucchi, *Commentario breve al Codice civile* (5th edition), 1997, Article 1898, point 5; see also footnote 32 above.

the insurer is only released from liability if the risk-increasing conduct of the policyholder has had an influence on the occurrence or severity of the damage and if this conduct is culpable.[34] If the insurance company is released from its liability on this basis, this will normally be a complete release; only if this sanction appears grossly inequitable does the judiciary grant partial exemptions.[35] In Austria, the 1994 amendment of the Insurance Contracts Act combined the two approaches: on the one hand, as in Germany, the policyholder must be culpable and the breach of obligation must have influenced the occurrence and/or extent of the damage, but even if these conditions apply, the insurer's obligation is only reduced *pro rata* in accordance with the ratio of the hypothetical to the actual premium.[36]

24. ***Résumé***

To sum up, most insurance contracts impose behavioural requirements on policyholders, the purpose of which is to avoid risk increases and thus to maintain the balance between the premium and the risk. As was mentioned above, policyholders seldom take note of these preformulated principles and often fail to adhere to them. For this reason, the question whether and to what extent such breaches release insurers from their obligation to pay out benefits assumes great economic importance. Given the legal position in the Member States as outlined in the preceding paragraphs, insurance companies wishing to market their policies throughout Europe must be ready for anything because, under European legislation, the law of the policyholder's country of residence applies to international insurance contracts.[37] This can mean that a breach of obligation in England would entirely absolve an insurance company of its liability for payment of the sum insured, whereas a breach of the selfsame obligation in Austria might have no effect on the insurer's liability if the breach had not been in any way instrumental in the occurrence of the damage; intermediate effects, such as the proportional limitation of the insurer's liability in France or, in the case of Sweden, the totally unpredictable possibility of a court judgment limiting liability, are conceivable. This is not an adequate basis for a calculated or even calculable system for processing claims and hence for the marketing of standard insurance policies on a European scale.

25. This comparative review has used three questions to illustrate the differences between the Member States' legal systems in the domain of insurance contracts, differences which have undoubted implications for the marketing of policies in the European single market and which are a huge obstacle to the cross-border provision of services.

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[34] Section 6(1) and (2) and section 25(2) and (3) of the Insurance Contracts Act.

[35] See Römer in Römer and Langheid, *op. cit.* (footnote 30 above), section 6, point 108.

[36] See section 6(1) and (2) as well as section 6(1a) of the Insurance Contracts Act; cf. Heiss in Heiss and Lorenz, *op. cit.* (footnote 30 above), section 6, point 2.

[37] See Article 7 of Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC in OJ 1988 L 172/1; for details, see Jürgen Basedow and Wolfgang Drasch, 'Das neue Internationale Versicherungsvertragsrecht', in *Neue Juristische Wochenschrift (NJW)*, 1991, pp. 785 *et seq.*; see also Article 4 of Second Council Directive 90/619/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC in OJ 1990 L 330/50.

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Non-contractual obligations, especially the law of tort

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I. The basic characteristics of non-contractual liability

1. *The law of tort*

Even from a superficial glance at the laws governing non-contractual liability in the European Union[1] the observer can quickly distinguish three groups of countries. First of all there is the common law of England and Ireland, which also radiates into Scots law in some key areas such as liability for negligence.[2] Common law is traditionally based on numerous individual 'torts' (wrongful acts). The system is at least outwardly reminiscent of the way in which the continental systems of criminal law tend to be structured. It must be said that the significance of these torts in the practical administration of justice varies widely. Although there must be about seventy recognised torts,[3] only a few of them play a significant role in everyday legal proceedings. The most common tort is trespass in all its forms, but actions for negligence and private nuisance also feature prominently. There are also specialised laws on numerous aspects of liability. Their large number largely derives from the rather narrow scope of each law. It is surely safe to say that English law is probably the European legal system with the largest number of special statutes on liability at the present time.[4]

2. *Systems with a basic norm*

All other European systems of liability law start from a basic legal norm, which may comprise several elements. This is the position not only in the legal codes of continental Europe but also in the systems of the three Scandinavian Member States. The latter are rooted in the so-called *culpa* rule, which is part of common law in Denmark and is enshrined in the relevant Damages Acts in Finland and Sweden.[5]

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[1] The subject of the following report is covered in greater detail in von Bar, *Gemeineuropäisches Deliktsrecht.* Vol. I: *Die Kernbereiche des Deliktsrechts, seine Angleichung in Europa und seine Einbettung in die Gesamtrechtsordnungen* (1996) and Vol. II: *Schaden und Schadensersatz, Haftung für und ohne eigenes Fehlverhalten, Kausalität und Verteidigungsgründe* (1999). Where details have been omitted from this report, they can be found quite easily in these two volumes.

[2] The case of Donoghue v. Stevenson [1932], A.C. 562, is of enormous importance, not only in its impact on the development of general liability for negligence but also in its contribution to legal uniformity within the United Kingdom in the domain of non-contractual liability, because this leading judgment was based on the assumption that Scots and English law were substantively identical in the matters under examination. *Donoghue v. Stevenson* was 'nominally' a Scots case.

[3] Rudden, in Torticles, Tul.Civ.Law Forum 6/7 (1991-92), pp. 105-129, counted 72 torts.

[4] Listed in von Bar (Shaw), *Deliktsrecht in Europa, England und Wales* (1993).

[5] German translations may be found in von Bar (Witte), *Deliktsrecht in Europa, Schweden* (1993) and in Fasterling, *VersRAI*, 1995, pp. 14-16.

3. ***General clauses***

The aforementioned basic norms, however, differ from each other in many different respects. It is customary to group together those laws which are based on the simple legislative principle that anyone who has injured another person by conduct which deviates from the required standard is obliged to compensate the injured party for the effects of that conduct. It is normal practice in German legal terminology to refer to this as a general clause (*Generalklausel*), and Articles 1382 and 1383 of the Belgian, French and Luxembourg civil codes naturally spring to mind in this context. Another provision in this group is Article 1902 of the Spanish Civil Code, which only differs from its French model in that its wording explicitly covers the civil liability of corporate entities as well as natural persons.

4. ***Greece and Italy***

There are possibly grounds for disputing whether Greece and Italy may be included in the category of countries that operate with a general clause. Article 914 of the Greek Civil Code contains a blanket norm which states that injurious conduct gives rise to liability if it is unlawful. Reading this as a German lawyer, I am initially reminded only of section 823(2) of the German Civil Code. The Supreme Court inAthens (*Areios Pagos*), however, has long held that the 'laws' referred to in Article 914 include the provision of the Greek Civil Code concerning good faith, so it may be said that Greek law has at least moved in the direction of a general clause. A similar situation obtains in Italy, where Article 2043 of the *Codice civile* only deviates from the formulations contained in the other Roman-based codes in so far as it requires 'unjust injury' (*danno ingiusto*) before a person can be held liable for damages. Initially, the Italian courts interpreted this expression in such a way that its main characteristics were akin to those of section 823(1) of the German Civil Code. Later, however, they abandoned this position and began to recognise other rights, especially relative rights and a 'right to the integrity of one's own assets'. With the possible exception of the specifically Italian concept of 'biological injury' (*danno biologico*), Italian law has subsequently been far more squarely in the mainstream of European legal development than German law.

5. ***Portugal, Austria and Germany***

A separate group of basic norms of liability law may be found in Portugal, Austria and Germany. These three countries have refined and/or interpreted their liability provisions in considerably greater detail than has been the case in the other continental legal systems and in the Scandinavian systems. The most restrictive of these provisions is Article 483 of the Portuguese Civil Code, which recognises only the infringement of absolute and statutory rights and of protective laws as giving rise to liability. Liability for 'wilful damage committed in breach of good morals', as recognised – though sometimes expressed in more contemporary language – by the Austrian, German, Dutch, Greek and Finnish legal systems, does not feature in the Portuguese Civil Code. Section 1295 of the Austrian General Civil Code (*Allgemeines Bürgerliches Gesetzbuch*), on the other hand, is actually worded like a real general liability clause, but it is not read in that way by the courts, which normally interpret it in accordance with the German model (section 823(1) of the German Civil Code). The German Civil Code, for its part, divides the basic norm

governing civil liability into three parts: liability arises from (a) infringement of an absolute or statutory right, (b) infringement of a protective law, and (c) wilful damage committed in breach of public policy.

6. ***Pure economic losses***

Various legislative strategies, it must be said, do not automatically translate into practical results. If it is at all possible to highlight a key area in which the theoretical approach and social reality are out of step with each other, that area will surely be pure economic losses. When the German Civil Code (*Bürgerliches Gesetzbuch*) appeared on the European scene a hundred years ago, one of the aims behind its creation was that it should outshine the French Civil Code. The authors of the *Bürgerliches Gesetzbuch* intentionally omitted purely pecuniary interests from the rights protected by section 823(1). If we approach non-contractual liability law from the perspective of this type of loss, we can say that the fissure which still divides European liability law today is not between common law and the systems of continental Europe but actually between the 'Germanic' and 'Roman' systems. The case of *Hedley Byrne* v. *Heller*[6] suggests, or perhaps even proves, that the similarities between German law and English common law are far greater than those that exist between German and French law, for example. Against this background, it must be said that the legal systems which have tried to bridge this gap between France and Germany have assumed a veritable strategic role in the field of comparative law today. I am referring here to the Scandinavian systems and especially to the Dutch system, which gives me the impression of being the foremost bridge-builder in this domain.

7. ***Article 6:162 of the Dutch Civil Code***

The new Civil Code (*Burgerlijk Wetboek*) of the Netherlands was formulated on the basis of some brilliant comparative analysis. This analysis, along with a lengthy development process in Dutch case law and jurisprudence, paved the way for a provision which is extremely appealing in numerous respects. Article 6:162 translates into English as follows: "(1) Anyone who commits against another person or persons an unlawful act for which he can be held accountable shall be required to compensate the other for any loss or injury thereby sustained. (2) An encroachment upon a right and an action or omission contrary to statutory obligations or to a code of social conduct based on unwritten laws shall be regarded as an unlawful act in the absence of legally recognised justification. (3) A person may be held accountable for an unlawful act if he has culpably caused the act to be committed or if, in law or by generally accepted standards, the cause of the act is one of the risks for which he is liable."[7] So although the new Dutch Civil Code, unlike its forerunner and borrowing from the German model, has emphasised the role played by the infringement of a right or law in establishing liability for damages, it has not left it at that. On the contrary, it also recognises what we in Germany might call "generally

[6] Hedley Byrne & Co. Ltd. v. Heller and Partners [1964], A.C. 465, is such an important judgment because it extended liability for negligence in the provision of information to cover purely financial loss es.

[7] Translated into English from the German translation in Nieper and Westerdijk, *Niederländisches Bürgerliches Gesetzbuch. Buch 6 Allgemeiner Teil des Schuldrechts, Bücher 7 und 7A Besondere Verträge* (1995).

accepted obligations to protect other persons' property". Moreover, the new *Burgerlijk Wetboek* manages to reflect in its basic norm both of the sources of accountability in modern liability law, namely liability for culpable actions and the strict liability that arises from the law and/or from 'generally accepted standards'.

8. ***The concept of pure economic losses***

Whether the principle underlying Article 6:162 of the Dutch Civil Code can ultimately be 'Europeanised' remains to be seen. It is certainly important to recognise that liability for purely financial loss es cannot be discussed on a European scale unless the protagonists are aware from the outset that the European legal systems themselves are still far from a common understanding of the concept. As was mentioned above, Italian courts have developed the device of the integrity of a person's own assets. English, Irish, Scottish, Swedish and Finnish lawyers would define a 'purely financial loss' as a loss that does not result either from injury of a person's physical integrity or from damage to his property.[8] For a German, Austrian or Portuguese lawyer, on the other hand, a loss is 'purely' financial if it has not been caused by the infringement of an absolute or statutory right. Many losses which are purely financial losses in the first five jurisdictions would be consequential losses arising from infringement of a right in the other three. Belgian, French or Luxembourg lawyers, for their part, would be able to make precious little sense of this whole category of losses. In their countries, only the principle of total reparation counts; a '*dommage purement économique*' is a concept of which they have probably never even heard.

9. ***Protection of intangible personal assets***

As far as the protection of intangible personal assets is concerned, the dividing lines cut across Europe in a different direction again. A person's honour and reputation, of course, are among the intangible assets that every system of private law has traditionally protected. With regard to the concept that is known in Germany, on the basis of the relevant decisions of both the Federal Court of Justice and the Federal Constitutional Court, as the 'general right of personality' (*allgemeines Persönlichkeitsrecht*) and which complements a whole series of so-called 'particular rights of personality', such as the right to prevent unauthorised commercial use of one's name and likeness, English common law[9] continues to be something of a special case. The protection of privacy, for example, is now guaranteed everywhere except in the British Isles, often on the basis of a general clause.[10] English law, however, has not yet developed a right to privacy or a tort of infringement of privacy. Here too, however, the trend is towards convergence. The Protection from Harassment Act 1997 was an important first step. More significantly, however, the British Parliament adopted the Human Rights Act 1998 shortly afterwards, thereby incorporating the European Human Rights Convention into English law. So there is reason to hope that English and Scottish courts might follow the path marked out for

[8] The only legal definition of a 'purely financial loss' is found in Sweden (chapter 1, section 2, of the Swedish Damages Act states that "In the present Act, purely financial loss shall mean an economic loss that is entirely unconnected with a person sustaining personal injury or damage to his property").

[9] The Irish Law Commission addressed this issue, albeit against a quite different constitutional background, in 1996 in its *Consultation Paper on Privacy: Surveillance and the Interception of Communications*. The Commission's report, however, only concerns one part of the overall problem.

[10] One example is Article 9 of the French Civil Code ("*Chacun a droit au respect de sa vie privée*").

them some time ago by the Irish judiciary so that the law of tort and delict can be used to extend the requisite protection of human rights and fundamental freedoms to 'horizontal' dealings between subjects of private law.

II. The place of the law of tort in the general structure of private law

10. ***General remarks***

Even these very brief remarks demonstrate that no meaningful review of the legal systems in the present European Union can confine itself to the 'lowest common denominator', in other words to the rules that are recognised by all legal systems as belonging to the law of tort or delict. The truth is that the law of tort or delict in every country is influenced by a host of extraneous rules, and there are scarcely two countries in which the same demarcation lines are drawn. This not only applies to the influence of constitutional law on the law of non-contractual liability.[11]

11. ***Property law***

A similar situation obtains, for instance, on the borderline between liability law and property law. One need only think of the rules regarding liability arising from the disturbance of neighbourly relations, which are still important today in the field of environmental law (*troubles de voisinage*, nuisance, liability under section 906 of the German Civil Code or analogous provisions, etc.), of the liability of persons in *bona fide* possession of goods who believe that they are dealing with their own property, of the general liability that arises from breaches of the peace and so forth. Some of the relevant rules come from quite a wide variety of legal sources. In particular, the rules concerning damages in disputes between neighbours are tending to develop into a strict regime almost everywhere.

12. ***Criminal law***

Considerable importance also attaches to criminal law. In the Scandinavian legal systems, which for centuries have regarded public criminal law and private liability law as two subsystems of a single body of compensation law, it is still observable today that decisions on the awarding of damages vary in many types of case according to whether or not the act giving rise to liability is a criminal offence. This extends even to liability for purely financial losses. In Spain, this principle is taken still further. Spanish liability law is divided into two parts from the outset. Liability for damages arising from a criminal offence is governed by the provisions of the Penal Code. The Civil Code, on the other hand, only covers liability for unlawful acts which are not criminal offences. Although Spain is the only European country to make this distinction, criminal law can also play a crucial role in individual liability cases in many other legal systems. Take Article 2059 of the Italian Civil Code, for example, which essentially states that the awarding of compensation for *il danno non patrimoniale*, i.e. immaterial damage, depends on a criminal offence having been committed (Article 185 of the Italian Penal Code), or the

[11] For details see von Bar, 'Der Einfluß des Verfassungsrechts auf die westeuropäischen Deliktsrechte', in *Rabels Zeitschrift für ausländisches und internationales Privatrecht (RabelsZ)* 59 (1995), pp. 203-228.

numerous provisions that exist in Europe whereby liability under private law cannot be statute-barred before the corresponding criminal liability has expired. German law, however, does not have such a rule.

13. ***Insurance law***

Another universal key factor in the operation of liability law is the influence of the insurance industry. In the most general terms, this means that, often without being able to furnish specific evidence, experts in liability law largely agree that there is a close link between the proliferation of liability policies and the level of care that has to be exercised in dealings with people and property. The development of strict liability in every country was ultimately possible only because liability insurance was perceived as the norm or was prescribed by law. The particularly stringent liability rules in French road-traffic law are but one example among many. Wide disparities continue to exist between the Member States' social security systems, which has not infrequently resulted in the invalidation of claims under liability law, although this has certainly not been a universal problem. The law governing liability for occupational accidents is one example. In England, for instance, this remains largely a matter of private law, which often means, in fact, that special statutory rules are applied. In France and Germany, on the other hand, common liability for negligence no longer exists in this domain. In other countries, while civil liability *per se* has been left intact, the establishment of parallel entitlements against insurers has undermined its role in the everyday administration of justice and condemned it to insignificance. Examples of this development may be found in Scandinavian liability laws relating to medical practitioners and hospitals. The Belgian legislature recently opted for its own unique variant when it reformed the law governing liability for road accidents. Apart from some minor exceptions in special circumstances, the system is still based on the principle of liability for *faute* (fault).[12] However, the provider of liability insurance for the vehicle which caused the accident is required to pay for the damage even if the policyholder is not deemed to be at fault. This is essentially a combination of personal liability insurance and third-party accident insurance.

14. The influence of insurance on the law of liability, indeed, is often directly observable in the provisions of the law of tort or delict itself. The Scandinavian systems lead the way in this development. Scandinavian liability laws contain quite a considerable number of provisions based on equity, such as the so-called reduction clauses, which enable courts to reduce the level of a person's liability in order to avoid ruinous claims for damages. Under this type of provision, the existence of insurance cover – both the victim's and the offender's policies – has been explicitly invoked time and again as a key factor in the assessment of equitable damages. Danish law has gone one step further than the other Scandinavian systems. Mainly for the purpose of avoiding transaction costs, but also in the interests of the liable party, Danish law recognises the general rule that private individuals are not liable in principle for damage they cause to property through ordinary

[12] The word '*faute*' means a deviation from an objectively defined standard of due care and attention; the law does not focus primarily on the question why an offender was unable to meet the required standard. Moreover, the criterion is the level of care and attention that a good father (*un bon père de famille*) would exercise; there is no reduced standard of care and attention for any particular group, such as younger road users.

negligence unless the victim is not insured against such damage.[13] The injured party, in other words, has no choice but to claim on his insurance policy, and since the law only assigns to the insurer the rights of the policyholder, who in this particular case has no legal entitlement, the insurer has no assigned right of recourse against the offending party either.

15. ***The law of contract***
The most important as well as the most fraught relationship is most probably the one that exists between the law of contract and the law of tort or delict. The demarcation line between these two main branches of the civil law of obligations is extremely difficult to distinguish at almost any point. To put it simplistically, we could say that all the European systems of private law display a degree of uncertainty in this domain, because nobody has ever developed a convincing method of distinguishing between contractual and non-contractual liability for damages, and it may well be the case that no such method ever can be developed.

16. The law of obligations in every European country certainly distinguishes between the law of contract and the law of tort or delict, and each country therefore has its own 'national' strategy for dealing with the difficulties this distinction entails. German and English law, for example, essentially operate with the principle of competing claims. On the other hand, only the legal systems of the British Isles have enshrined in their law of contract the need for a consideration, which has prevented developments such as a principle of *culpa in contrahendo* rooted in the law of contract and the concept of a contract for the provision of information free of charge and, in conjunction with the complementary principle of privity of contract, has blocked the development of a contractual device with protective effects in favour of third parties. France, on the other hand, which is perfectly familiar with such 'contracts' (in the framework of the *stipulation pour autrui*), has taken a fundamentally different approach to the question of competing branches of law: in France, liability is always contractual or non-contractual, but never both. There is an imprecise clause prohibiting the cumulation of liability (*cumul des responsabilités*). This *non-cumul* rule, however, soon led to a number of problems, one of which was that it threatened to have the undesired side-effect of preventing the subsequent development of strict keeper's liability. So on the one hand the scope of contractual security obligations had to be cut back if at all possible, while on the other hand, if that could not be done, the concentration of contractual security obligations had to be increased to the extent that they were no longer subordinate to obligations under the law of delict. A distinction therefore began to emerge between means-based security obligations (*obligations de sécurité de moyens*) and result-based security obligations (*obligations de sécurité de résultat*). The only effect of the latter, at the end of the day, was to create contractual

[13] See in particular section 19(1) and (2) of the Danish Damages Act 1984: "[1] To the extent that damage is covered by property insurance or business-interruption insurance, there is no obligation to provide compensation. [2] The provision set forth in paragraph 1 above shall not apply if [a] the party who caused the damage did so wilfully or through gross negligence, or [b] the damage was caused in the performance of a public, commercial or equivalent activity or of equivalent activity". Translated from the German version in von Bar (Nørgaard/Vagner), *Deliktsrecht in Europa, Dänemark* (1993).

keeper's liability. A great deal of energy is expended today in trying to establish when and how a distinction should be made between these types of obligation. The current verdict almost seems to be that an obligation is either result-based or it is not contractual at all. Another important peculiarity of French law is the general assumption that non-contractual liability is '*d'ordre public*', in other words it is not subject to contrary agreement between parties. However, in the limited legislative material on non-contractual liability that the EU has produced to date, it certainly seems to have adopted a similar position, at least in terms of results.

III. *Negotiorum gestio* and unjustified enrichment

17. *Quasi-tortious functions*

The laws governing unjustified enrichment and *negotiorum gestio* – the conduct of another person's affairs without formal authorisation – essentially occupy a position between the law of contract and the law of tort. As a result, a distinction has often been made between the quasi-contractual and quasi-tortious functions of these two sources of obligation, and indeed, until fairly recently, common law rigorously denied the justifiability of treating them as separate categories of obligation. Even today, in the context of the European harmonisation process, their boundaries are still subject to displacements, which are sometimes quite substantial. As far as the connections with the law of tort or delict are concerned (I cannot pursue here the question of the law governing the reimbursement of tenants' expenses, which touches upon property law), the examples that immediately spring to mind are the unauthorised use of other persons' property and the siphoning of profits from crime. The potential for conflict that is resolved by section 816 of the German Civil Code in the domain of unjustified enrichment, together with the tort of conversion in English law, constitutes part of the law of tort or delict. The problem of so-called restitutionary damages is also dealt with by the law of tort, whereas in Germany siphoning the profits of crime, if not discreetly hidden away in the framework of *Schmerzensgeld* (compensation for immaterial damage or *solatium*), is essentially one of the problems addressed under the heading of presumptive conduct of another's affairs (section 687(2) of the German Civil Code).[14] In the Netherlands, on the other hand, such an arrangement has become unnecessary, since the Dutch law of damages already makes provision for profit-siphoning (Dutch Civil Code, Article 6:104). Conduct of another's affairs against his will is also dealt with by the German Civil Code under the provisions on *negotiorum gestio* (section 678), while the Austrian General Civil Code (*Allgemeines Bürgerliches Gesetzbuch*) lays down that anyone who meddles in another's affairs (section 1035) is liable under the law of delict (section 1311) if he is proved to have been at fault in starting to conduct the other's affairs. Some other countries' legal systems have no provisions at all on *negotiorum gestio*. The legal systems of the British Isles are among these, but so too is the Danish system, for example, apart from its provisions on the right of salvage and the law governing finds.[15] The main issue regarding the relationship between warranted *negotiorum gestio* and the law of tort or

[14] For details, see for example Canaris, *Gewinnabschöpfung bei Verletzung des allgemeinen Persönlichkeitsrechts*, FS Deutsch (1999) pp. 85-110.
[15] For details, see Dübeck, *Einführung in das dänische Recht* (1996) p. 227.

delict is whether someone who puts himself in danger for the sake of another person and suffers injury can claim damages from the other for this if the other bears no responsibility for the fact that his rescuer was endangered. The answer to this question remains a matter of controversy, often no less within individual legal systems than among comparative lawyers on a European level. The differences are less striking, however, when it comes to the question whether the law should make a concession to those who justifiably conduct another person's affairs, i.e. whether it should restrict their liability for a fault in the management of the other's affairs or even for a culpably injudicious decision to conduct the other's affairs. In the British Isles, where *negotiorum gestio* is enshrined in Scots law but not in English or Irish law, there has been little apparent inclination to distinguish between various grades of negligence, but the courts ultimately do take account of the altruistic character of assistance when examining a breach of obligation.[16]

18. ***Compensation for expenses in cases of warranted negotiorum gestio***

The core question regarding warranted *negotiorum gestio* is probably whether a person who, out of altruistic motives and in the objective true interest of another, spends some of his own assets may claim compensation from the other or, to put it another way, whether the person's reason for conducting the other's affairs may be seen as equivalent to a contract. The answers vary. In common law, the question is answered in the negative in principle. In the legal codes of continental Europe, on the other hand, and in the Scandinavian legal systems too, in the main, an affirmative answer is given.

19. ***Condictio indebiti***

The core of the law relating to unjustified enrichment, namely the rescission of a performance rendered without any legal ground (*condictio indebiti*), naturally has no point of contact with the law of tort or delict except in highly exceptional cases, and even such points of contact will tend to be coincidental.[17] This particular issue, in fact, is essentially about the reversal of payments made to an apparent creditor – usually, though not always, because the payer acted in the mistaken belief that he was contractually bound to make the payment or payments in question. The European legal systems continue to respond to this basic problem with a glittering array of approaches and basic technical concepts. A comprehensive comparative examination of these approaches and concepts is still in the pipeline and will not be available until some time around the middle of the year 2000.[18]

20. ***Common Law***

Subject to the qualification that the publication of the Schlechtriem research project may compel us to reappraise a good few of our current perceptions, it can probably be said that the law of unjustified enrichment, along with the less important field of *negotiorum gestio*, are among the areas of the law of obligations in which common law and civil law

[16] Von Bar, *op. cit.* (see footnote 1 above), point 511.
[17] For details, see von Bar, *op. cit.*, points 517-518.
[18] That is when the research project on the European law of unjustified enrichment which is currently being undertaken by Professor Schlechtriem of Freiburg is scheduled for completion and publication.

have long been pursuing fundamentally different approaches.[19] Common law, which has admittedly been making great strides in recent times towards the continental way of thinking,[20] still has no general fundamental principle, strictly speaking, on which its provisions on unjustified enrichment are based (such a principle as is enshrined with particular clarity in the first sentence of Article 904(1) of the Greek Civil Code, [21] for example); not even the *condictio indebiti*[22] is accepted in its full breadth.[23] The law relies here on case-by-case analysis. The English 'law of unjust enrichment' has ultimately evolved from the law of tort and of contract, in the latter case from the imputation of the will to be contractually bound (*assumpsit* = implied contract) to return the received payment. Modern English obligation theorists, however, have long been trying to develop a real systematically autonomous law of enrichment,[24] and these efforts are evidently gaining ever more acceptance among practitioners.

21. ***Scandinavia***

In the Scandinavian legal systems too, a rather sceptical view has traditionally been taken of the idea of a general basic principle in the form of a rule of law underlying the provisions on unjust enrichment.[25] There is none to be found anywhere in the law; where actions for unjustified enrichment are covered by statutory rules, they have merely been inserted as special cases. A somewhat simplified assessment would be that Scandinavian lawyers believe that the diversity of constellations which can figure in enrichment claims is too broad to permit the formulation of a single rule of law that would cover them all. The law governing unjustified enrichment is perceived to be rooted in equity – the parallels with classical Roman law should not be overlooked – and requires a tentative case-by-case approach.

22. ***The civil codes***

The last remark, it must be said, applies to many differences in the codified legal systems of continental Europe too. Take, for example, the oft-repeated principle established by the German Federal Court of Justice that the particularly complex domain of enrichment actions involving several parties "prohibits any schematic form of examination".[26]

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[19] An extremely instructive insight into these differences is provided by Zweigert and Kötz, *Einführung in die Rechtsvergleichung* (3rd ed., 1996), sections 38 and 39.

[20] One of the latest moves in this direction was the abandonment of the distinction between mistakes of law and of fact with the rejection of the rule that there are no grounds for a restitutionary remedy for money paid under a mistake of law; see *Kleinwort Benson Ltd* v. *Lincoln City Council and other appeals* [1998], 4 AllER 513 (House of Lords).

[21] The text translates as follows: "Anyone who has enriched himself without legal reason from the assets of another or to the other's injury shall be bound to return the benefits thereby acquired".

[22] It is still necessary, of course, to exercise caution when using this expression, since it is sometimes used as a synonym for the *condictio* in general (as in the following quotation) and sometimes merely to denote a particular group of *condictio* cases. In the latter instance, it is customary to distinguish the *condictio indebiti* from the *condictio sine causa* (a claim for the return of a performance rendered under a contract which is null and void).

[23] *Woolwich Building Society* v. *Inland Revenue Commissioners* [1992], 3 W.L.R. 366, 391 (per Lord Goff of Chieveley): "That law might have developed so as to recognise a condictio indebiti - an action for the recovery of money on the ground that it was not due. But it did not do so ...".

[24] See also Zweigert and Kötz, *op. cit.* (footnote 19), section 38 IV.

[25] For another recent appraisal from a Finnish point of view, see Roos, *För mycket obehörig vinst?*, JFT (1992), pp. 75-97.

[26] See for example BGH, 8 July 1988, in *NJW*, 1989, p. 161, or BGH, 20 June 1990, *WM*, 1990, p. 1531.

Moreover, it has to be stated from the outset in quite general terms that the practical significance of the law of unjust enrichment in cases involving the return of property acquired on the basis of an invalid contract will vary, depending on whether the legal system in question recognises abstract transactions. Where it does not, the owner's action for the restitution of his property will often suffice to achieve the desired result. This is a possible explanation for the absence of a separate title on enrichment in the Spanish Civil Code, for example. Apart from the odd provision in various different parts of the Code, the Spanish rules on unjustified enrichment have been developed by the courts. Nor does the French Civil Code have a general rule governing enrichment. Besides Articles 1376 to 1381 (*répétition de l'indu*; see also Article 1235 under the law of specific performance), the *Code civil* relies on supplementary special provisions, such as those relating to acquisition of property by accession and *impenses* (disbursements to maintain or improve property). The French judiciary, however, abandoned this narrow approach over a hundred years ago and, sometimes resorting to the device of *actio de in rem verso*, developed a general entitlement to the restitution of property in the event of unjustified enrichment, an entitlement which is based on equity and is hence subsidiary.[27] For such claims to be enforced, the plaintiff must have suffered pecuniary prejudice, the value of the defendant's total assets must have increased as a result, and the transaction must have taken place without a legitimate reason (*sans cause légitime*).[28]

23. These few brushstrokes are enough to show that even the codified enrichment laws of continental Europe are clearly anything but a monolithic block. Greece, as was mentioned above, has resorted to a real general clause in the form of a rule of law in the Civil Code itself (Article 904), which ultimately covers all the *condictiones* of Roman law. In Germany, on the other hand, where section 812 of the Civil Code is worded differently in any case, an initial distinction at least has been made since the fifties between two types of *condictio*, namely the claim arising from enrichment by transfer (*Leistungskondiktion*) and the claim arising from other forms of enrichment (*Nichtleistungskondiktion*), and further subcategories of these basic forms have also been developed. Austrian jurisprudence uses a similar structure.[29] Portugal also operates with a general clause (Article 473 of the Portuguese Civil Code), but subjects it to the subsidiarity principle in Article 474, which is reminiscent of the approach adopted in Article 2042 of the Italian Civil Code. The last-named provision states that "An action for unjustified enrichment cannot be brought if the injured party is able to assert another cause of action in order to obtain compensation for the prejudice he has suffered".[30] Article 2042 of the Italian Civil Code, however, relates only to the title headed "*Dell'arricchimento senza causa*" (unjustified enrichment). There is also a separate title devoted to 'payment of a non-debt' (Articles 2033-2040), which, although it does not fall under the heading of 'unjustified enrichment' in the Code, contains what German lawyers regard as the very heart of the law of unjust enrichment (the first sentence of Article 2033 of the Italian Civil Code

[27] For details, see for example Flour and Aubert, *Obligations II* (6th ed., 1994) points 33 *et seq.*
[28] For details in German, see Zweigert and Kötz, *op. cit.* (footnote 19), section 38 III.
[29] See for example Koziol and Welser, *Grundriß des bürgerlichen Rechts I* (10th ed., 1995), pp. 414-415.
[30] Tr. from *Italienisches Zivilgesetzbuch*, Bolzano, 1987, a bilingual version of the Italian Civil Code published in the Südtirol/Alto Adige region.

reads as follows: "Anyone who has made an undue payment shall be entitled to reclaim what he has paid"). This essentially means that Article 2041 of the Italian Civil Code relates to claims arising from enrichment by means other than transfer, while Article 2033 covers claims based on enrichment by transfer. The structure of the new Dutch Civil Code is quite similar ('undue performance' in Article 6:203 and 'unjustified enrichment' in Article 6:212). A restitutionary entitlement arising from Article 6:212 of the Dutch Civil Code is deemed to be a genuine entitlement to damages, although it must be conceded that, while it does not constitute a subsidiary claim, the broad scope of the general entitlement to damages is enough to ensure that no great importance is attached to Article 6:212 in practice.[31]

IV. Strict liability

24. *General remarks*

Returning to the subject of non-contractual liability, the concept commonly known in Germany as *'Gefährdungshaftung*' or '*Haftung ohne Verschulden*' (absolute liability; liability without fault) may be regarded as a largely autonomous part of the law of non-contractual liability. Although the lines that are drawn in Europe between liability for negligence and strict liability, which goes by many different names in the other European countries, are uncertain in many cases and blurred almost everywhere, every system of liability law in Europe is nevertheless familiar with the distinction between these two types of liability. European Community law also operates with this distinction. For example, the Directive concerning liability for defective products, which has now been transposed into the domestic legislation of all EU Member States, stipulates explicitly in its second recital that "liability without fault on the part of the producer is the sole means of adequately solving the problem, peculiar to our age of increasing technicality, of a fair apportionment of the risks involved in modern technological production".

25. *Common law*

Most of the body of law on strict liability, however, is still of autonomous national origin rather than harmonised legislation. Consequently, there are wide disparities. Apart from the strict torts of traditional common law (employer's liability, conversion, nuisance and specific forms of trespass, which vary according to the perspective adopted) and the laws of product and environmental liability, the legal systems of the British Isles in particular recognise very few situations in which strict liability applies, an almost negligible fraction of all liability provisions. Liability irrespective of fault does not even extend to the keeper of a motor vehicle, whose liability still depends on negligence. I must immediately add, however, that the English courts have raised their standards of due care and attention so high in this domain that one might well ask whether this piece of liability law still merits the description 'liability for negligence'. Common law, of course, has long recognised the so-called rule from (or in) *Rylands* v. *Fletcher*.[32] But the English courts, it seems, have done everything in their power to restrict this liability principle again, little

[31] Vranken, *Einführung in das neue niederländische Schuldrecht, Teil II*, AcP 191 (1991), pp. 411-432 (especially pp. 428-429).
[32] For details see von Bar, *op. cit.* (footnote 1 above) I, points 262-267.

by little. The latest move in this direction is a ruling that a defendant's liability for damage caused by substances escaping from his land, though strict by nature, depended on his being able to foresee the way in which the damage would occur.[33]

26. ***France***

As soon as we have crossed the English Channel, we enter a different world. We leave behind the narrowest possible system of strict liability and enter a country where, like other subbranches of law, the law of strict liability is developed from a general clause. Round about the dawn of the twentieth century, the French courts began to develop a provision (Article 1384(1) of the *Code civil*), to which the function of a mere narrative norm had hitherto been assigned, into a separate basis for claims and to infer from it the general imposition of strict liability on the keeper (*gardien*) of an item of property. Today this keeper's liability is far more important in practice than liability deriving from *faute*. Article 1384(1) has overtaken Articles 1382 and 1383. There is no doubt, however, that it is far from easy to distinguish precisely between these two basic forms of liability, since liability for *faute* does not require a fault in the sense of personal blameworthiness, while keeper's liability requires 'abnormal behaviour' (*comportement anormal*) of his property, which is often simply another way of saying that the keeper is at fault. Modern French keeper's liability, to be precise, actually rests on two general clauses, for, besides the liability for damage caused by items of property, ever since the Blieck judgment[34] there has also been strict liability for harm or injury occurring to people under one's care. Since the liability of parents, employers and educators is covered by special legislation, this essentially relates to liability for inmates of institutions.

27. ***Belgium***

Keeper's liability is truly a graphic illustration of the fact that the existence of one and the same legal text in different countries offers absolutely no guarantee that the same rules will be developed in each country where that legal text is in force. Under their old Civil Code, for example, the Netherlands never accepted the strict liability of keepers, even though Article 1403 (old version) of the *Burgerlijk Wetboek* was nothing other than a literal translation of Article 1384(1) of the French *Code civil*. Even more important from a contemporary point of view, however, is the fact that Belgium, though having adopted the concept of keeper's liability, has restricted the concept so much that it is not really possible to speak of one and the same rule. In particular, the Belgian courts require the item of property to have a defect. Moreover, Belgian courts have never accepted the concept of a *garde de la structure*, which has played a not insignificant part (on occasion, at least) in French product liability. Lastly, the Belgian *Cour de cassation* has also refused to introduce general liability for *gardiens* with people under their care.

28. ***The special status of strict liability in Germany***

German liability law stands in stark contrast to that of all other European legal systems. It does not even recognise strict liability for dangerous items or at least for dangerous

[33] *Cambridge Water Co.* v. *Eastern Counties Leather Plc.* [1994], 2 A.C. 264 (HL).
[34] Cass. ass. plén., 29 March 1991, D. 1991 Jur. 324 (note Larroumet).

activities, let alone strict liability for persons (section 831 of the German Civil Code (*Bürgerliches Gesetzbuch*)). The German law of strict liability (*Gefährdungshaftungsrecht*) works with special laws designed to deal with specific risks. No unifying principle underlies this motley assortment of laws; to some extent, it remains a matter of chance whether a particular accident is covered by special legislation or not. In Austria, where, for historical reasons, many of the laws on strict liability are the same as those in the German statute book, the courts have at least been able, in some cases, to extend the available set of statutory instruments to cover analogous situations. The Scandinavian courts have also created a considerable proportion of their countries' present law of strict liability. Besides Article 6:162(3) of the *Burgerlijk Wetboek* – a provision, incidentally, that has yet to be applied in practice - Dutch law also has general liability for the malfunctioning of items of all types (*ibid.*, Article 6:173). Italy and Portugal have broad liability of the general-clause type for both dangerous activities and for property of which one is the *custode* (Articles 2050 and 2052 of the Italian Civil Code, and Article 493(1) and (2) of the Portuguese Civil Code), while the Spanish courts have created their own system of quasi-objective forms of liability, which only bear a superficial resemblance now to the liability for negligence that is enshrined in Article 1902 of the Spanish Civil Code.

V. Legal consequences

29. ***General remarks***

In the domain of legal consequences too, some significant differences are easily spotted. The European laws governing liability do not yet have even a reasonably uniform idea of what damage is or how it can be defined, which naturally threatens to frustrate any efforts to develop European directives in this field.[35] Similar difficulties arise in the law of damages proper, because the prevailing basic categories are still not entirely compatible.

30. ***A résumé of some of the main differences***

Greater importance attaches, of course, to the differences between these laws in terms of their actual effects. One such effect is the quite extraordinary reticence of the German legal system when it comes to awarding *solatium* (general damages) in cases where strict liability or contractual liability applies. The relevant rules of German law can only be termed counterproductive from a European perspective. One of the unique features of Scandinavian law – and once again Denmark has led the way in this field – is that the law lays down standard methods for the assessment of damages in the event of personal injury. The special feature that is generally ascribed to common law, for its part, is that it recognises various forms of punitive damages, although it is doubtful whether this really remains characteristic of common law today. It is merely less squeamish about operating with punitive damages than the other legal systems, which like to 'hide' them, for example in the assessment of compensation for immaterial damage. In the realm of compensation for immaterial damage arising from the infringement of intangible rights of personality, Austria has put itself out on a limb in so far as it is the last country that still refrains in principle from awarding compensation for this type of injury. By contrast, a

[35] For details, see von Bar, *op. cit.* (footnote 1), points 396-398.

unique feature of the Italian legal system – in which, I believe, it is ahead of its time – is the device of biological injury (*danno biologico*). This was developed from the definitional element 'unjust detriment' (*danno ingiusto*, Article 2043 of the *Codigo civile*) and essentially means that injury to a person *per se* founds a claim to compensation. So alongside patrimonial loss and non-patrimonial loss (*solatium*), there is a separate third type of damage, namely the *danno biologico*. Liability for biological injury is certainly not confined to nominal compensation, as is usually the case with the English torts which are 'actionable *per se*', but can amount to substantial sums – about double the figure that is deemed appropriate for non-patrimonial loss. Other countries are now beginning to follow this approach. It accords with the special status that attaches to the integrity of the individual, and it is conceivable that it will find its way into the law of liability wherever it relates to protection of the rights of personality.

The law governing credit security

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I. Introductory remarks

1. ***General demarcation***
The comparative examination of credit security is restricted to personal security and real security in the form of movables. It excludes the treatment of mortgages on immovable property, because harmonisation of the national legal and administrative provisions in this area is fraught with particular problems; rooted in strong national traditions in the domain of land law and influenced by the close connection that exists between land law and the prevailing system of land registration, these provisions diverge very sharply. Moreover, the practical need for harmonisation of these mortgages has hitherto seemed to be less urgent. By comparison, the safeguarding of loans in one country with real and personal security from another can surely be regarded as a far more common phenomenon, despite the lack of statistical evidence on the subject. Efforts to harmonise the types of security that are dealt with here also appear to have brighter prospects of success in general terms.

2. ***Categorisation***
The vast differences that exist between the national rules governing personal security on the one hand and those governing real security on the other make it advisable to examine these two categories separately. At the same time, account must be taken of marginal overlaps. For example, if a third party, rather than the debtor himself, puts up real collateral, this has elements of a contract of surety between the debtor and the guarantor. Most of the collateral offered by third parties, however, takes the form of real security.

II. Personal credit security

A. Substantive scope

3. The distinction between personal security and related legal devices with similar functions is not always clear-cut and therefore requires a brief explanation at this point. The main criterion of security is that it creates for the creditor who is owed a monetary amount by a debtor (the principal debtor) a claim on another person (the guarantor), who is prepared to be answerable for the performance of the obligation. This is the basic position that underlies the following classification.

4. ***Suretyship and its variants***

The contract of suretyship is the basic form of personal security. Suretyship is a familiar concept in all Member States of the EU and has deep historical roots. Even today, it remains the foremost type of personal loan collateral.

Accordingly, all the codes of civil law of the continental European States contain more or less extensive rules governing suretyship. In Anglo-Irish common law and in Scots law, on the other hand, there are no comprehensive statutory provisions on the matter; only individual aspects of suretyship are covered there in a number of fragmented provisions, some of which are of great antiquity. A similar situation applies to the sources of law in Denmark, Finland and Sweden.

One variant of suretyship is the *credit agreement*. If a lender grants a loan in his own name, but at the request of a client, to a third party, the law of some countries states that the client is liable to the lender for the third party's obligation as a surety or in an equivalent role.[1] Only the newer civil codes deal with the credit agreement, and not all of the Member States' legal systems recognise it. It will be treated here as a special form of suretyship which is probably of fairly minor importance in practice.

5. ***Commercial del credere liability***

Some brokers of business transactions, especially commission agents and commercial agents, may give an undertaking to accept liability to their principal for the performance of the transactions they have brokered. In legal terms, this may be suretyship or a contract of indemnity. It is not possible to deal separately with this special form of personal guarantee in the framework of the present summary.

6. ***The contract of indemnity***

In the legal systems of all Member States, the term 'guarantee' suffers from its broad range of meanings and from imprecision; in English law the 'guarantee' is used as a synonym for suretyship, whereas the term *Garantie* as used in continental civil law refers especially to the promise of a primary contractual performance or of a secondary performance in the event of inadequate performance by a party to the contract. Such promises, known as *contracts of indemnity* in English law, do not encompass personal security as referred to in the present summary.

What is meant in our context by a contract of indemnity is a specific alternative to the personal security offered by a surety. Indemnity in this sense has developed over the past hundred years, especially in commercial transactions.

The chief difference between indemnity and suretyship is that the liability of the guarantor in a contract of indemnity, unlike the accessory liability of a surety, is not co-extensive with the legal and actual amount of the principal debtor's obligation but is independent of the legal validity of the claim against the principal debtor; the relationship

[1] Section 778 of the German Civil Code, Article 870 of the Greek Civil Code, Article 1958 of the Italian Cicil Code, Article 7:863 of the Dutch Civil Code and Article 629(1) of the Portuguese Civil Code.

between the contract of indemnity and the secured obligation is abstract. The civil codes of continental Europe have scarcely formulated any rules governing the *Garantie*. However, in view of the importance that this form of security has actually acquired in domestic trade and, more especially, in international trade, the contract of indemnity must be included in the examination of personal security.

Two views of the relationship between indemnity and suretyship have developed in Europe; they require brief discussion here because of their importance to the commercial system in general. In most countries indemnity is regarded as an autonomous legal institution alongside suretyship. For that reason, the statutory rules on suretyship are not extended to contracts of indemnity in principle. This is the position in Germany, France and Belgium.[2] In Italy and now in the Netherlands too, on the other hand, indemnity is regarded as a variant of suretyship. The Italian rules are rooted in Article 1939 of the Civil Code, according to which a suretyship is valid even if the secured obligation is null and void because of the legal incapacity of the principal debtor. Court judgments and legal literature state that the parties may derogate in other cases from the principle that suretyships are accessory in character; this happens specifically in the case of indemnity contracts with banks and loans payable on call.[3] In the Netherlands, the new Civil Code, which entered into force in 1992, contains a complex provision, the gist of which is that the rules governing suretyship are to apply *mutatis mutandis* to consumers' contracts of indemnity (Article 7:863).

These different interpretations of the contract of indemnity as either an autonomous institution or a variant of suretyship make it appear inadvisable to treat the contract of indemnity as one or the other from the outset. On the contrary, suretyship and contracts of indemnity must be understood as two closely linked manifestations of the personal security. Accordingly, they must be presented in an integrated manner, because that is the best way to highlight their common characteristics and their differences.

7. ***Bill guarantees***

In spite of their names, bill guarantees and cheque guarantees, in other words the guarantees on each of these payment titles, are not suretyships as defined in civil law. In terms of substantive law, bill and cheque guarantees do not depend on the validity of the principal debtor's liability under the bill,[4] nor can the guarantor plead all defences open to the principal debtor for whom he has assumed the bill guarantee. In substantive terms, then, it is a bill-type contract of indemnity (see point 6 above). If, however, the collateral

[2] Germany: Bülow, *Recht der Kreditsicherheiten*, 4th ed., 1997, pp. 385-394; France: Vasseur, *Garantie Indépendante*, 1984, points 22-29; Encyclopédie Dalloz, *Répertoire de droit commercial IV*; Belgium: Heenen, *Les sûretés personnelles dans le droit bancaire belge*, Recueil de la Société Jean Bodin XXX, 1969, pp. 161-162

[3] Italy: Piazza, 'Garanzia. I) Diritto Civile', points 1.5.1 and 2.2.1-2.2.2, in *Enciclopedia Giuridica XIV*, 1989; Netherlands: Chao-Duivis, *Borgtocht, Inleiding no. 9-10: Bijzondere Overeenkomsten I* (loose-leaf pages 1992 *et seq.*), Boek 7, Titel 14.

[4] Article 32(2) of the 1930 Geneva Uniform Law on Bills of Exchange; Article 27(2) of the 1931 Geneva Uniform Law on Cheques.

for a bill debtor were assumed in any form other than a guarantee on the bill of exchange, that would be normal suretyship.

8. ***Plurality of debtors, including collateral promise***
If a third party chooses not to set any of the available limits on his liability for the principal debtor's obligation but to stand guarantor for the whole amount, he must assume joint and several liability, either from the outset or by means of a subsequent collateral promise. Two or more debtors are jointly and severally liable for the full amount of the obligation, and the creditor can choose to claim payment from any of the joint and several debtors as he sees fit. The debtor on whom the claim is made cannot plead the defences open to or pleaded by another of the joint and several debtors. In all these points, plurality of debtors differs from suretyship.

Elsewhere, the statute books state that the debtors may agree among themselves that one of them should assume sole internal liability for the entire obligation. In this case, if the creditor claims all or part of the obligation from the joint debtor who benefits from this agreement, the latter may claim compensation from the one who is effectively the principal debtor.

9. ***Porte-fort***
The French-speaking Member States have rules governing a special case that is akin to the contract of indemnity. The guarantor (*porte-fort*) promises the creditor that he (the guarantor) will assume liability for the performance of a particular obligation by a third party. This often amounts to the ratification of a contract that the guarantor has concluded for a third party without formal authorisation from the latter to act on his behalf. If the third party refuses to accept the contract, the guarantor is liable for damages.[5] The *porte-fort* system therefore does not create liability for a contractual obligation of a third party; this also means that the guarantor is not liable for the non-performance of another person's contractual obligation. The liability of the *porte-fort* is not accessory in character either. Consequently, it does not in any way constitute security as defined in civil law.

B. Consumer protection for the surety

10. One feature of the general development of legal remedies for consumers in recent times has been the emergence of the need to protect sureties who are consumers. In so far as legal remedies for consumers have already been harmonised within the European Union, namely through the 1985 Directive to protect the consumer in respect of contracts negotiated away from business premises, there is no need for further harmonisation at the present time. Whether and to what extent the 1986 Directive on consumer credit covers personal security has not yet been clarified. For most types of personal security provided by consumers, however, no harmonisation of laws has been effected yet within the European Union.

[5] Article 1120 of the French, Belgian and Luxembourg Civil Codes.

Special legal provisions protecting the surety as a consumer are contained in the new Dutch Civil Code of 1992,[6] while some countries have included them in their legislation on consumer protection[7] as well as in various special laws.[8] Moreover, in many countries the courts have more or less firm rules for the protection of citizens, especially in cases where they stand surety;[9] with regard to German and English law, special mention should be made of court rulings on suretyship assumed by close relatives of a debtor.[10] In the context of the following summary, however, this case law can only be mentioned in passing.

C. Form and evidence of contract

11. ***Suretyships***

Rules laying down formal requirements and provisions limiting the admissibility of witness testimony as evidence of oral contracts, thereby indirectly imposing mandatory formal requirements, vary quite considerably from one country to another. Freedom to choose any form of contract exists only in Scandinavia and, at least in principle, in the Netherlands. The only requirement in Portugal is adherence to the form of the contract establishing the secured obligation. In other countries, not even a merchant's promise of suretyship is always free of formal requirements; even the United Kingdom, Ireland and Spain require observance of certain formalities.

Other than in the aforementioned exceptional cases, because of the risk involved in suretyship and the potential for non-payment, it is normal to require a promise of suretyship in writing. In English and Irish law, to compensate for the frequent absence of a consideration (see point 14 below), a deed, i.e. a signed, sealed and delivered document, must be executed. The absence of a deed, in principle, invalidates the suretyship or makes it unenforceable; the surety is able, however, to avoid these legal consequences by voluntarily performing the obligation. On consumer suretyships, see point 13 below.

12. ***Contracts of indemnity***

Where the contract of indemnity is recognised in its own right as a separate legal institution, it is not generally subject to the same conditions as a suretyship in terms of form and evidence of contract. This exemption from mandatory formal requirements is itself one of the reasons for the development of this special form of personal security. Observers usually combine this description of the current legal position with a reference

[6] Articles 7:857 to 7:864 of the *Burgerlijk Wetboek.*

[7] France has incorporated them into Articles L. 313-7 to 313-10 of its *Code de la Consommation* of 1993, but see also footnote 8 below.

[8] The evidence relating to France is contained in Croq, 'Suretés. Publicité foncière' in the *Revue trimestrielle du droit civil*, 1998, pp. 950-958.

[9] For Germany, see for example Drexl, 'Der Bürge als deutscher und europäischer Verbraucher', in *Juristen Zeitung (JZ)*, 1998, pp. 1046–1058; for France, see Croq, *op. cit.* (previous footnote).

[10] For Germany, see for example Schapp, 'Privatautonomie und Verfassungsrecht', in *Zeitschrift für Bankrecht und Bankwirtschaft*, 1999, pp. 30-42; for England, see Fehlberg, *Surety Experience and English Law*, 1998.

to the absurdity of its result, since the contract of indemnity, because of its detachment from the substance of the secured obligation, poses a greater risk to the guarantor than suretyship.

13. ***Consumers' personal security***
In very recent times, some countries have introduced special protective rules for the conclusion of contracts by consumers who provide personal security (point 10 above refers to this situation in general terms). The Netherlands requires this type of agreement to be set out in writing. Even more helpful to consumers are provisions that require creditors to provide guarantors with details of the extent and possible consequences of their commitment (Austria does this and so does France, though only for suretyships) or even to draw their attention to any special financial implications of non-performance for the debtor (Austria); where such information is prescribed by law, the consumer-surety will actually be released from his obligation as a rule if the seller-creditor fails to provide the necessary information.

D. Substantive validity

14. The promise of a personal guarantee or a contract for the provision of such a guarantee must naturally satisfy the general requirements for valid contracts, especially with regard to the legal capacity of the guarantor and compliance with the law and public policy. Declarations in the form of a condition of business must also observe the rules that are generally applied to such instruments.

Because of their practical importance, three conditions of validity should be mentioned explicitly here. In Anglo-Irish common law, promises such as the provision of personal security are only valid if they are made in exchange for a consideration by the other party, unless the promise has been made in the form of a deed (see point 11 above). Under certain circumstances, however, an undertaking by the creditor to make a loan to the principal debtor or to continue with an existing loan may constitute a consideration for the guarantor's promise.

In Italy and the Netherlands, if the amount of the secured claim against the principal debtor has not yet been established when the contract of suretyship is concluded, a maximum amount must be set for the consumer's liability.[11] Since 1995, the German courts have been restricting the validity of blanket guarantees contained in standard sales-agreement forms, particularly where they relate to 'all future obligations' of the principal debtor, even in the case of commercial suretyships. Such suretyships are essentially inapplicable now to any obligations of the principal debtor other than those which exist when the contract of surety is concluded.[12] A similar effect is achieved in Italy by means of a provision, which has recently become mandatory, exempting the surety from liability

[11] Italy: Article 1938 of the *Codigo civile*, as amended in 1992; Netherlands: Article 7:858(1) of the *Burgerlijk Wetboek*.
[12] For details see Fischer, *Aktuelle Rechtsprechung des Bundesgerichtshofs zur Bürgschaft und ...*: WM, 1998, pp. 1705 *et seq.* (especially pp. 1708-1710).

for a future debt if the creditor makes him a loan in the knowledge that his financial position has seriously deteriorated.[13]

Judicial review of the substantive equity of suretyships, such as France in particular has recently introduced for consumer suretyships, goes much further. Suretyship obligations must not deprive consumers of the minimum financial resources they require to cover their household overheads and provide themselves with a minimum income; if a credit institution is the creditor, it has no recourse against a surety if the amount of the suretyship was obviously disproportionately high in relation to the consumer's economic circumstances at the time of the original transaction and if his assets are insufficient when the suretyship becomes exigible.[14] In Austria, the court may lower the surety's obligation if the personal security is 'inequitably disproportionate' to the surety's degree of solvency and this situation was known to the creditor when the guarantee was given.[15] In Germany, in England and Wales and in Austria, the courts take a particularly critical view of close relatives standing surety, especially one spouse for the other or parents and children for each other. Such guarantees are often given for emotional reasons without thought for the risk and the far-reaching consequences of a claim. In Germany a steady stream of judgments on this matter has resulted in the development of a more or less clearly defined body of case law (see footnote 10 above).

E. The relationship between the guarantor and the recipient of the guarantee

15. ***Extent of liability***

The ***suretyship***, like all types of 'genetic' security, is subject to the principle of accessoriness; in other words, the surety's liability is normally co-extensive with that of the principal debtor. This means that the legal existence of the suretyship obligation depends on the legal existence of the principal obligation; the amount of the suretyship obligation may be lower and subject to less onerous conditions than the secured principal obligation, but it may not exceed the latter. This accessory nature of suretyships is recognised in all Member States.

The scope and structure of accessoriness, however, varies between legal systems. Contrary to the principle of accessoriness, for example, almost all Member States have statutory provisions which lay down that a suretyship contract on the obligation of an under-age debtor is admissible, even though the principal obligation is invalid; in some countries, however, this only applies if the surety is aware that the person for whom he is standing surety is a minor. In every Member State the surety may plead defences and objections that have been pleaded by, or are open to, the principal debtor, particularly the defence of prescription of the principal obligation. Once again, however, there is a slight

[13] Article 1956 of the *Codigo civile*, as amended in 1992.
[14] Article 2024, second sentence, of the *Code civil* (inserted in 1998); Article L. 313-10 of the Code of Consumer Law (*Code de la consommation*).
[15] Section 25d of the Consumer Protection Act (*Konsumentenschutzgesetz*).

difference in the treatment of the principal debtor's right of reformatory action, for instance his right to avoid and terminate the contract and even his right to set off his own claim against that of the creditor. In the countries whose civil codes are based primarily on Roman law, the surety may exercise these rights by virtue of the accessory nature of the suretyship,[16] while in other countries this is regarded as encroachment on the rights of the debtor, and so the surety is only granted the right to refuse performance.[17]

The principle of accessoriness is a characteristic of the suretyship contract; it does not apply, however, to the ***contract of indemnity***, in which the guarantor's liability is governed solely by the substance and terms of the contract, which often require payment 'on call' to the creditor. So although it is a legally autonomous institution, a contract of indemnity always serves to guarantee a particular entitlement. In certain very specific conditions, the debtor of the guaranteed obligation may prohibit the creditor and/or the guarantor from claiming or performing the indemnification.

If two or more persons stand guarantor under a contract of suretyship or indemnity, they will generally be liable to the creditor as joint and several debtors (see point 8 above). In some of the Roman-based legal systems, however, each co-guarantor may require that the creditor's right of recourse against him be restricted to his own *per capita* share of the total obligation.

16. ***Ranking of guarantors' liability***

In the interests of the creditor, the parties may agree that the guarantor is to rank equally with the principal debtor in terms of liability for the creditor's claim. In this type of security transaction, there is joint and several liability, which means that the creditor has recourse against the debtor of his choice for all or part of the claim (see point 8 above). On the other hand, it is in the interest of the guarantor not to receive an application until the creditor has tried and failed to obtain satisfaction from the principal debtor or at least until it is established that an application to the latter would prove fruitless; the guarantor would then bear only subsidiary liability, namely as a surety. In principle the contracting parties are free to stipulate the conditions on which they wish the subsidiary liability of the surety to depend in such cases.

The statutory rules of the continental and Scandinavian countries, which are mostly surety-friendly, generally provide for purely subsidiary liability. As befits the fundamental non-mandatory character of this liability, its subsidiarity only comes into play if it is invoked by the surety. In most countries the effect of this plea is that the creditor must first try execution against the principal debtor's property. In some of the legal systems based on Roman law, the surety must indicate to the creditor the seizable property of the principal debtor and must even meet the cost of legal proceedings and enforcement against the principal debtor. The defences of the surety are invalidated,

[16] The general rule is contained in Article 1945 of the Italian Civil Code. Set-off is dealt with in Article 1994(1) of the French, Belgian and Luxembourg Civil Codes and Article 1247(1) of the Italian Civil Code.

[17] Avoidance and set-off: section 770(1) of the German Civil Code, Article 642 of the Portuguese Civil Code and Articles 7:852(2) (avoidance) and Article 6:139(1) (set-off) of the Dutch Civil Code.

however, if execution against the principal debtor's property is likely to prove fruitless. The subsidiary liability of the surety is non-mandatory; commercial creditors, especially the banks, generally avail themselves of it. In Austria, on the other hand, the principal debtor's failure to meet a demand for payment is sufficient. In most countries, the liability of a merchant who stands surety is not only subsidiary; in Portugal, not even a non-merchant may invoke subsidiarity if he has undertaken to stand surety for a commercial transaction.

Anglo-Irish common law as well as Italian and Dutch law provide in principle for joint and several liability of the surety and the principal debtor; the parties may, however, conclude an agreement whereby the liability of the surety is entirely subsidiary.[18] Any person who binds himself by a contract of indemnity to stand guarantor is also liable as a primary debtor.

Legal changes to the substance of the secured entitlement may result from a breach of the underlying contract by the principal debtor, for example by delayed performance, impossibility or other infringement of the secured rights of the creditor. Financial sanctions, including in particular payment of damages, interest or contractual penalties, are also normally covered by a contract of suretyship. Where statutory rules are lacking – as they usually are – the interpretation of the suretyship is crucial. The preceding principles apply to both the extension of the suretyship to contractual or statutory ancillary rights and, in particular, to contractual claims against the principal debtor for the payment of interest.

17. ***Obligations and duties of the creditor***

While the traditional law of suretyship generally assigns nothing but rights to creditors, in recent times an obligation has been imposed on the creditor to provide information, not only when the contract is concluded (see point 13 above) but also during the term of the contract; this applies in particular to information for consumer sureties. In the Netherlands, every creditor must inform a surety of any delay in payment by the principal debtor.[19] In France and Austria, this obligation applies only to credit institutions in their dealings with consumers who stand surety or guarantor.[20] In France, where unrestricted suretyships are contracted, every creditor must inform the surety at least once a year of the position regarding the principal obligation. In both countries, failure to provide this information has perceptible repercussions in that the surety or guarantor is not liable for any contractual penalties and default interest incurred by the principal debtor during the period between the due date for the communication of the information and the date of its actual communication.[21]

[18] This is laid down explicitly in Article 1944(2) and (3) of the Italian Civil Code, along with the legal consequences outlined in the text.

[19] Article 7:855(2) of the Dutch Civil Code.

[20] Article L. 313-9 of the French Code of Consumer Law (*Code la consommation*); section 25b(1) of the Austrian Consumer Protection Act (*Konsumentenschutzgesetz*).

[21] Article 2016, second sentence, of the French Civil Code (inserted in 1998); section 25b(2) of the Austrian Consumer Protection Act.

Besides such obligations, which are still the exception rather than the rule, the creditor has traditionally had certain duties; if he fails in these duties, he forfeits all or some of his rights under the suretyship. The most important duty of a creditor is that he must maintain any security interest he possesses in the property of the principal debtor or third parties. The purpose of this is to facilitate the surety's recourse against the principal debtor once the surety has satisfied the creditor. For this reason, most Member States discharge the surety of his obligation if his creditor has surrendered such an interest or made its redemption impossible. However, the range of security interests to which this duty relates is not the same in every legal system; creditors are also subject to varying sets of behavioural requirements; lastly, the assessment of the extent to which the creditor should be discharged is not entirely uniform.

Whether the aforementioned rules also apply to a guarantor in a contract of indemnity is scarcely mentioned and therefore remains largely unresolved.

In more general terms, provision is made to some extent for the surety to be discharged if, through the fault of the creditor, it becomes impossible for the debtor to perform the principal obligation.[22] The prime example of this abstract rule is probably the Austrian provision which formulates the requirement to the effect that the creditor must be guilty of "dilatoriness in collection of the debt".[23] As a means of averting losses of this type, in three countries of southern Europe creditors are expected to bring an action against the principal debtor one, three and six months respectively after the due date of the secured claim and to pursue their claim resolutely, otherwise the suretyship will lapse.[24]

18. ***Termination of the guarantor's liability***

As far as termination of liability is concerned, the only point of interest here is the identification of the typical grounds for terminating the provision of personal security. Some of them have already been explicitly mentioned. The expiry of the secured claim, which, by virtue of its accessory character, releases the surety as well as the principal debtor, need not be discussed in detail. A narrower provision is the Dutch rule on consumer sureties designed to secure future obligations; this rule states that the surety is not liable for damages owed to the creditor by the principal debtor if the creditor could have taken reasonable care to prevent the damage.[25] The provisions referred to at the end of point 17 above are also relevant: if the creditor does not respond to the surety's request to pursue resolutely his claim against the principal debtor that has fallen due or has been notified, the surety is discharged.

[22] Article 862 of the Greek Civil Code.
[23] Section 1364, second sentence, of the Austrian General Civil Code.
[24] Article 867 of the Greek Civil Code (in the case of a suretyship contracted for an indeterminate period), Article 1957(1) of the Italian Civil Code and Article 652(1) of the Portuguese Civil Code. In Greece and Portugal, one year after concluding the suretyship contract, the surety may even prevail upon the creditor to make the secured claim fall due by giving notice of maturity to the principal debtor (Article 868 of the Greek Civil Code and Article 652(2) of the Portuguese Civil Code).
[25] Article 7:861(3) of the Dutch Civil Code.

The effect of a ***fixed-term suretyship*** is assessed in various ways. In some countries the suretyship expires *ipso jure* at the end of the fixed term. Where there are no relevant statutory rules, it depends on the interpretation of the suretyship; in some countries, the courts are inclined to grant automatic expiry, while in others the suretyship obligation is frozen at the level of the security due on the debts existing at the end of the fixed term. Germany, Greece and Italy lay down that the surety is discharged unless the creditor brings an action against the principal debtor without delay, within one month and within two months respectively of the end of the fixed term and pursues his claim resolutely.[26] In Germany, the creditor must give the surety notice of recourse against him without delay upon termination of the suretyship; if the surety has waived the defence of failure to pursue remedies, this notice must be given immediately upon termination of the suretyship. If notice is given in good time, the suretyship is confined in the first case to the amount of the secured claim on completion of proceedings and in the second case to the amount of the claim at the end of the fixed term.[27] In the Netherlands a consumer surety may terminate a fixed-term contract of suretyship for future obligations after five years.[28]

Statutory rules governing the termination of ***personal security pledged for an indeterminate period*** are rare. In the Netherlands a consumer may terminate a suretyship at any time if it was contracted for an indeterminate period to cover future debts; the amount of his obligation is restricted to the secured claim existing at the time of termination (see footnote 26). In Germany the courts have achieved the same result by applying the general principle that contracts for the performance of a continuing or recurrent obligation are terminated when sufficient prior notice of termination is given. In other countries the legal position does not seem to have been clarified yet, but it is often standard practice in the banking world to grant the surety a right of termination.

In Portugal every surety for future obligations may be terminated after five years.[29]

In some instances a surety is granted ***discharge for future debts*** if, after contracting the suretyship, the creditor has made a loan to the principal debtor in the knowledge that the debtor's financial circumstances have deteriorated to such an extent as to render the redemption of the loan considerably more difficult.[30]

Because of the accessory nature of suretyships, a ***statute of limitations*** may constitute grounds for their termination if the secured claim is time-barred. Apart from this,

[26] Section 777(1) of the German Civil Code, Article 866 of the Greek Civil Code and Article 1957(2) to (4) of the Italian Civil Code.
[27] Section 777(2) of the German Civil Code.
[28] Article 7:861(1) and (2) of the Dutch Civil Code; the suretyship will then be limited to the obligations as they stand at that time.
[29] Article 654 of the Portuguese Civil Code.
[30] Article 1956 of the Italian Civil Code; the surety cannot waive these rights in advance. Similar rules, albeit with slight substantive differences, exist in Article 654 ofthe Portuguese Civil Code, Article 7:861(4) of the Dutch Civil Code (for consumer sureties) and in German case law.

however, the suretyship is also subject to time limits in its own right. The period of limitation is prescribed in the general statute of limitations; the 19th-century civil codes set the limitation period at 30 years, but most of the codes adopted in the 20th century prescribe a 20-year period, although Spain lays down 15 years, Italy and, in most cases, Sweden prescribe ten years and English law prescribes six. In Sweden a special limitation period of three years applies to sureties designed to safeguard merchants' rights arising from the sale of goods or services to consumers.[31]

F. The relationship between the guarantor and the principal debtor

19. ***Surety's rights prior to satisfaction***

The civil codes of continental Europe grant sureties the right, in a fairly uniform set of circumstances, to require the principal debtor to discharge him from the suretyship or to provide him with security. All such provisions are based on the idea that the surety should be protected from the risk that, once he has satisfied the creditor, he no longer has a realistic prospect of recovering his outlay from the assets of the principal debtor. The following are the circumstances that give rise to this risk:

(a) maturity of the secured claim and/or default by the principal debtor;

(b) significant deterioration of the principal debtor's financial position and/or his insolvency;

(c) the immediate threat of recourse by the creditor against the surety, the pendency of an action for payment or at least the existence of an enforceable judgment against the surety;

(d) in the countries which have received Roman law, the fact that ten years (in 19th-century civil codes) or five years (in 20th-century codes) have elapsed since the conclusion of the contract of suretyship.

The Anglo-Irish legal systems seem to grant the surety only a few rudimentary rights of discharge against the principal debtor.

20. ***Surety's rights after satisfaction***

Since the surety only binds himself to be responsible for the fulfilment of the principal debtor's obligation, once the surety has satisfied the creditor the latter's claim against the principal debtor is transferred to the surety. The legal systems of all Member States provide two different remedies for this purpose.

In the first place, the surety acquires ***ipso jure***, i.e. automatically, the creditor's former claims against the principal debtor. Besides the secured claim itself, these include the ancillary preferential rights and accessory security interests attaching to the claim. In the case of non-accessory security, the creditor is bound to effect a legal transaction transferring such security to the surety. Where the surety performs part of the obligation, only the corresponding part of the secured claim is transferred to the surety.

Besides the claims and security interests of the creditor that are automatically transferred to the surety, the latter is also entitled as a rule to ***claim compensation in his own right***

[31] Section 2(2) of the Prescription Act (*Preskriptionslag*) 1981 (Statute No 130).

from the principal debtor. This entitlement may relate to contractual claims if – as is mostly the case – the surety has bound himself under contract to the principal debtor. In the absence of a contract, claims arising from *negotiorum gestio* are a possibility. Because of its divergent basis, this type of claim to compensation cannot be supported by the statutory preferential rights and legal security that exist for the transferred principal claim. On the other hand, the right of compensation includes certain costs incurred by the surety and any loss or injury he may sustain.

To avoid ***duplication of payments to the creditor***, some of the more recent laws require either the surety to notify the principal debtor, or both the surety and the principal debtor to notify each other, of payments made to the creditor. If the surety omits to provide the principal debtor with such notification, he thereby forfeits his right of recourse against the debtor and may only apply to the creditor for repayment. [32] If the debtor culpably omits to notify a payment, he shall be liable to the surety for any loss or injury resulting therefrom.[33]

III. Real security

21. ***Introduction and structure***

Unlike personal security on loans, which are essentially represented by the legal institutions of suretyship and indemnity, real security in the form of movables appears in very many guises in the Member States. This is partly due to the various functions it performs, for example as security for monetary credit on the one hand and trade credit on the other, and also results in some cases from differences between the secured items, which may be property or rights. Alongside these and other variations relating to the nature and purpose of real security, however, are disparities that arise from differences in legal cultures, economic structures and the lack of a common European tradition that could still be built upon today – with the exception of the possessory pledge, although that instrument is scarcely equipped to satisfy modern-day demands. The great variety of forms of real security is visible even from the widely diverse designations that have developed around the basic device of the pledge: non-possessory pledge, movable hypothec, retention of title, security transfer, security assignment, chattel mortgage, security bill of sale, etc. However, none of these concepts, rooted as they are in specific national legal systems, is a suitable means of systematising a comparative review. On the contrary, it is essential to use a functionally calibrated scale of neutral terms so as to avoid evoking erroneous associations and creating confusion.

The *summa divisio* of the following summary is drawn between real security for monetary credit and real security for trade credit. The first group is the broader and more complex and is divided into three subgroups: security in the possession of the creditor, security

[32] Article 1952 of the Italian Civil Code and Article 645 of the Portuguese Civil Code.
[33] Article 646 of the Portuguese Civil Code.

held by the debtor and security in the form of entitlements which cannot be classed as possessions.

A. Security for monetary credit

22. ***Form of the security arrangement***

The provision of all types of security for monetary credit (especially loans) is based on a security agreement, which may well be connected with the contract on the granting of credit – a loan agreement, for instance. The basic starting point is that there is no prescribed form for a security arrangement. This principle applies in the German and Scandinavian legal systems and essentially in the Anglo-Irish systems too; as far as commercial transactions are concerned, it even applies in the systems that are directly based on Roman law.[34]

There are, however, major exceptions to this principle in the countries with received Roman law as well as in Greece, the Netherlands and Sweden. Security arrangements made under civil law in many of these countries must be in the prescribed form of a written document containing the designation of the item used as security and the secured claim and indicating a 'secure date'.[35]

The secure date is established by registering the document with the tax authorities, but this is not the form of security-interest registration that gives rise to compulsory disclosure. The purpose of registering the secure date is to prevent fraudulent backdating of the security agreement. In Italy and the Netherlands, where the distinction between contracts under civil and commercial law has been dropped, this formality is also mandatory in other cases, being required in principle for commercial security agreements in Italy but only for non-possessory pledges in the Netherlands.[36]

Under the special statutes relating to non-possessory pledges in France, most commercial security agreements also have to be concluded in writing, especially as such contracts are generally subject to compulsory registration. Some countries insist that security arrangements covering monetary credit should be in writing.[37] In Spain, it is even stipulated that the security agreement must be set out in a public document and securely dated.[38] Even stricter formal requirements for security bills of sale are imposed by English law for the protection of 'small borrowers' (i.e. individuals, sole traders and partnerships [!]); the debtor has to sign a prescribed model contract in the presence of a witness.[39] Even more complex and antiquated are the formalities required in Sweden for a so-called 'security purchase' under a regulation enacted in 1845, whereby notice of the

[34] Cf. Wahl and Blomeyer, points 37, 42 and 45.
[35] Articles 2074 and 1328 of the French, Belgian and Luxembourg Civil Codes, and Articles 1211 and 1247 of the Greek Civil Code.
[36] Articles 2787(3) and 2704 of the Italian Civil Code and Article 3:237(1) of the Dutch Civil Code.
[37] Section 47(1) of the Danish *Tingslysningslov*.
[38] Section 1865 of the Spanish Civil Code and Article 3(1) of the *Ley de hipoteca mobiliaro.*
[39] Cf. Goode, *Landesbericht England*, pp. 73-74.

conclusion of the contract, attested by a witness, must be published in a newspaper în the debtor's place of residence before it can be registered.[40]

(1) Collateral in the creditor's possession

23. This subgroup relates to the age-old instrument of pledged movable property. The main condition is that such a pledge can only be created if the pledged object is transferred by the debtor to the creditor or to another person who will keep the pledged property for the creditor – a storekeeper, for example. Being in the creditor's possession is a permanent prerequisite; the continued existence of the pledge depends on it too, which it why it is known as a 'possessory pledge'.

The system governing possessory pledges bears the unmistakable stamp of the rules of Roman law on *pignus*, which have not only been handed down virtually unchanged to the civil codes of continental Europe but have also found their way into Anglo-Irish common law and the Scandinavian legal systems. There is such a vast area of common ground that a detailed treatment would be superfluous.

Regrettably, however, this legal harmony is of limited value in practice, for the defining legal characteristic of a pledge is also its fatal flaw. Since the debtor must surrender possession of the pledged property, he cannot use it for his own economic ends; he cannot sell it, develop it or process it in his own company. This is the reason why a possessory pledge can only be used, to all intents and purposes, for objects which the debtor can do without, such as valuables, or which are embodied in securities, such as fungible shares in joint-stock companies, goods or pecuniary claims.

These disadvantages of possessory pledges also apply to the Austrian variant of assignment. In order to preserve the principle of pledged movable property (*Faustpfand*), Austrian courts and legal scholars have taken the view that an assignment is only admissible on the same conditions as the creation of a possessory pledge, in other words if the security is transferred to the creditor.

(2) Collateral in the debtor's possession

24. ***Preliminary remarks***

In stark contrast to both the convergence of the rules on possessory pledges and to their relative insignificance, real property pledged without transfer of possession is not only governed by a wide diversity of rules but is also a vital economic factor. The reason for both of these phenomena is historical: since an overwhelming demand for a form of credit security that would keep the collateral in use and at the *de jure* and *de facto* disposal of the debtor did not develop and establish itself in law until the late 19th

[40] Fischler and Vogel, *op. cit.*, pp. 134-136.

century, it was no longer possible to fall back on a common treasury of Roman legal rules. Each country therefore had to find its own way of authorising the creation and use of non-possessory security interests and is still doing so today. In view of the various economic needs on the one hand and the diverse legal starting points on the other, it is hardly surprising that the countries of today's European Union present a confusing patchwork of approaches and practical solutions. For that reason, the following summary must likewise be confined to a rough sketch of the main problem areas and the ways in which the various legal systems have been trying to solve them.

25. ***Restrictions on personal and real security***

In many countries not everyone can create non-possessory security interests for monetary credits, and in some countries the permissible forms of collateral and the range of securable claims are also restricted. Such barriers are mainly to be found in the countries of continental Europe which have not developed a general legal regime for non-possessory credit collateral alongside the age-old rules governing possessory pledges and have merely adopted various special laws to deal with particular categories of case. This applies to all the Mediterranean Member States, Austria, Belgium, Luxembourg and the Scandinavian countries; France has a dozen of these special laws. It is naturally impossible to go into details here. At any rate, the result in these legal systems is that large sections of the population, especially private individuals, are prevented from safeguarding their loans by means of non-possessory securities (and thus from being able to benefit from lower interest rates).

England and Ireland differentiate between the legal forms in which companies are constituted: sole traders and partnerships are unable to secure their credit by means of the floating charge that is open to joint-stock companies; instead, they are pointed towards the cumbersome and slightly disreputable device of the security bill of sale.

Only Germany and the Netherlands, as well as Greece and Spain to a lesser extent, have generally accessible systems of non-possessory security.

26. ***Creation***

On the form of the security agreement, see point 22 above.

In accordance with the general principles governing the transfer of real rights, two approaches to the creation of non-possessory securities may be distinguished in the Member States. In the split systems of the countries which have received Roman law and of the Anglo-Irish legal domain, real rights are automatically transferred to the acquirer on conclusion of the contract, but only within the direct relationship between the two parties; the effect on third parties usually depends on an additional act, such as the transfer or registration of the object, which gives rise to a disclosure requirement. Since the very purpose of non-possessory credit collateral is to avoid a real transfer, provision is generally made for compulsory recording of the collateral in a register. There are, however, exemptions from the registration requirement in exceptional circumstances; in the Netherlands the security agreement must at least be in an appropriate written form (see footnote 36 above).

In general terms, the only countries where registration is not required are Germany and, as a rule, Greece. Since both countries use the instrument of assignment, a notional handover to the acquirer is essential. The need for a real transfer is obviated by an agreement on 'constructive possession', the parties agreeing that, although the debtor transfers possession of the chattels in question to the creditor, the handover which the law of both countries requires is replaced by an arrangement whereby the debtor will henceforth keep the chattels for the creditor.

27. ***Specific and blanket security***

The legal systems of all Member States require in principle that the collateral must be precisely identified in the security agreement. In many of the systems based directly on Roman law, this principle is still strictly interpreted today, and the object used as security must be specified exactly; this basically rules out the inclusion of additional objects in the security, such as those the debtor might acquire after concluding the contract, unless the new property takes the place of security that has been used up or lost.[41] In England, however, the only requirement is that the security agreement should describe the collateral so unambiguously that it can be identified without the involvement of the contracting parties; in the case of a car dealer, for example, this means that the security agreement should cover his entire present and future stock of vehicles.[42]

The increased financial requirements of modern business have resulted in the exertion of pressure to relax the principle of precise identification. In the past, capital goods such as machinery were the main form of security for loans for capital investments and the acquisition of working capital. Since capital goods are generally covered by the suppliers' security interests and many sectors of the economy scarcely require any capital goods nowadays, a company's current assets are often its only available collateral when it needs to borrow in order to finance its operations. These assets, however, are intended for use; they may take the form of finished goods that are ready for sale, or they may have to be finished before being sold; they will then be replaced by more of the same goods, raw materials or semi-finished products. If a company wishes to use such assets as collateral, it will need to furnish a form of blanket security; in other words, instead of specifying individual items of collateral, it needs to put up a variable mass of collateral. This mass, of course, will also have to be defined.

The Member States have only taken partial account of this new type of requirement. They have embarked upon two paths, which can be pursued individually or in combination. The first path introduces some relaxation of the traditional exact specification requirements by permitting a general definition of the collateral (e.g. all the debtor's goods in storage area B). This method has been authorised in Germany and the Netherlands but not in France.[43]

[41] For France, see Simler, *Landesbericht Frankreich*, pp. 111-112.
[42] Goode, *Landesbericht England*, pp. 56-57.
[43] Drobnig, *Generalbericht*, p. 22.

The second path consists in the creation of a new security interest, namely the company mortgage, in so far as it can cover all or part of a company's current assets. This latter aim is only partially achieved by the 'small' company mortgages of the Roman-law countries; to be more specific, such mortgages are not available at all in France, they are only available for up to 50% of product stocks in Belgium, whereas they are unlimited in Spain. 'Large' company mortgages, i.e. those which cover all types of company assets, exist in Sweden and Finland and, by virtue of case law, in the United Kingdom and Ireland in the form of the floating charge. In any event, both the small and large versions of the company mortgage are also suitable means of providing collateral on the basis of a company's fixed assets as they stand at any given time.

28. ***Substance and ranking of security***

If the highly diverse national designations for the legal institutions in the domain of real security are reduced to their objective substance, they boil down to two basic institutions of property law, namely pledging and property. The main elements of pledges in the general sense are those legal institutions associated with the term 'hypothec' or 'mortgage' which are based on security interests in land, in which the encumbered parcel of land remains the property of its owner and normally stays in his possession too; these institutions include chattel, ship, aircraft, vehicle and company mortgages. The terminological unity of the terms 'pledge' and 'mortgage' is even recognised by law in some countries.[44]

An alternative security instrument to the pledge is property in the two basic forms of retention of title (for details see points 33 to 39 below) and assignment, as well as corresponding legal devices in the various Member States, such as the chattel mortgage and the security bill of sale. If property is defined in a wider sense, assignment will also fall under this heading. All these forms by which a full property right is transferred to the creditor to afford him security have been created and cultivated in response to shortcomings in the legal or statutory formulation of the pledge as the 'genetic' form of security interest. The study of legal history and comparative law, however, also shows that the borderline between pledges and property can be crossed. There is an observable general tendency for the use of property as security to be assimilated to pledging through functional reduction. In the countries where property is used as security, various different stages have been reached in this process; as a rule, the degree of assimilation depends on whether the property is used to secure trade credit or monetary credit. Austrian law provides an example of almost complete assimilation (see point 25 above), and only in 1992 the Netherlands effected the complete conversion of assignment into a non-possessory pledge.

[44] An explicit provision to this effect is contained in section 448 of the Austrian General Civil Code; the Spanish Chattel Mortgages Act (*Ley de hipoteca mobiliaro*) also proceeds in its general provisions on the assumption that the two terms mean the same and only distinguishes between them in terms of the external characteristic of the greater or lesser ease with which the collateral is identifiable in each case – see Reichmann, *op. cit.*, p. 85. In France, however, the synonymity of the terms is disputed – see Drobnig, *Generalbericht*, pp. 15-16.

It is no coincidence, however, that the value of the property transferred as security is often eroded in individual cases by the debtor's insolvency. The third-party creditors' interest in the satisfaction of their claim against the debtor impels them to realise the full value of the collateral rather than leaving it to its proprietor. That is why in Germany, for example, the proprietor of the security only has a preferential right to satisfaction (*Absonderungsrecht*) in the event of the debtor's insolvency and not, like a normal proprietor, a right to separate his property from the bankrupt's estate (*Aussonderungsrecht*). While the proprietor of the security is able to satisfy the secured claim from the collateral on a preferential basis, any additional yield from the collateral must be paid over to the receiver for the benefit of the other creditors.[45]

Pledges and, more especially, chattel mortgages take precedence if the collateral was unencumbered when these security interests were created. This applies especially when the debtor's other legally recognised creditors have competing claims, in other words when the creditor holding the pledge or mortgage brings a foreclosure action. On the other hand, there are national variations in the ranking of debt security in relation to statutory priority claims, such as those of the tax administration, employees and social insurance schemes.

29. ***Realisation of security***

The practical realisation of the credit collateral in case of necessity, i.e. if the debtor defaults, is of paramount importance to the creditor. Yet here, as elsewhere, we are faced with wide divergences within Europe. These directly reflect a variety of attitudes among the Member States as to the balance that should be struck between the interests of the creditor and those of the debtor. Although it would be impossible to set forth all the relevant details here, especially as many of them would lead us into the realm of procedural law, the prevailing trends can at least be indicated.

The protection of debtors is particularly well developed in the legal systems based directly on Roman law. In France, for example, the realisation of collateral in the form of non-possessory pledges and chattel mortgages such as the company mortgage must be effected as a rule through an auction sale ordered by the court. Alternatively, the creditor of a non-possessory pledge may have the collateral assigned to him by the court at a price determined by a court-appointed expert. If the creditor is the proprietor of the collateral, he may claim the collateral without compulsory realisation. In Spain, too, an auction is also compulsory and can be ordered by the court in summary proceedings.

Germany has adopted a middle position in the sense that, when security is transferred, the parties can generally agree on rules governing the realisation of the collateral, provided that these rules are consistent with high moral standards (*gute Sitten*) and that the customary agreement on general terms and conditions complies with the applicable laws and regulations. The legal position becomes uncertain in the absence of an agreement

[45] Section 51(1) of the Insolvency Code 1994 (*Insolvenzordnung*). The same applies in Austria under section 10(3) of the Bankruptcy Code (*Konkursordnung*).

between the parties. According to a disputed but increasingly widespread view, it is supposed to be in the parties' interest to permit the sale of the collateral or its purchase by the creditor in lieu of the cumbersome, expensive and time-consuming process of organising a public auction. Any surplus over and above the value of the secured claim must be paid over to the debtor.

The interests of creditors are afforded an even higher level of protection in Anglo-Irish law. The creditor can, partly by virtue of the law and partly on the basis of an agreement, take over the collateral amicably. He can also – again by virtue of a mixture of legal and contractual provisions – sell the collateral in the open market. In the case of the floating charge, the creditor is empowered, if he so wishes, to appoint an administrator to take charge of the statutory organs of the debtor company and the bodies established by its constitution until the creditor is satisfied.

(3) Claims used as security

30. ***Creation of the security interest***
On the form of the security agreement, see point 22 above.

As far as additional requirements are concerned, particularly in terms of effects on third parties and the third-party debtor (the debtor of the assigned claim), a distinction has to be made. It is agreed that the security interest cannot be set up against the third-party debtor of the claim used as credit security until he has received notice thereof.

What is more doubtful, on the other hand, is whether and in which respects conditions have to be fulfilled before the security interest can have an effect on other third parties, particularly the creditors of the pledger or assignor, and in particular whether it is necessary to give notice to the third-party debtor in this case too. To answer these questions, we must begin by distinguishing between two basic ways in which claims are used as security. According to the civil codes of continental Europe and the Scandinavian laws, a claim may be pledged to the security creditor; to that end, the possessory-pledge regime is extended to claims, even though the latter are not in any way possessions. The Anglo-Irish legal systems reject this approach.

Almost all the legal systems, on the other hand, recognise the assignment of claims for security purposes, even though a few dissenting voices can still be found in the legal systems that are rooted in Roman law. In view of the similarity of pledging and assignment, both will be treated together here.

In most countries the effect on third parties of both a pledge of a claim and an assignment depend on the pledge or assignment being notified to the debtor of the claim in question. In some countries there are special prescribed formalities, such as formal service of the notification; the notice of pledge or assignment may, however, be replaced by recognition of the assignment by the third-party debtor, though this must also be recorded in a public document.[46] In addition to this notification, English and Irish law require that the

[46] Articles 2075 and 1690(1) of the French Civil Code.

assignment be registered in the company's official records. The legal position in Portugal has yet to crystallise.[47] In Austria, the need to notify the third-party debtor may be circumvented in the case of claims on which ledgers are kept by means of an entry in the ledgers recording the pledge or assignment.[48]

In a small number of countries there is no need to notify the third-party debtor. This is the case in Austria, Belgium and Germany for assignment and in the Netherlands for the undisclosed pledge of a claim, which has replaced the device of undisclosed assignment.

31. ***Future claims***

As far as the practical value of pledging and assignment is concerned, great importance attaches to the question whether these dispositions will also be able to cover future claims, in other words claims for which there was no basis yet when these dispositions were made.[49] Only if this question can be answered in the affirmative will blanket assignments be possible; the economic need for blanket security is discussed in point 27.

In most of the Member States today the courts permit the assignment of future claims. In some countries, such as France, the issue has yet to be resolved, but blanket assignment covering future claims is occasionally permitted in special cases by virtue of particular legislation.

32. ***Realisation***

The main aspects of the rules concerning the realisation of claims that have been pledged or assigned as security are in agreement, and so there is no need to discuss them.

B. Security for trade credit

33. ***Preliminary remarks***

A special functional form of credit security that has been developed in all the Member States is the retention of title, with the aid of which a seller can obtain security for the purchase price for which he has granted credit and possibly for additional claims against the buyer. In many countries supplier's credit (trade credit) and the corresponding security, which involves the seller retaining the title to the purchased object, play a major role. In law and practice, retention of title takes a place of its own alongside the various forms of security for monetary credit (see subsection A above).

[47] See also section 398 of the German Civil Code and Article 1690(1) of the Belgian Civil Code, as amended in 1994.

[48] This requirement stems from a judicial opinion delivered by the Supreme Court of Justice on 15 November 1929 (SZ 11, No 15) – a highly unusual source of case law. The entry in the ledger, containing the date and the name of the assignor, must be made for each claim affected by the pledge or assignment; these details may also be abbreviated by means of symbols.

[49] If there is a contractual basis for a claim, it is immaterial whether the claim already exists or even whether it has fallen due.

However, the boundary between the two principal means by which a supplier can secure the credit he has granted is not absolute. Some countries, particularly France, have special laws which make it possible to secure trade credit by means of a non-possessory pledge when certain types of item, such as vehicles and machinery, are purchased. The vast majority of these laws date from a time when retention of title did not yet provide sellers in those countries with comprehensive protection, especially if the buyer went bankrupt.

In some countries, notably England, the legal distinction between pledges – including non-possessory pledges – on the one hand and retention of title on the other is strongly emphasised, retention of title being defined as quasi-security. The purpose of this sharp distinction is to dissociate retention of title clearly from the general conditions governing the third-party effects of non-possessory credit security and in particular to keep it exempt from compulsory registration.[50] This divergence from the 'genetic' forms of credit security is certainly apparent elsewhere, albeit less clearly. It reflects an attitude that is particularly prevalent in countries which also use a property-based form of security, such as assignation, for monetary credit.

The following summary begins by discussing simple retention of title as the basic form of this legal institution. In its simple form, retention of title only serves to secure the purchase price for the object of which the seller reserves ownership. Extended and broadened retention are dealt with in points 38 and 39 below.

34. ***Creation of simple retention of title***

In the Scandinavian countries as well as in Greece and Italy, retention of title is invalid in the case of objects intended for resale or processing.

The formal requirements set out in the retention-of-title clause, which is normally found in the sales agreement and/or in supplementary general terms and conditions of trade, tend to vary. Only German, English and Irish law accept any form in principle. Written form is a general requirement in the Scandinavian countries; in France, written form is prescribed at least in the event of the buyer's bankruptcy – which makes it altogether indispensable! Italy and Spain require the same written form with a 'secure date' as is prescribed for non-possessory security for monetary credit (see point 22 above). In the Netherlands, written form is essential for leases with a purchase option, but all other credit sales are regarded as hire purchase, which confers ownership on the buyer when the object is handed over, thereby ruling out retention of title.

An additional formal disclosure, such as registration, is generally neither necessary nor possible. In exceptional cases, Italian law prescribes registration for retention of title when machinery is sold. In France, registration became possible only recently and puts the creditor in a slightly more advantageous position in bankruptcy proceedings against the buyer.

35. ***Specific and blanket security***

[50] See for example Goode, *Landesbericht England*, pp. 70-71.

Blanket security in the present context does not refer to the possibility of extending or broadening a retention of title, because extension merely stretches the security for a particular claim to cover replacement collateral, while broadening makes existing collateral cover liability for additional obligations (for more details see points 38 to 39 below).

What a blanket retention of title actually means is a retention in which the retained items are exchangeable, i.e. in which objects may be withdrawn from the mass of collateral for legitimate purposes, such as sale or processing, and be replaced by objects of the same type. The authorisation of this type of blanket retention is governed by the same criteria as non-possessory security for monetary credit (see point 27 above). Recently, however, the French legislature took this form of protection a step further by laying down that, in insolvency proceedings against a buyer, a retention of title relating to substitutable objects is valid even if the buyer's assets include objects of the same class and quality as the objects covered by retention of title that the buyer has sold.[51] So in such cases the seller no longer needs to prove that the objects he is reclaiming are identical with the ones he supplied.

36. ***Third-party effects and ranking***

The special status accorded to retention of title in relation to other non-possessory forms of credit security is reflected with particular clarity in the fact that its effect on third parties is not fundamentally dependent on registration, other than in the exceptional cases in which registration is prescribed (see point 34 above). The most important third-party effect and, at the same time, the special character of retention of title come to the fore when the buyer becomes insolvent. By virtue of his retention of title, the seller is able to retrieve what belongs to him from the buyer's estate without the need for compulsory realisation. This is the crucial difference between retention of title and the other forms of non-possessory credit security – the 'genetic' forms, of course, but also, in most countries, the 'synthetic' forms too, particularly the transfer or assignment of security (see point 28 above). Only in Greece, and probably in Luxembourg too, does retention of title have no effect in the event of the buyer's bankruptcy, unless the seller terminated the sales contract on the grounds of default by the buyer prior to the institution of bankruptcy proceedings.

Ownership, being the supreme and most comprehensive property right, must always rank highest, according to the uniformity principle in Roman law. Herein lies a certain weakness too, however, which manifests itself most clearly in retention of title as a form of security designed to secure the funding of a purchase. Payment of the purchase price in instalments leads to an increase with each instalment in the buyer's entitlement to acquire ownership of the object in question, at least in economic terms. The absolute nature of ownership, however, rules out the possibility of converting this entitlement into a right *in rem*. Only in Germany, apparently, has a way out of this dilemma been found. The German approach, breaking with the principle of *numerus clausus*, assigns a new right *in*

[51] Article 121(2), second sentence, of the Bankruptcy Act 1985 (inserted in 1994).

rem to the buyer, namely – on the basis of the suspensively conditional transfer – an inchoate right to acquire ownership. The buyer may encumber this right with real or personal security or make other use of it; but his creditors too may attach this right and levy execution on it.[52] For anyone who is so minded, it is possible to see in this a certain convergence with the U.S. system, in which retention of title has been subsumed into the category of security interests, a system that is advocated by a number of commentators in Europe. The buyer in the United States acquires ownership of the object when the contract is concluded and the object is handed over, the seller's security being converted into a non-possessory pledge.

37. ***Realisation***

The realisation that is effected in the case of security interests is ruled out for retention of title if and in so far as the latter is recognised as a full right, which is in fact the case in all Member States. If the buyer defaults, the seller may reclaim the merchandise and do with it as he pleases without having to settle accounts with the buyer. The same applies in principle if the buyer goes bankrupt (see also point 36 above).

38. ***Extended retention of title***

The sale of current assets is often subject to retention of title because the buyer needs the seller to allow him to defer payment of the purchase price until such time as he himself has resold the goods. If a manufacturing company has bought raw materials or semi-finished products under a contract prescribing retention of title, it cannot resell these items at a profit until it has turned them into other products (e.g. wool into garments, steel into tools). A seller who is aware of this situation and is willing to grant this type of extended credit will allow the buyer a legal and/or actual right of disposal over the supplied merchandise but will have to extend his own security accordingly. In the first case, the buyer's claim on his customers for payment of the selling price on resale of the goods lends itself to use as collateral; in the second case, in which the merchandise is processed by the buyer, security may initially take the form of the newly processed goods and be extended thereafter to the processor's claim to payment on resale. These two economic needs equate to two types of extended retention of title. Extension to the future claim against customers for the selling price on resale of the collateral is achieved by means of an assignment of future claim in the sales contract; extension to the new products that result from processing is effected by means of a processing clause. A processing clause is often combined with an assignment of future claim clause.

Only in Germany, which has been in the vanguard of the development of extension clauses, are both clauses effective in principle, provided they are carefully formulated. Details and refinements must be left untreated in the present summary. In English and Irish law, while it is possible to assign future accounts receivable, such assignment is only valid if it is registered in the purchasing company's records, since it amounts to an assignment of security (see point 30 above). The same applies to a processing clause.

In all other Member States contractually extended retention of title is either not practised or is at least ineffective in law. In France, however, if the buyer is declared bankrupt, the

[52] For a brief treatment, see Drobnig, *Generalbericht*, pp. 29-30.

seller has an automatic legal claim against him for the outstanding amount of the selling price owed to the buyer by the customers to whom he has resold the seller's goods; this entitlement only applies, however, if the goods subject to retention of title were not processed before being resold.[53] In those countries in which even simple retention of title in respect of items intended for resale or processing by the buyer (see point 34 above) has no legal effect, extension clauses are naturally a legal impossibility.

39. ***Broadened retention of title***

Unlike extended retention of title, broadened retention is not about extending security to include future rights in respect of the original merchandise but rather about widening the circle of secured claims beyond the buyer's claim to the purchase price for the merchandise itself. The scope of the seller's retention of title may undergo minor broadening by the inclusion of other claims that the seller has against the buyer, especially if the buyer is a regular customer. In the case of major broadening, besides the seller's claims, the claims of other creditors associated with the seller against the buyer are included in the mass of security; a group clause, for example, would include the claims of an entire group of companies.

Germany permits broadened retention of title in principle, although it has recently prohibited the said group clause. Moreover, any retention of title extending beyond the merchandise that was originally secured is only regarded as an assignment of security. This means that, in the event of the buyer's insolvency, it has the more limited effect of an assignment, merely entitling the seller to preferential satisfaction rather than complete separation of his assets from the estate (see point 28 above). Broadened retention of title is recognised in the United Kingdom and presumably in Ireland too.

In Denmark and the Netherlands, on the other hand, broadened retention of title is prohibited, while in Sweden it is inapplicable to consumer purchases at any rate. Dutch law explicitly lays down that the presence of an inadmissible broadened-retention clause does not invalidate retention of title as such, so simple retention of title remains in force.[54] Whether this reasoning would be accepted in the other two countries remains open to question. In all other Member States, broadened retention of title is virtually unknown, so its legal effect is quite uncertain, though it does seem rather doubtful that the courts in those countries would uphold such a clause.[55]

[53] See the thorough treatment of this topic in Kieninger, pp. 68-107.
[54] Article 3:92(2) of the Dutch Civil Code.
[55] For a general discussion of this issue, see Kieninger, pp. 113-119.

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Harmonisation of the law of civil procedure in the European Union in the context of the creation of a European Civil Code

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I. Variations in procedural law within the European Union

1. ***Standardised and autonomous procedural law***
The current situation in the European Union with regard to the harmonisation of procedural law is somewhat ambivalent. While the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters and its ripple effects on more general issues of procedural law (see point 18 below) have standardised some important areas of the international law of civil procedure, the core of the systems of civil procedural law in the individual Member States has remained largely untouched. This core is subject to countless variations throughout Europe. On the one hand, the divergences between the continental procedural codes and English procedural law are considerable, although it must be said that the gap has been narrowed to some extent by the implementation of the Woolf Report in England and Wales in April 1999 and that at least the differences are far less significant than those which exist between the European procedural codes and the procedural law of the United States. On the other hand, even if we look beyond English procedural law, considerable variations exist among the continental procedural codes themselves. In view of these significant disparities, which derive from historical, ideological, constitutional and structural differences between the nations of Europe, the only way to start is by focusing on the distinction (see points 5 and 6 below) between technical procedural rules, which lend themselves to harmonisation, and non-technical rules, which do not. We should not be pessimistic, however, about the outcome of this examination; given a proper understanding of the nature of technicality, we shall discover a host of everyday procedural laws which may be classed as technical and which are therefore ripe for harmonisation.

2. ***Technical procedural rules: the dynamics of harmonisation***
Two further aspects merit consideration. The first is that the concept of technicality will have to be construed in a European rather than a national manner. The crucial factor will be the function of the relevant rules within the single market and not so much on their

nationally conditioned status within their respective Member States. Secondly, the momentum that the harmonisation process will gather once it has been set in motion must not be disregarded or underestimated. The fact is that, if the initial harmonisation of the technical issues is tackled judiciously and successfully, it will probably generate its own dynamism and lead in due course to attempts to harmonise areas of procedural law that were once considered taboo and unchangeable. On this basis we can begin by considering the harmonisation of civil procedural law in general (section II) and within the European Union (section III).

II. Harmonisation of civil procedural law in general

3. *Harmonisation of substantive law and procedural law*

In both theory and practice, the main difference between these two great categories of law in terms of harmonisation lies in the applicability or non-applicability of foreign law by domestic courts. While domestic courts are competent to apply foreign substantive law, provided it does not conflict with national law, in procedural law this avenue, this obligation, is effectively closed to them because of the primacy of the *lex fori* principle in the domain of adjective law. This means that one of the main incentives for the harmonisation of substantive law, namely the prospect of consistent treatment, coupled with the virtual absence of conflicting laws and with simplified administration of justice, is unavailable in procedural law. As long as national courts apply only their own domestic procedural law and do not concern themselves with foreign procedural rules, the coexistence of divergent systems of procedural law is unlikely to trouble them.

4. *The international law of civil procedure*

Two reservations, however, have to be made. The first concerns the international rules of civil procedure, such as the provisions on international jurisdiction, international litispendence, the probative value and admissibility of contracts concluded abroad or deeds executed abroad, the recognition and enforceability of foreign judgments and arbitral awards, and so forth. Even when procedural rules are adopted by national legislatures, their substance should take account of the needs of international legal proceedings. In this respect any normative provision on a particular subject requires consultation regarding the substance of the norm.

5. *Procedural law in the process of political integration*

The second reservation is that, irrespective of the international law of civil procedure, cross-border harmonisation of procedural laws also becomes necessary whenever the various jurisdictions cooperate closely with each other or governments seek economic, social and/or political integration. Within the sort of framework that exists at the present time and may exist in the future, there is no justification for procedural divergences such as the way in which a debtor's place of residence affects the permissibility of issuing a payment order (default summons) to him or the variations in the available means of enforcement from one country to another. Harmonisation of procedural law is desirable, perhaps even imperative, in order to eliminate obstacles to a normal flow of trade and to the burgeoning integration process.

6. ***Desirable harmonisation of procedural law***
It is within the areas covered by the two reservations outlined above, i.e. the international law of civil procedure on the one hand and the burgeoning integration process on the other, that the harmonisation of procedural law is desirable. Admittedly, these two areas are both heterogeneous and heteroclite; in the first case, we have an area of law that is located between civil procedural law and private international law in the wider sense of the term; in the second case, we are not dealing with any particular domain of the law of civil procedure but the entire branch of the law, and we have to choose the subject of our examination on the basis of non-legal criteria, namely whether specific territories are in close contact with each other or are seeking fuller integration. Thus the harmonisation of procedural law emerges as a desirable and useful aim, at least in the context of the international law of civil procedure, irrespective of non-legal parameters, and then additionally across the entire field of civil procedural law, wherever it serves to promote the realistic pursuit of integration.

7. ***Inequality of treatment and freedom of movement***
With regard to the second area of harmonisation, two aspects merit consideration. First of all, procedural law must not place any obstacles in the way of the consistent treatment of persons and factual circumstances, nor must it suppress or restrict free competition. On the other hand, this free competition, especially in so far as it relates to professions involved in the administration of justice and particularly solicitors, must operate on firm and soundly underpinned foundations. In our context, this means that the free movement of solicitors within an area undergoing a process of integration can only come to full fruition within a fundamentally uniform system of procedural law throughout that area.

8. ***Is harmonisation an achievable aim?***
Moving on from the desirability to the practicability of the harmonisation of procedural law, we must focus on the various functions that characterise the relationship between the procedural and substantive aspects of a case. In fact, three such functions can be identified and distinguished.

9. ***Functions of procedural norms***
Firstly, the norms of procedural law can supply the technical instruments required for the judicial application of substantive law. These include the rules for calculating time limits or for the service of documents in civil proceedings and, in the main, the rules governing the institution of proceedings through the filing and service of actions. These rules serve no other purpose than to provide the necessary mechanisms for the conduct of civil proceedings. The only value to which these rules may be said to relate is surely that of the swift delivery of a fair judgment. But the values of swiftness and justice are inherent in all procedures governed by the rule of law. For that reason, the rules relating to the aforementioned aspects of civil procedure can, in principle, be applied irrespective of the other provisions of procedural law or indeed of the nature of the substantive law which the court is competent to administer.

10. A second function of procedure in relation to cognisance of the merits of a case emerges as soon as we look at procedural norms that are specially designed to support specific aspects of a particular branch of substantive law. One example would be the inadmissibility as evidence with full probative value of a deposition by one of the parties in a family action in which the parties are not free to determine the matter in dispute. In this case, harmonisation of the procedural rules would make no sense as long as no convergence of the corresponding substantive law had taken place, particularly with regard to the right of parties to determine freely the matter in dispute. The same applies on a wider scale too. For example, the rules governing special types of legal procedure, such as those relating to labour disputes or to disputes arising from securities, are often based on substantive legal positions concerning the claims that arise from these types of dispute. As long as no agreement is reached, at least in principle, on these substantive positions, harmonisation of the corresponding procedural provisions would be either impossible or meaningless. The specific supporting role of procedural law in relation to the corresponding areas of substantive law means that any rational harmonisation of the law must cover both procedural and substantive law; harmonisation that does not cover both types of law should not be undertaken at all.

11. Lastly, the function of procedural law can also be to take far-reaching policy decisions relating to the entire domain of the judicial settlement of disputes. For example, modern Anglo-American discovery procedure is closely linked with fundamental ideas on the duty of disclosure and on the need to achieve a balanced cost-benefit ratio. At the same time, the institution of the 'class suit' (representative action) raises fundamental questions about the fair and adequate representation of a diffuse host of parties, about effective summoning of the parties, about jurisdiction over parties living abroad and, above all, about whether and how the judicial system can address wide-ranging social problems. The extension of the binding force of *res judicata* to third parties as well as to the preliminary questions among the parties is connected with political ideas on the appropriate degree of judicial cognisance and on the utmost bounds of the effectiveness of a court judgment. In this domain, of course, the harmonisation of procedural law does not depend on any convergence of substantive law. It does, however, presuppose that a basic consensus can be achieved on the responsibilities of the judiciary, especially in relation to other functions of state and other forces within society.

12. ***Civil procedural law and technicality***
The presentation of the three functions of procedure in relation to substantive law (points 9-11 above) demonstrates that harmonisation of procedural law is both desirable and possible in the first group more than in the other two. This seems to suggest that procedural rules will lend themselves to harmonisation if they are of a technical nature. Be that as it may, the concept of technicality is polyvalent. According to one view, the entire body of procedural law is technical in terms of its role in relation to substantive law. As has been shown, however, for the purposes of procedural harmonisation a narrower concept of technicality is required, encompassing only those provisions of procedural law which are not value-based and so do not conflict with any value judgements that underlie the procedural law of particular countries within the convergence area. By this standard, both the European Civil Jurisdiction Convention and

the New York Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards are technical in nature. The first does not contain any decisions on legal policy beyond the necessary definition of the boundaries of international jurisdiction. The second Convention, besides defining these boundaries, also had to include rules on the objective right to arbitrate in international disputes. The choice to restrict the range of provisions to be harmonised has proved to be a reasonable price to pay for two manifestly successful pieces of international harmonisation of procedural law that would otherwise have been impossible.

13. ***Limits of procedural harmonisation***
Besides the technicality of provisions, there are other factors that affect the harmonisation of administrative law – adversely in this case. The most important are probably the key features of the various national court systems, which largely defy harmonisation, and the divergence between the functions that the same procedural institution is expected to perform in the various legal systems we seek to harmonise. On the first point, I need only refer to the role of national constitutions and organisational structures in determining the organisation and government of the courts. Both of these determinants depend directly on the machinery of government in the territory in question and, being such powerful external forces, are far from conducive to procedural harmonisation, making it extremely difficult if not downright impossible. At the same time, it must be stressed that the impossibility of harmonisation which results from the structure of the judicature frequently reverberates on other procedural issues. The law relating to appeals, for instance, which is anchored in a country's judicial structure and hierarchy, is often necessarily drawn into this body of procedural law that resists harmonisation, since the available remedies are almost invariably conditioned by the way in which the stages of appeal are structured.

14. As far as the various functions of a single procedural institution are concerned, one need only focus, for example, on the status of default proceedings. Whereas in English law the purpose of default proceedings is to distinguish the matters that are actually in dispute from those that are not and to organise the subsequent procedure accordingly, in France such proceedings are merely regarded as an expression of procedural abstinence, and in several other continental legal systems they are misused in practice by defendants as a delaying tactic. This sort of example demonstrates that it is not always enough to coordinate or harmonise the technical subtleties of a common procedural institution. On the contrary, it may become necessary to reach an agreement on the function and practical utilisation of such an institution. As long as that is not done, any attempt to harmonise the institution in question will be doomed to failure.

III. Harmonisation of civil procedural law in the European Union

15. ***Civil procedural law and the single market***
It has already been pointed out that the engagement of the component parts of a sizeable geographical area in a developing integration process creates a situation in which the judicious harmonisation of procedural law is both desirable and possible (see point 6 above). This applies all the more to an organised single market, since an additional factor comes into play here, namely the need for completely unhampered competition, which sometimes implies a uniform set of substantive and procedural rules for the treatment of claims. The argument that there have long been federally constituted states without uniform codes of civil procedure and that the European Union has not even attained the status of a genuine federation is unconvincing. First of all, the law of civil procedure is not accorded the same treatment within every federation. In the Federal Republic of Germany, for example, while the courts, apart from the courts of last resort, are organs of the individual federal states rather than the Republic, the procedural law they apply is almost exclusively national. The procedural law of the federal states no longer plays any more than a minor role. Other countries with a long tradition of federalism not only have this dispersed jurisdiction but also have separate systems of procedural law in the federal and state courts. In both the United States and Switzerland the individual state courts and cantonal courts apply the civil procedural law of their own state or canton. It is a fact that no fewer than 26 cantonal codes of civil procedure are in force in Switzerland. This provides a basis for the argument that a fragmented system of procedural law is compatible with a single market which is already operational, since both the United States and Switzerland clearly possess such markets.

16. The argument, however, is not watertight, for both countries have two important attributes that the European Union does not possess, namely a federal constitution and a supreme federal court, one responsibility of which is to verify the constitutionality of the various state law. On the basis of federal constitutional provisions, some of which are encapsulated in a single phrase (e.g. *due process of law*), the supreme federal court in both countries, through its rulings, has forged ahead with the creation of a system of civil procedural law which has never appeared in a statute book and yet is applied throughout the federation. Such institutions, however, have never been created in the European Union, not even by the Treaty of Amsterdam. The Treaty itself did not don the mantle of a European constitution. Nor has the Court of Justice of the European Communities been entrusted with the task of reviewing, on a general basis or even at the request of a litigant, the compatibility of the systems of civil procedural law in the Member States with a broad raft of principles that could be drawn from the founding treaties. As long as the potential unifying forces of a European constitution and a supreme court of justice with general jurisdiction fail to materialise, the harmonisation of civil procedural law will have to be left to secondary Community legislation.

17. ***Free movement of solicitors***
At this point I intend to return to the question of the free movement of solicitors, which has already been discussed in point 7 above. I do so because there is a need to put an end

to the argument that, when it comes to the free movement of solicitors, all the legal systems in the Member States have to be standardised. That is going too far. Such an argument overlooks the functional distinction between procedural and substantive law. Whereas the norms of substantive law are addressed to every citizen of the European Union, procedural law is essentially a matter for those who are professionally involved in the administration of justice. This primarily means judges and solicitors. Judges, however, can be eliminated at this point, since they are organs of their own state and are not subject to freedom of movement. The same applies, *mutatis mutandis*, to notaries public and bailiffs or sheriffs' officers. All of these regard their national system of civil procedural law as their staff regulations in the wider sense. However, when it comes to freedom of movement as a reason for the harmonisation of procedural law, solicitors emerge as the only group to be affected. The increasing amount of case law emanating from the Court of Justice of the European Communities on the free movement of solicitors, on freedom of establishment and on the mutual recognition of law degrees and other legal qualifications as well as of academic and professional titles furnishes additional proof of the importance attaching to this solicitor-centred freedom of movement between the legal systems in the Community. If this freedom of movement is to be fully implemented, a uniform basis for legal practice throughout the territory of the Community is required.

18. ***Lessons from the European Civil Jurisdiction Convention and its application***
Looking back at the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters and its application over a period of more than twenty-five years, I am prompted to make two observations which are particularly relevant to our present project. The first concerns the scope of its provisions and their gradual ripple effects on other issues in the realm of civil procedural law. In essence, Article 220 of the EEC Treaty charged the Member States to secure for the benefit of their nationals the reciprocal recognition and enforcement of judicial decisions within the Community. The Brussels Convention seems to have taken two giant steps towards the fulfilment of that mission. First of all, in place of the nationals of the various Member States it focused on all persons, irrespective of nationality, who live in the same territory. Secondly, it also regulated direct international jurisdiction, stipulating that the Convention applies even to cognisance by a court of first instance in the originating state. Even greater importance, however, attaches to the way in which the interpretation of the Convention, particularly by the Court of Justice of the European Communities, has widened its implications. In its attempt to construe the specific provisions of the Brussels Convention in a functional and appropriate manner, the Court began to interpret and coordinate the provisions of the Convention in terms of far wider issues such as entitlements under private law, the distinction between contractual and delictual claims, litispendence, the subject matter of actions and the incompatibility of court decisions with the spirit of the Convention. As a result of this effort, a multilateral enforcement convention has proved to be a treasure trove of mechanisms for the general harmonisation of the law of civil procedure. The description *European civil procedural law* that several commentaries have applied to the European Civil Jurisprudence Convention is not unwarranted. A successful convergence process has thus developed out of an instrument

of fairly limited scope which, through interpretation, quickly became an effective vehicle in the quest for a considerably more comprehensive harmonisation of procedural law.

19. The second observation concerns this very question of leaving the uniform and more or less binding interpretation of the European Civil Jurisdiction Convention to a single, central and permanent judicial organ such as the Court of Justice of the European Communities. Only through this centralised and binding interpretation has it been possible not only to maintain the Convention as a tool of everyday practice but also to imbue it with new spirit and link it to additional areas of judicial procedure. A comparison with the Hague Convention of Civil Procedure, which deals in part with similar questions, is quite revealing, because it is precisely the lack of a central binding interpretation that seems to have prevented the latter Convention from achieving the same sort of impact.

20. ***Areas of procedural law that are not yet covered by the Brussels Convention***
Given the success of the European Civil Jurisdiction Convention in its present form, consideration must now be given to extending the scope of its subject matter, particularly through the deletion of the exceptions listed in Article 1(2), especially those in subparagraph 2. A first small step has just been taken in this direction with the broadening of the scope of the Convention to cover certain family property disputes (the so-called Brussels II Convention), but the other exceptions listed in Article 1(2)(1) – the status, legal capacity and legal representation of natural persons as well as wills and succession – remain in place. The gradual removal of these exceptions could be built on the experience acquired through the implementation of the Convention and continue a tradition that has gained universal recognition.

21. ***Lessons from the work of the Storme Commission***
On the basis of the principles outlined above, the Storme Commission has made an initial tentative contribution to harmonisation of European civil procedural law, including the procedural systems in the United Kingdom. The Commission expressly based its reflections on the characteristic of technicality and the convergence of norms that already exists to some extent among the Member States. Its cooperation with prominent representatives of the common-law countries who are also acknowledged authorities on continental procedural law proved to be a sound and fruitful approach. Looking back at the Commission's published report, I am struck by two aspects of its working methods which could have been organised even more productively. First of all, the Commission seems to have been overoptimistic and overhasty in its pursuit of a comprehensive harmonisation of civil procedural law. Limiting itself to those areas that are truly ripe for harmonisation would probably have helped its cause. Secondly, it would have benefited from closer examination of court rulings in the various Member States; this would have revealed that many a divergence in the wording of national provisions has been counteracted by the judicious adjustments which the courts have made. I do appreciate, however, that the Commission would have needed an adequate infrastructure and far more time if its project were to go into such detail.

22. ***How much civil procedural law should be harmonised?***
Two concluding remarks should be made regarding the scope of the harmonisation effort and the actual geographical area in which the harmonised law should apply. With regard to the scope of the harmonisation process, legal practitioners are asking whether it should cover matters which have been traditionally regarded in Europe as straddling the borderline between procedural and substantive law, for example the rules of evidence or litispendence. If the principal aim is to codify civil law, with any partial harmonisation of procedural law being confined within that framework, the problem does not arise, because such a comprehensive harmonisation of private law would cover both sides of the borderline in any case. If, on the other hand, the harmonisation of civil procedural law is to be pursued as an end in itself, it would be more advisable to exclude such borderline cases, otherwise a project that is already difficult enough would be further complicated by additional and largely artificial definition problems.

23. As far as the territory of application is concerned, the question that must be considered is whether the harmonised procedural law should only apply to cases involving more than one Member State or whether it should extend to purely domestic cases in each of the Member States. This issue has cropped up time and again in recent discussions within various forums. Two arguments in favour of general applicability have perhaps been somewhat overlooked so far. Firstly, within a European Union in which the integration process is far advanced, there will be no more truly international cases. And secondly, general applicability of the (albeit only partially) harmonised law of civil procedure would relieve legal systems of the difficulties inherent in the need to define the distinction between national and supranational cases.

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Chapter II

Discrimination on grounds of nationality

The law governing service contracts

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1. ***Introduction***

Discrimination on grounds of nationality has always been almost totally absent from the law governing the sale of goods, which is why we do not have to deal with that branch of the law here; however, it has long been one of the main problems affecting the international law of service contracts. For that reason, the European Economic Community, shortly after its creation, began to consider what could be done to facilitate the activity of contractors outside their home countries. This applies in particular to the domains of financial services and insurance.[1] The legal position of commercial representatives[2] und of certain intermediaries in the domains of transport and travel services (travel agents)[3] was also examined at quite an early date. General directives designed to facilitate market access by promoting the mutual recognition of diplomas and certificates were adopted in 1988 and 1992.[4] There are also special sets of rules for particular types of contractor.[5] In many domains of the law governing service provision, structural discrimination has already been eliminated.

2. ***Shortcomings of the single market***

Despite these advances, the single market in services is not yet flourishing. *De facto* discrimination continues to rear its head everywhere, even – or perhaps especially – through individual customers. In our view, these cases of discrimination are the result of a whole complex of problems, relating to language and culture, occupational requirements and national substantive and adjective law. We believe that the present

[1] See for example Directive 64/225/EEC of 25 February 1964, OJ 56, pp. 878 *et seq.*, Directive 73/183/EEC of 28 June 1973, OJ L 194, pp. 1 *et seq.*, Directive 73/240/EEC of 24 July 1973, OJ L 228, pp. 20 *et seq.*, and Directive 76/580/EEC of 29 June 1976, OJ L 189, pp. 13 *et seq.*

[2] Directive 86/653/EEC of 18 December 1986, OJ L 382, pp. 17 *et seq.*

[3] Directive 82/470/EEC of 29 June 1982, OJ L 213, pp. 1 *et seq.*

[4] Directive 89/48/EEC of 21 December 1988, OJ 19/1989, pp. 16 *et seq.*, and Directive 92/51/EEC of 18 June 1992, OJ L 209, pp. 25 *et seq.* For examples of such recognition, see the annexes to Directive 92/51/EEC, as amended by Commission Directives 94/38/EC of 26 July 1994, OJ L 217, pp. 8 *et seq.*, 95/43/EC of 20 July 1995, OJ L 184, pp. 21 *et seq.*, and 97/38/EC of 20 June 1997, OJ L 184, pp. 31 *et seq.*

[5] Cf. Directive 89/595/EEC of 10 October 1989, OJ L 341, pp. 30 *et seq.*, which relates to nurses, Directive 93/16/EEC of 5 April 1993, OJ L 165, pp. 1 *et seq.*, which deals with physicians, Directive 98/5/EC of 16 February 1998, OJ L 77, pp. 36 *et seq.*, on solicitors and Directives 96/26/EC of 29 April 1996, OJ L 124, pp. 1 *et seq.*, and 98/76/EC of 1 October 1998, OJ L 277, pp. 17 *et seq.*, dealing with transport operators.

concentration of the European legislature on the effort to eliminate formal differences in the conditions for the practice of specific trades and professions has tended to result in neglect of the role played by other factors. It is, of course, impossible for linguistic and cultural barriers to be removed by means of legislation, even though there may be scope for the development of some initiatives, such as the provision of information on the cultural characteristics of individual countries to prospective contractors.

3. ***Outstanding legal problems that can be solved***

Whatever else might be required, there is certainly a need for appropriate measures to remove any obstacles of a judicial nature. The main substantive problem has already been discussed in the first chapter of this study, namely the absence of an adequate legal framework for service contracts. As a solution to this problem we propose the creation of a European regulatory system (see chapter III below). We are naturally well aware of the fact that such a system cannot be successfully created overnight.

Discrimination by prospective customers, however, is also encouraged by the procedural law of the Member States and of the European Union itself. Under Article 4(2) of the EEC Convention on the Law Applicable to Contractual Obligations, in principle – i.e. if the customer is not a consumer and the parties have not included a choice-of-law clause in their contract – the applicable law is that of the country where the contractor's principal place of business is situated. It is almost impossible, however, for a customer to obtain knowledge of the substance of the law that applies to the contract. A careful prospective customer can easily come to the conclusion that he should not get involved with foreign contractors. Such thinking repeatedly leads to effective discrimination against foreign contractors. This discrimination may even be reinforced by a 'race to the bottom' – a familiar phenomenon in the realm of social welfare legislation - whereby the provisions of private international law expose contractors to the temptation to establish their place of business in the country in which customers are afforded the lowest level of legal protection. Where customers are aware of this, it gives them another reason to discriminate against foreign contractors. The former will inevitably fear generalised unfair treatment by the latter.

The law governing insurance contracts

Jürgen Basedow, Hamburg

1. ***Direct discrimination***
   The law governing insurance contracts, like almost the entire law of contract, assigns rights and obligations to parties on the basis of the roles they fulfil, i.e. whether they are applicants or recipients, creditors or debtors, insurers or policyholders. These roles are not affected by the nationality of the parties, so insurance contracts are not subject to direct discrimination within the meaning of Article 12 of the EC Treaty.[1] In particular, there is no evidence to suggest that the acquisition of contractual rights by foreign insurance companies is subject to tighter conditions, that the rights themselves are any less extensive those enjoyed by nationally based insurance companies or that foreign insurers are required to fulfil stricter obligations than their domestic competitors.

2. ***Indirect discrimination***
   Discrimination in breach of Community law may, of course, be indirect in nature. For example, while the same statutory provisions may govern the contractual status of domestic and foreign insurance companies, it is possible that foreign companies might be required to pay more than their domestic counterparts.

3. ***Private international law***
   Rules of private international law are discriminatory in their effects if they invariably subject insurance contracts to the law of the policyholder's country. The consequence of such rules governing the choice of law is that, as well as enjoying the 'home advantage' of greater familiarity with the market, domestic companies also benefit from their greater knowledge of the law of the land; in particular, they are able to go on using the selfsame policies that have been in use for ever and a day in that country. When their competitors from other Member States conclude contracts with residents of the host country, on the other hand, they have to adjust to an entirely different law of contract (see chapter I above). If they do not operate in that market from a base within the host country but engage in trade in services from their registered office abroad, the considerable divergence between the systems of contract law in different counties will compel them to

[1] Following the entry into force of the Treaty of Amsterdam, the articles of the EC Treaty are referred to here and in the remainder of this summary by their new numbers.

draw up virtually new policies based on the host country's law governing insurance contracts. This means that they will have to seek expensive legal advice, which will certainly not be economically justifiable for those companies that baulk at the cost of establishing their own branches in the host country but would nevertheless be very interested in doing a certain amount of business in the intra-Community provision of services.

4. As long as private international law subjects such contracts to the law of the policyholder, i.e. of the host country, it is discriminating against foreign insurers to the benefit of domestic companies. This is the case throughout the European Community, except in the realm of large-risk cover and is not based on national law but on the choice-of-law rules enshrined in the second generation of insurance directives.[2] Only in the case of large-risk cover can contracts contain choice-of-law clauses in which insurance companies are free to stipulate that one and the same national law, normally the law of the country in which the insurer is based, is to apply to risks located in various countries; in this way, insurers can form sufficiently comprehensive risk pools throughout Europe.

5. ***Statistical data***
These theoretical deductions are confirmed by statistical data and recent political pronouncements. According to figures from Eurostat, the statistical office of the European Union, most insurance companies from EU Member States apparently prefer either not to operate in other Member States at all or to operate there through subsidiary companies or branch offices than to obtain cross-border business from their home base. The German non-life insurance companies, for example, evidently obtain only 0.13% of their total sales volume through direct cross-border transactions. The statistics show that only smaller Member States – Luxembourg, Belgium and Ireland – sell a significant percentage of their policies in direct cross-border transactions.[3]

6. ***Estimates made by the Commission and the Economic and Social Committee***
These statistical findings equate with the estimates made by the European Commission and the Economic and Social Committee. At the end of 1997, in a draft interpretative communication, the Commission stated that, "In the course of its contacts with numerous economic agents, the Commission has come to realise that the continuing uncertainty surrounding the basic concepts of freedom to provide services and the general good […] is likely to deter certain insurance undertakings from exercising the freedoms created by the Treaty which the Third Directives set out to promote".[4] In a meticulously prepared opinion it delivered at the beginning of 1998, the Economic and Social Committee also spoke of "a whole series of obstacles hampering completion of the single market".[5] More specifically, this means that "consumers are not therefore guaranteed non-discriminatory

[2] See Basedow in chapter I above, footnote 37.

[3] See the article headed 'Grenzüberschreitendes Versicherungsgeschäft noch bescheiden' in the *Frankfurter Allgemeine Zeitung* No 187 of 14 August 1998, p. 26.

[4] Draft Commission interpretative communication – freedom to provide services and the general good in the insurance sector, OJ C 365 (1997), p. 7.

[5] Opinion of the Economic and Social Committee on the subject of consumers in the insurance market, OJ C 95 (1998), pp. 72 *et seq.*; the quotation here is from p. 77, point 2.1.9.

access to insurance in Member States other than the one in which they reside or of which they are nationals".[6] This opinion of the Economic and Social Committee is simply stating the fact that freedom of consumers to be provided with services has not yet been achieved; discrimination between domestic and foreign insurers, in other words, affects consumers too.

7. ***Compulsory insurance***
Indirect discrimination resulting from the choice-of-law rules in the Second Directives on insurance is particularly serious, because it is rooted in Community law itself. Discrimination through national legislation almost pales into insignificance by comparison, but it must nevertheless be mentioned. The first area of national discrimination is actually connected with the choice-of-law rules in the Second Directives.[7] Under Article 8(2) of the Second Directive on direct insurance other than life insurance, when a Member State imposes an obligation to take out insurance, the contract must be in accordance with the specific provisions laid down for the policy in question by that Member State; this applies to all compulsory policies, whether they cover typical consumer risks or large risks and transport risks. The Directive therefore presents Member States with the opportunity to prescribe the application of national insurance law, even in the case of large-risk cover, by making insurance cover compulsory; where this is done, obligatory compliance with national insurance law constitutes another barrier to market access for foreign insurers and effectively discriminates against them and in favour of domestic providers.

8. There are wide variations in the volume of compulsory insurance and the number of compulsory policies prescribed by the Member States. The commentary on the German Insurance Contracts Act (*Versicherungsvertragsgesetz*) identifies 18 cases in which federal law prescribes compulsory insurance.[8] By contrast, the French Ministry of the Economy, Finance and Industry has published a list containing no fewer than 87 categories of compulsory insurance policy.[9] A detailed analysis of these numerous insurance requirements is not possible in the present context, but it is crystal-clear that the completion of the European single market in large-risk and transport insurance is being undermined when national laws prescribe compulsory insurance for a substantial number of such risks and thereby block the free choice of applicable law.

9. ***Statutory language requirements***
Discriminatory effects can also result from statutory provisions requiring that the language of the host country or another specific language be used for the conclusion of

[6] *ibid.*, p. 73, point 1.7.

[7] As footnote 2.

[8] Cf. Jürgen Prölss in Prölss and Martin, *op. cit.* (chapter I, footnote 3, above), *Vorbemerkung* IV, points 1-18.

[9] This list is reproduced in Dalloz, *Code des Assurances*, 4th ed., 1998, pp. 757 *et seq.*; see also Yvonne Lambert-Faivre, 'Les assurances obligatoires', in François Ewald and Jean-Hervé Lorenzi (ed.), *Encyclopédie de l'Assurance*, 1998, p. 541 and pp. 542 *et seq.*

insurance contracts. In relation to the free movement of goods, for example, the European Court of Justice has ruled that the "obligation exclusively to use the language of the linguistic region constitutes a measure having equivalent effect to a quantitative restriction on imports, prohibited by Article 30 of the Treaty".[10] In so far as services, such as insurance itself, are provided by means of language and cannot be provided without the use of a language, national rules which impose the use of a particular language in service contracts must be regarded as another violation of freedom to provide services and thus of a special facet of the general ban on discrimination.

10. Such language clauses are also found in insurance law. Where they prescribe the use of the national language for dealings with the supervisory authorities of the host country,[11] they are justifiable in the overriding general interest, especially as the Third Directives do not, in principle, permit systematic submission of the conditions of insurance to the supervisory authorities of the Member States.[12] Such clauses are difficult to justify, however, when the law of contract itself prescribes the use of the national language as a condition of the validity of an insurance contract, as is the case in Article L 112-3 of the *Code des Assurances* in France. According to Article L 111-2 of the *Code*, this is a mandatory provision.[13] Since Article L 181-1 states that French law is applicable as a rule in cases where the risk is covered in France, this means that such risks can only effectively be insured in the French language, even if the cover is provided by a foreign company.

11. The fact that the obligatory translation into French of foreign companies' insurance policies drastically increases the difficulty and cost incurred by those companies, especially in relation to the normal requirements of service provision, need not be spelled out. While the requirements of consumer protection might justify the application of this linguistic rule to insurance policies that are intended for the general public, there is no justification for its application to large-risk cover and transport operations. In these cases, although Article L 181-1(5) of the French Insurance Code grants the parties free choice of law in principle, this is granted without prejudice to the mandatory provisions of the French law on insurance contracts if, at the time when the applicable law is determined, all elements of the contract are located in the territory of the French Republic.

12. So to the extent that French branch offices of foreign insurance companies issue policies to French clients and that these policies cover risks in France, they must be drawn up in the French language. In the domain of marine insurance, this has already prompted the French *Cour de Cassation* to rule that the statutory language clause does not apply to marine and inland shipping insurance.[14] No such exception has been made for industrial insurance, which means that, even if French law is not chosen to govern the contract, it

[10] ECJ judgment of 18 June 1991, Case No C-369/89 (*Piageme*), ECR 1991 I, 2971, ground No 16.

[11] As in Article 82 of the Italian *Decreto Legislativo* No 175 of 17 March 1995, *Gazzetta Ufficiale* of 18 May 1995, No 114.

[12] See Article 29 of both Directives, which are referred to in Basedow, chapter I above, footnote 9.

[13] I am grateful to Professor Fritz Reichert-Facilides of Innsbruck and Hamburg, who brought these provisions to my attention.

[14] Cass. com. 11 March 1997, *Bull. civ.* 1997 IV, point 66.

must still be drawn up in the French language. In view of the close links between the law and the language in which it is formulated, this is hard to justify. In practice, of course, such difficulties can be circumvented if the contract is prepared and negotiated by the foreign company's branch office in France but is then concluded at its headquarters in its home Member State, so that the overriding mandatory provisions referred to in Article L 181-1(5) do not apply.

Statutory obligations

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1. ***The general law of tort or delict***
   As in the other branches of private law, discrimination against fellow EU citizens on grounds of nationality have become virtually non-existent in the domain of general tort. The delictual provisions of the codified systems of civil law have never distinguished between nationals and non-nationals anyway. Article 27 of the Spanish Civil Code states explicitly that foreigners shall enjoy the same civil rights in Spain as Spaniards unless otherwise provided in special laws and agreements. And although the reciprocity requirement set out in Article 16 of the general preliminary provisions (*disp. prel.; disposizioni sulla legge in generale*) of the Italian Civil Code[1] may seem extremely dubious at first sight, its impact on the general law of delict in particular has been considerably 'cushioned' by the Italian courts. In particular, 'moral damages' (*solatium* or general damages) are awarded by the Italian courts irrespective of reciprocity, provided the relevant foreign system does not discriminate against Italians on grounds of nationality. The Italian courts do not restrict their awards to cases in which a court in the plaintiff's country would award general damages to an Italian in the same circumstances.[2] So-called biological damages (*danno biologico*)[3] are awarded entirely independently of the reciprocity requirement.[4]

2. In areas where commercial law, company law, industrial and trade law,[5] the law of civil procedure[6] and the law governing land purchases[7] still recognise direct and indirect

[1] The text translates as follows: "Aliens shall enjoy the civil rights attributed to citizens, subject to reciprocity and save as otherwise provided in special laws".
[2] App. Trieste, 19 February 1983, *Riv.circ. e trasp.*, 1983 p. 804.
[3] On this point, see von Bar in chapter I above, point 30.
[4] Trib. Roma, 29 January 1993, *Riv. circ. e trasp.*, 1993, p. 558; Toriello, *Orientamenti giurisprudenziali in tema di condizione di reciprocità*, NGCC, 1995 II, pp. 159-182 (particularly p. 165).
[5] On this point, the reader is referred once more to the ECJ judgment of 7 May 1998 (Case No C-350/96: *Clean Car Autoservice* v. *Landeshauptmann von Wien)*, European Court Reports 1998 I, p. 2521. On the basis of this judgment, it would have to be assumed that provisions which imply that the publisher of a newspaper must be a national of the country of publication (such as Article 4 of the Italian law of 2 February 1948 - statute No 47) are contrary to Cummunity law.
[6] See the contribution to the present study by Konstantinos Kerameus.

discrimination, such provisions bear no specific relation to the law of non-contractual obligations. In cases where legally prescribed standards of behaviour indirectly influence the law of tort or delict, the courts of the Member States are usually careful to avoid any form of discrimination.[8]

3. ***Industrial and commercial property and copyright***
Discrimination against aliens was quite widespread for many years in the realms of the law against unfair competition and the law governing industrial and commercial property and copyright. This discrimination too has now largely disappeared in the wake of the relevant rulings by the European Court of Justice. The German legislature, for example, responded to the Court's identification of discriminatory provisions in the Copyright Act with the adoption on 23 June 1995 of amended versions of sections 120 and 125, which are no longer discriminatory. The old versions of Article 88 of the Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*) and section 28 of the Unfair Competition Act (*Gesetz über den unlauteren Wettbewerb*) were repealed. In Italy, however, the law of 22 April 1941 (statute No 633), with its reciprocity requirement in the domain of copyright, has yet to be repealed. In all of these matters, reciprocity should in any case be guaranteed within the European Union.

4. ***Compensation funds and related matters***
For a long time the law governing compensation funds was a source of problems in terms of discrimination. The idea of national solidarity will have been the factor that originally motivated many a legislature to make the availability of this form of protection subject to reciprocal arrangements for its own nationals. Now, however, all European legal systems seem to have realised that rules of this type are contrary to Community law.[9] More recent legislation on compensation funds, such as the French law granting compensation to those who have received infusions of AIDS-infected blood,[10] no longer makes any distinction on the basis of nationality. Compensation funds for environmental pollution tend to focus on the fact that the damage occurred within the territory of the awarding country rather than considering who caused it or suffered from it.[11] With regard to the Italian compensation fund for road-accident victims, back in 1993 the Supreme Court of Appeal (*Corte di Cassazione*) ruled that the right to compensation is independent of the existence of an equivalent fund in the victim's country.[12] The corresponding rules in French law explicitly place citizens of the EU on an equal footing with French

[7] In this domain, a whole series of restrictions on foreigners evidently still apply; the same goes for rent law (see for example Article 7 of the Spanish *Ley de Arrendamientos Urbanos*, which lays down that the enjoyment by foreign landlords and tenants of the benefits granted under Spanish rent law is subject to reciprocity.

[8] For a more recent example, see the judgment delivered by the Luxembourg Cour d'appel (*Pas.lux.*, 1997, p. 213). This case concerned a Luxembourg resident's Portuguese driving licence which had not been converted into a Luxembourg licence as the law required; the court ruled that this situation was not equivalent to driving without a licence.

[9] ECJ, 2 February 1989, *Neue Juristische Wochenschrift (NJW)* 1989, p. 2183 (*Ian Williams Cowan* v. *Le Trésor Public*).

[10] For details, see Pontier, *L'indemnisation des victimes contaminées par le virus du SIDA*, ALD 1992, comm. 37.

[11] See for example von Bar and van Veldhuizen, *Der niederländische Luftverunreinigungsfonds*, UTR 12, 1990. pp. 367-380.

[12] Cass., 10 February 1993, point 1681, *Foro it.* 1993, I, p. 3067 (per Calò).

nationals.[13] France has reformed its law on compensation of the victims of crime in the same way,[14] and Belgium has done likewise.[15]

5. ***Problem cases***
Here and there, however, some problem cases do still exist. One example from German law is section 11 of the Vehicular Accident Compensation Fund Order (*Verordnung über den Entschädigungsfonds für Schäden aus Kraftfahrzeugunfällen*), enacted on the basis of section 14(2) of the Compulsory Insurance Act (*Pflichtversicherungsgesetz*). The said section 11, as amended by the regulatory order of 17 December 1994,[16] translates as follows: "The road-accident victims' fund shall provide benefits to foreign nationals without a fixed address in Germany only if reciprocal arrangements exist. This shall not apply in cases where it is inconsistent with the provisions of international agreements concluded by the Federal Republic of Germany." This reciprocity clause is probably contrary to Community law.

6. Another provision that is not entirely without its problems occurs in the Swedish law on compensation for victims of crime, namely the third sentence of section 1(2) of the *Brottskadelag*,[17] which lays down that the Act is not applicable if the crime and its victim have so little connection with Sweden that compensation from Swedish tax revenue appears inappropriate. The legislature was evidently thinking of cases in which the foreign victim of a crime committed abroad was resident in Sweden at the time of the crime but subsequently returned to his own country. This rule does not apply, however, to a Swede who takes up residence abroad.[18]

7. ***Swedish law on damages arising from traffic accidents***
The problem referred to in point 6 above is admittedly very marginal in its scope. It is more important to focus on the all-out efforts made by Sweden before her accession to the EU to abolish every form of discrimination on grounds of nationality. A good example is furnished by the amendments to the Traffic Accident Damages Act.[19] Until 1992, damages were not awarded for traffic accidents unless the accident had occurred in Sweden or a Swedish-registered car had injured a Swede or a resident of Sweden in a foreign country (section 8(1) of the *Trafikskadelag* prior to amendment). For a short time, the Swedish legislature extended the scope for damages under the *Trafikskadelag* to the other countries of the European Economic Area, giving the injured party the right to choose between the Swedish and the foreign law on damages (section 8a of the Act as amended in 1992). This, however, proved to be impractical because of the frequent

[13] Viney, *L'indemnisation des victimes d'accidents de la circulation*, 1992, point 133.
[14] Article 706-3 of the Code of Criminal Procedure (*Code de procédure pénale*) as amended by the law of 6 July 1990.
[15] Cromheecke, *Hulpbehoevend slachtoffer word je niet zomaar. Commissie voor hulp aan slachtoffers van opzettelijke gewelddaden*, R.W., 1993, pp. 969-984 (particularly p. 977).
[16] Federal Law Gazette (BGBl.), 1994 I, p. 3845.
[17] Law of 18 May 1978, SFS 1978, p. 413.
[18] SchwKarnov (Nordborg), *Brottskadelag*, p. 1114, point 4.
[19] A German translation of this Act is contained in von Bar (Witte), *Deliktsrecht in Europa, Schweden*.

recourse to foreign law, even for accidents that had occurred in Sweden. Consequently, the Amendment Act of 9 December 1993[20] introduced an amended section 35(1), the wording of which translates as follows: "The motor insurance issued in pursuance of this Act, besides covering the traffic-accident damages prescribed herein, shall also cover damage arising from the use of a motor vehicle for transport by road in a country of the European Economic Area (EEA) other than Sweden, to the extent that such damage would be covered by a compulsory third-party motor-insurance policy under the legislation of the country in which the damage occurred. This shall also apply to damage arising during a direct journey between two countries of the EEA if the injured party is a citizen of such a country."

8. ***The international law of criminal procedure***
It may seem puzzling at first sight to find observations on the international law of criminal procedure in the context of a discourse on private law. The subject may, however, crop up in connection with discrimination problems in cases where civil damages are claimed in the framework of criminal proceedings (so-called 'adhesion proceedings'). The problem is illustrated by a question referred to the European Court of Justice by the German Federal Court of Justice (*Bundesgerichtshof*)[21] for a preliminary ruling. The European Court was asked to rule on the recognisability of a French judgment against a German doctor who had treated a French girl in Lindau (Germany) and, in so doing, had (in the French but not the German view) negligently caused the girl's death. The French court had based its claim to international jurisdiction exclusively on the French nationality of the deceased girl. The point at issue in this case is whether the French claim may be considered contrary to public policy under the terms of the European Civil Jurisdiction Convention and thus whether recognition of the French judgment may be withheld in Germany. The European Court of Justice has not yet delivered its preliminary ruling.

9. ***Private international law***
The most glaring example to date of preferential treatment of a country's own nationals was provided by Article 38 of the Introductory Act to the German Civil Code, which laid down that an unlawful act committed abroad against a German could not give rise to claims in access of those allowable in German law. However, by virtue of the second German Private International Law Reform Act, which entered into force on 1 June 1999, this provision has been deleted *in toto.* The same applies to the Application of Law Order (*Rechtsanwendungsverordnung*), which dated from 1942.[22]

10. One provision which, though reminiscent of the repealed Article 38 of the Introductory Act to the German Civil Code, is actually worded in general terms and is therefore non-discriminatory is to be found in section 23(2) of the Austrian Nuclear Liability Act (*Atomhaftungsgesetz*) of 1999, which states that compensation for damage which has

[20] SFS, 1993, p. 1384
[21] Federal Court of Justice (BGH) decision of 4 December 1997, *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)*, 1999, p. 26.
[22] More details are contained in the legislation report in Nähere Angaben in dem Gesetzgebungsreport in the *Zeitschrift für Rechtspolitik (ZRP),*1999, p. 224.

occurred abroad but is assessable on the basis of Austrian law is payable only if and to the extent that the injured party's personal status so permits. At two points (sections 8(1) and 10(2)), however, the Act stipulates that the requisite insurance (third-party liability and provision for cover) is subject to Austrian law.

11. ***State liability***

In the realm of official liability in relation to aliens, the Imperial Liability (Civil Servants) Act,[23] prior to its amendment on 30 June 1992, only allowed a claim for official liability against the Federal Republic of Germany if the legislation of the relevant foreign State or an international agreement guaranteed a reciprocal right and that guarantee was promulgated in the Federal Law Gazette. This rule has now undergone considerable amendment.[24] What is most important is that the reciprocity requirement for claims by nationals of EU Member States was abolished with effect from 1 July 1992 (section 7(II) of the Imperial Liability (Civil Servants) Act as amended). This being the case, there is no longer a risk of discrimination against aliens.

[23] Law of 22 May 1910 on the Liability of the Empire for its Civil Servants (*Gesetz über die Haftung des Reiches für seine Beamten*) – Imperial Law Gazette (*Reichsgesetzblatt*), p. 798.

[24] The amendment was effected by Article 6 of the Law governing Staff Regulations for Public Servants on Special Missions Abroad (*Gesetz über dienstrechtliche Regelungen für besondere Verwendungen im Ausland*) of 28 July 1993, Federal Law Gazette (BGBl.) I, pp. 1394 and 1398.

The law governing credit security

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1. ***Discrimination on grounds of nationality***
   There is no evidence of discrimination on grounds of nationality in the general law governing credit security in any of the Member States. On the contrary, the relevant provisions always refer in neutral terms to creditors and debtors, sureties, assignors and assignees.

2. ***Indirect discrimination on grounds of residence abroad***
   The European Court of Justice has consistently stated that indirect discrimination on grounds of nationality may obtain if statutory provisions link a person's place of residence abroad with adverse legal effects, since in practice the vast majority of those who are adversely affected are foreigners. There is no discrimination, on the other hand, in the national statutory requirement that a person should reside within the national territory for objective reasons unrelated to nationality if that requirement is an appropriate means of achieving a legitimate purpose of the statute in question.[1]

   Similarly, a rule prohibiting the provision of services by persons who are based in a Member State other than the one in which the recipients of the services reside or have their registered office is in breach of Article 49(1) of the EC Treaty (new numbering), as the European Court of Justice recently decided in a case relating to suretyship law.[2]

   In ther light of these considerations, some provisions have to be reviewed, particularly those provisions of older instruments in the realm of suretyship law which link the lack of a place of residence in the national territory with adverse legal consequences for one of the contracting parties. On the other hand, rules which provide for legal consequences in the event of a person moving his place of residence out of the national territory or even giving up a place of residence in the national territory do not involve any of the indirect discrimination to which I have been referring here, for in these cases there are no grounds for the assumption that such persons will normally be foreigners. On the contrary, they

[1] For a recent example, see the ECJ judgment of 7 May 1998, Case No C. 350-96 (*Clean Car Service GmbH v. Landeshauptmann von Wien*), ECR 1998 I-2521 (especially pp. 2546-2547).
[2] ECJ judgment of 1 December 1998, Case No C. 410/96 (*Ambry v. France*), WM 1998, p. 2517.

are most likely to be nationals. Such rules may, however, be questionable on the basis that they restrict freedom to provide services (see point 3 below).

Not every country has a rule like the one contained in section 1349 of the Austrian General Civil Code whereby 'anyone' may bind himself to be responsible for the fulfilment of another person's obligation. On the contrary, in some countries there are restrictive rules on the 'suitability' of a person as a surety for a principal debtor who is required or permitted by contract, by law or by court order to provide security by means of a suretyship. The severest restriction is imposed by section 239(1) of the German Civil Code, which stipulates that a person is suitable to stand surety only if his court of general jurisdiction is in Germany. Since sections 13 to 17 of the German Code of Civil Procedure (*Zivilprozeßordnung*) lay down that, in principle, a person's court of jurisdiction is the one situated in or nearest to the place where he has his residence or registered office, section 239(1) of the Civil Code therefore indirectly requires that the place of residence and/or registered office of the surety to be appointed by the principal debtor (and not explicitly accepted by creditor) be situated in Germany. Herein lies a case of indirect discrimination against persons whose place of residence and/or registered office is in a foreign country as well as a restriction of their freedom to provide services. The fact that the provision focuses on the existence of a court of general jurisdiction in Germany reveals its intention, which is to guarantee that a creditor who is resident or established in Germany will be able to pursue the surety through the German courts in the event of default by the principal debtor. This purpose, however, can be achieved today throughout the entire territory of the EU by virtue of the provisions of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. Even a surety based in another Member State must therefore be regarded today as 'suitable' within the meaning of section 239 of the Civil Code.[3] It would be wise, however, to adapt today's misleading wording to the present legal position as set forth in European law.

A similar effect to that of the aforementioned German provision derives from a clause in the civil law of the French-speaking countries, which states that a principal debtor who is required to provide a suretyship must appoint as his surety a person with a place of residence in the judicial district of the appeal court of the place of performance.[4] Since this condition is normally only fulfilled by a national of the country concerned, this rule also constitutes covert discrimination as well as restricting freedom to provide services and should likewise be brought into line with the current position in European law.

Although Italy has a similar provision, but it is compatible with Community law because it is sufficient if the surety chooses a court of jurisdiction in the district in which the place of performance is situated.[5] In Spain, the surety is even required by law to do this.[6]

[3] A judgment to this effect was delivered by the Düsseldorf Higher Regional Court (*Oberlandesgericht*) on 18 September 1995, RIW 1996, p. 512, *Die deutsche Rechtsprechung auf dem Gebiete des internationaslen Privatrechts im Jahre (IPRspr)* 1995, point 135 (a major French bank stood surety in this case). See also the Hamburg Higher Regional Court judgment of 4 May 1995, *NJW* 1995, p. 2859, *IPRspr*. 1995, point 133 (this case involved a major Swedish bank, and the parallel Lugano Convention was invoked).

[4] Article 2018 of the French, Belgian and Luxembourg Civil Code.

[5] Article 1943(1) of the Italian Civil Code.

The same basic idea, albeit approached from the opposite angle, underlies Article 1831(4) of the Spanish Civil Code, which provides that a surety with subsidiary liability is not entitled to the normal *beneficium excussionis*, i.e. the defence of failure to pursue remedies, if the principal debtor has no court of jurisdiction in Spain. In such cases the creditor is not required to seek satisfaction from the estate of the principal debtor at his foreign place of residence or registered office but can turn directly against the surety who is based in Spain. The brunt of this provision, however, is borne by the Spanish-based surety, who, contrary to normal practice, is liable as a principal because the principal debtor is presumed to be a foreigner on account of his foreign court of jurisdiction. Although placing a country's own nationals at a legal disadvantage is not discrimination within the meaning of Article 12 (new numbering) of the EC Treaty, there is a need to examine whether this derogation from the normal rules of suretyship still has a place within a single market where freedom of movement applies to court judgments too.

3. ***When a principal debtor moves to a foreign country***

A few Member States make special remedies available, some against the surety and some in his favour if, after concluding the contract of surety, the main debtor moves his place of residence to a foreign country or threatens to do so. This cannot be regarded as covert discrimination on grounds of nationality, because most debtors who move abroad will be nationals of the country of jurisdiction. Such special provisions may, however, constitute an unlawful restriction of the freedom to provide services in all Member States under Article 49(1) (new numbering) of the EC Treaty (see footnote 2 above).

In German and Greek law a surety with subsidiary liability loses his normal entitlement to invoke the *beneficium excussionis* against the creditor if the creditor's pursuit of the principal debtor is considerably complicated by the fact that the latter has moved home since concluding the contract of surety.[7] When the courts interpret this provision, they are more likely to assume such complication in cases where the principal debtor has moved to another country. However, now that the free movement of court judgments is possible within the EU, the pursuit of a debtor can no longer be said to have been unduly complicated by the fact that the principal debtor has moved his residence or registered office to another Member State.

On the other hand, in the circumstances described above, any surety in Germany and Greece may require the principal debtor to release him from his suretyship or to furnish security.[8]

With a view to eliminating the restrictions of freedom to provide services in the European Community which are embodied in these provisions, steps should be taken to guarantee

[6] Article 1828 of the Spanish Civil Code.
[7] Section 773(1)(2) of the German Civil Code and Article 857(2) of the Greek Civil Code.
[8] Section 775(1)(2) and (2) of the German Civil Code and Article 861(2) of the Greek Civil Code; section 1365 of the Austrian General Civil Code lays down similar provisions.

that the aforementioned adverse legal consequences can no longer ensue when a principal debtor moves his residence or registered office to another Member State of the Union.

4. ***Principal debtors' property in foreign countries***
Spain and Portugal rule out the *beneficium excussionis* for a surety whose liability is only subsidiary if the surety is unable to indicate to the creditor any seizable property of the principal debtor which is located in Spanish or Portuguese territory on the European continent or on offshore islands.[9] In Portugal, however, the surety can also require the principal debtor to release him from his suretyship in such a case.[10]

These special provisions of Spanish and Portuguese law also entail restrictions of freedom to provide services in the single market. These provisions too must cease to apply in cases where all the property of the principal debtor is located in another Member State.

[9] Article 1832 of the Spanish Civil Code and Article 640(b) of the Portuguese Civil Code.
[10] Article 648(c) of the Portuguese Civil Code; in this case a co-surety would also be deemed insolvent (Article 649(3)).

The law of civil procedure

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I. Introduction

1. ***Minimum standards of human rights***
Equality of status for nationals and non-nationals in the formulation and application of the rules governing legal protection is a concept which has been recognised since time immemorial but which is undoubtedly difficult to implement when it comes down to details. The international law relating to aliens has laid down that an alien's state of residence must afford him appropriate legal protection and make the general legal channels accessible to him. The Swiss Federal Tribunal (*Bundesgericht*), indeed, has expressed the view that any modern constitutional state must put foreigners on a par with its own nationals in the administration of justice and guarantee them the same legal protection within its territory as it accords to its own nationals, even in the absence of any such obligation under an international agreement (Federal Tribunal Decisions (BGE) 41 I 148). Accordingly, it is now recognised that the right to equality in the administration of justice derives from general human rights, "including the minimum standard of human rights enshrined in general international law, as increasingly reflected in the practice of states since 1945, particularly in the universal and regional declarations and conventions on human rights" (tr. from the Federal Constitutional Court decision of 20 April 1982 – *Neue Juristische Wochenschrift (NJW),* 1982, pp. 2425 and 2430, II 3 a). In accordance with a minimum standard of human rights, therefore, impartial judges must examine the motion filed by the foreigner as a plaintiff or defendant and reach a decision by due process. (see P. Gottwald, 'Die Stellung des Ausländers im Prozeß', in *Grundfragen des Zivilprozeßrechts,* Athens and Bielefeld, 1991, pp. 9-10 and 12, with further references).

2. ***Types of procedure***
As far as the applicable procedure is concerned, however, the Federal Constitutional Court takes the view that, "if the legal protection of the foreigner is equivalent to that of a national, this does not exclude the possibility that decisions relating to matters of legal protection involving foreigners may be taken by special courts or by means of special procedures" (tr. from *NJW* 1982, p. 2430, II 3 a). Whether this restriction or reticence regarding the procedural construction is compatible with the modern principle of complete equality of nationals and non-nationals in the provision of legal protection is

surely questionable. The fact is that a certain discrimination, albeit merely covert and indirect, against foreigners pursuing their legal rights in their country of residence could also occur if a foreigner, precisely because of his nationality, had to take part in a form of procedure that did not apply to nationals of the host country. Such procedural differentiation would conflict with the principle of equality of redress for all, irrespective of nationality. Nowadays this principle ought to determine not only whether foreigners have access to the courts but also the form that such access should take.

II. Overt discrimination

3. *International jurisdiction*

Discrimination based on the nationality of the foreign party (*overt discrimination*) could affect both access to the courts *per se* and the structure of proceedings or the foreigner's right of audience during the proceedings. Any rules relating to the international jurisdiction of a state will affect access to the courts; if the jurisdiction of the state is not subject to the same conditions for nationals and non-nationals, this amounts to discrimination against foreigners. Although the use of nationality as a criterion of international jurisdiction has been expressly abolished in the domains covered by the Brussels Convention on Civil Jurisdiction, it still applies within the autonomous law of some EU countries and thus determines the jurisdiction of their courts over non-nationals. Article 3 of the Brussels Convention lists some provisions on which such exorbitant jurisdiction is based: Article 15 of the Belgian Civil Code, Articles 14 and 15 of the French Civil Code, Articles 14 and 15 of the Luxembourg Civil Code and Article 246(2) and (3) of the Danish Code of Civil Procedure are provisions which enable national courts to found their international jurisdiction over nationals and non-nationals on distinctive criteria. Discrimination is also inherent in provisions which grant conditional international jurisdiction. This is the case, for example, in Article 65(1)(c) of the Portuguese Code of Civil Procedure, which lays down a general reciprocity requirement; if the defendant is an alien and the plaintiff Portuguese, the jurisdiction of the Portuguese courts is subject to the proviso that, if the roles were reversed, an action could be brought against the Portuguese in the courts of the country to which the alien belongs. Admittedly, the mere listing of these provisions of exorbitant jurisdiction in Article 3 of the Brussels Convention does not mean that they are thereby repealed. Responsibility for the final abolition of such statutory discrimination lies with each individual Member State.

4. *Italian reforms*

Such an initiative has recently been taken by Italy, for example. Under Article 4(1) and (2) of the Code of Civil Procedure, an action could formerly have been brought against a foreigner in the Italian courts "*se quivi e residente o domicilitato anche elettivamente, o vi ha un rappresentate che sia autorizzato a stare in giudizio a norma dell'art. 77, oppure se ha accettato la giurisdizione italiana, salvoche la domanda sia relativa a beni immobili situati all'estero; se la domanda riguarda beni esistenti nella Repubblica o successioni ereditarie di cittadino italiano o aperte nella Repubblica, oppure obbligazioni quivi sorte o da eseguirsi*". This provision was based on the original view

that Italian nationality was the essential criterion for the international jurisdiction of Italian courts (see for example N. Picardi and G. Martino, *Codice di Procedura Civile*, 1994, Article 4(3), p. 47). Accordingly, Article 4(1) and (2) of the Italian Code of Civil procedure was considered in Article 3 of the Brussels Convention as part of the basis of exorbitant jurisdiction. The Italian legislature responded by adopting Law No 218 of 31 May 1995 ("*Riforma del sistema italiano di diritto internazionale privato*"), which transformed the original Italian approach to international jurisdiction and abandoned the nationality criterion. Article 3(1) of Law No 218 reads as follows: "*La giurisdizione italiana sussiste quando il convenuto e domiciliato o residente in Italia o vi ha un rappresentante che sia autorizzato a stare in giudizio a norma dell'articolo 77 del codice di procedura civile e negli altri casi in cui e prevista dalla legge*". What is noteworthy here is that the subject of the new rule is not 'Jurisdiction in respect of aliens' ("*Giurisdizione rispetto allo straniero*"), as the old Article 4 of the Code of Civil Procedure was headed; instead, the new Article 4 takes its title - 'Scope of jurisdiction' ("*Ambito della giurisdizione*") from Article 3 of Law No 218 of 1995. By dropping the 'alien' as the subject of this legal provision, the Italian legislature has undoubtedly managed to eliminate a type of direct discrimination.

5. ***Cases relating to civil status***
Nationality has traditionally been the decisive criterion of international jurisdiction in matters concerning civil status, where the general view is that an alien may be referred to the courts in his country of origin. However, if an alien is habitually resident in the host country, it may be impossible for him, legally or indeed practically, to initiate litigation in the courts of his native country over his own civil status. For that reason, international jurisdiction in matters of civil status is also governed, as a rule, by the ordinary residence of the spouses or of the children (see for example section 606a(1)(1)(2) of the German Code of Civil Procedure for matrimonial causes, section 76(3) of the Austrian Civil Jurisdiction Act (*Jurisdiktionsnorm*) for matrimonial causes, Article 622(1) of the Greek Code of Civil Procedure for legal relations between parents and children, Article 22(3) and (4) of the Spanish Judicature Act for matrimonial causes and the parent-child relationship). This enables foreigners to bring cases concerning their own civil status before the courts of both their country of residence and their country of origin.

6. It goes without saying that it would be a heavy burden for a foreigner to bear if he were unable to obtain legal redress in his country of residence with regard to his own personal affairs. That would be the case if the international jurisdiction of the host state in matters of civil status depended solely on the nationality of the litigants. Article 611(1) of the Greek Code of Civil Procedure, for example, stipulates that the Greek courts have no international jurisdiction in matrimonial causes (Article 592(1) of the same Code) if both spouses are foreign nationals at the time when the petition is filed and if the law of their countries of origin does not confer jurisdiction on the Greek courts.

7. ***Exclusive jurisdiction in matters of civil status***
If, on the other hand, a foreigner is granted access to the courts in his country of residence in matters relating to civil status, significance will then also attach to the question whether the international jurisdiction of his country of origin in personal matters is exclusive or not. If the state of origin claims exclusive jurisdiction in these matters, it might not recognise the decision of the court in the country of residence, which could result in the alien being denied legal protection. Consequently, a provision would have discriminatory effects on a non-national if it assigned exclusive international jurisdiction in matters of civil status to the courts in his country of origin.

8. ***Jurisdiction and recognition by the state of origin***
Moreover, it is doubtful whether access to the courts in the same matters can be refused on the grounds that the state of origin does not recognise the decision of a court in the country of residence. German international jurisdiction in matrimonial causes, for example, is recognised when one of the spouses is habitually resident in Germany, unless the decision to be taken would obviously not be recognised by the law of either spouse's country of origin (section 606(1)(1)(4) of the German Code of Civil Procedure). The court The court is not required to conduct thorough investigations to this end but merely to disclaim international jurisdiction if it is clear that neither spouse's State of origin will recognise the decision (Rosenborg, Schwab and Gottwald, *ZPR*, 15th ed., 1993, § 165 III 1 d, p. 1006). In an extreme case, however, this may result in the inadmissible denial of legal protection if the foreign spouses are permanently resident in Germany.

9. ***Alimentary actions***
Although actions concerning civil status are excluded from the scope of the Brussels Convention (Article 1), the question of the international jurisdiction of the parties in such actions is nevertheless important. For that reason, Article 5(2) of the Convention provides for special jurisdiction in alimentary actions. A person may be sued, "in matters relating to maintenance, in the courts for the place where the maintenance creditor is domiciled or habitually resident or, if the matter is ancillary to proceedings concerning the status of a person, in the court which, according to its own law, has jurisdiction to entertain those proceedings, unless that jurisdiction is based solely on the nationality of one of the parties". This means that, according to the Brussels Convention, joining a divorce suit with an alimentary action (under section 623 of the German Code of Civil Procedure or under Article 681b(2) in conjunction with Article 592(1)(a) of the Greek Code of Civil Procedure, for example) is inadmissible if international jurisdiction in the alimentary action is based solely on the nationality of one of the parties - as is the case, for example, in Article 611 of the Greek Code of Civil Procedure. This, however, gives rise to unacceptable procedural discrimination against maintenance claimants, who are unable to avail themselves of the simplified joined proceedings. It is also a further discriminatory procedural consequence of the practice of founding international jurisdiction in matters of civil status on the sole criterion of nationality.

10. ***Capacity to sue and be sued***
Several countries' legal systems have special rules concerning the capacity of an alien to sue and to be sued. This condition is, of course, the procedural equivalent of the concept

of legal capacity in substantive civil law. According to what is most probably the prevailing view, the capacity of aliens to sue and be sued is determined by the procedural law of their country of origin (Rosenborg, Schwab and Gottwald, *ZPR*, § 44 I, p. 225). In order to protect the integrity of the domestic legal system, however, several procedural codes make an exception from this linkage with the alien's capacity to sue and be sued on the basis of his personal status. Such provisions lay down that an alien who would not have the capacity to sue and be sued under the law of his native country may sue and be sued in the host country on the same basis as a national of the host country (as per section 55 of the German Code of Civil Procedure, section 3 of the Austrian Code of Civil Procedure and section 66 of the Greek Code of Civil Procedure). According to this 'most-favoured nationality' principle, a foreigner who would have the capacity to sue and be sued in the host country but does not have such capacity under his *lex patriae* should have the same status before the law as an adversary who is a national of the host country, in the interests of legal consistency and equality of recourse. Although this rule is designed to guarantee procedural equity, it may have unwelcome consequences because, given that the rules on the capacity to sue and be sued are designed to ensure that an incapacitated person is guaranteed a right of audience through his statutory representative, the establishment of procedural equality between a person who cannot sue or be sued under his *lex patriae* and an adversary who is a capacitated national of the host country constitutes discrimination against the former, since he has to take part in legal proceedings under the *lex fori* without a statutory representative. Moreover, this situation could have the additional procedural consequence that the judgment delivered in the host country would not be recognised and deemed enforceable in the foreigner's native country. (cf. Gottwald, *op. cit.*, p. 74).

11. ***Alien plaintiffs' security***

The use of the *caution judicatum solvi* to compel alien plaintiffs to furnish security for costs, a practice that originated in France, was once a fairly common occurrence but has now fallen largely, though not entirely, into desuetude. The foreign party is obliged to provide his adversary with full security for the future court costs incurred by the latter. Article 45 of the Brussels Convention legislates as follows on this type of compulsory provision of security: "No security, bond or deposit, however described, shall be required of a party who in one Contracting State applies for enforcement of a judgment given in another Contracting State on the ground that he is a foreign national or that he is not domiciled or resident in the State in which enforcement is sought." Such a duty is still imposed on aliens today in German and Austrian law in the domain of discovery procedure. At the defendant's request, the court must order the plaintiff to furnish security to guarantee the defendant's claim to reimbursement of costs if the plaintiff is an alien or stateless person who is not domiciled in the country in which he seeks enforcement (section 110(1) of the German Code of Civil Procedure). This duty, it must be said, is subject to a substantive reciprocity clause. The security burden is not imposed if the law of the plaintiff's State of origin does not require a German plaintiff to furnish security in proceedings of the same nature (section 110(2)(1) of the German Code). There is no such duty in summary proceedings for debt payment, in counterclaims, in actions brought in

response to a judicial order for the presentation of claims or in actions relating to registered title deeds (section 110(2)(2) to (5) of the German Code).

12. Similarly, under section 57 of the Austrian Code of Civil Procedure, foreign plaintiffs must furnish the defendant at his request with security to cover his court costs, unless the plaintiff is habitually resident in Austria or the Austrian decision on costs will be recognised in the plaintiff's country of residence or the plaintiff has enough immovable property to cover the court costs. Litigant's security of this type does not apply to matrimonial causes, summary proceedings for debt payment, counterclaims or actions under the Nuclear Liability Act. As has been rightly commented, this is a "very much watered-down provision relating to aliens in the Code of Civil Procedure, a provision which imposes certain disadvantages on a litigant on account of his foreign nationality" (tr. from Rechberger and Simotta, *Grundriß des österreichischen Zivilprozeßrechts*, 4th ed., 1994, No 303, p. 159).

13. It is generally recognised today that this security requirement constitutes a form of overt discrimination against foreign plaintiffs which is no longer justifiable. Accordingly, more and more voices are calling for its abolition. It has even been suggested that the requirement should be replaced by a system of international enforceability of court orders for the payment of costs (Gottwald, *op. cit.*, p. 53).

III. Covert discrimination

14. ***Summary debt-recovery proceedings and foreign domiciles***
One of the forms of covert discrimination that can occur is the imposition of procedural disadvantages on a party because he is domiciled abroad. Such a case is encountered in the context of summary proceedings for the recovery of debts. Under section 624(2) of the Greek Code of Civil Procedure, it is inadmissible to issue a default summons if it is to be served on a person or persons who are resident abroad. Likewise, Article 633(3) of the Italian Code of Civil Procedure lays down that "*l'ingiunzione non può essere pronunciata se la notificazione all'intimato di cui all'art. 643 deve avvenire fuori della Repubblica [o dei territori soggetti alla sovranità italiana]*". A corresponding rule was also contained in section 688(2) of the German Code of Civil Procedure, which stated that summary proceedings would not take place if the payment order would have to be served abroad. This provision, however, was amended by Article 1(49) of the Administration of Justice (Simplification) Act (*Rechtspflegevereinfachungsgesetz*) of 17 December 1990. Section 688(3) of the German Code of Civil Procedure now lays down that, if the default summons would have to be served abroad, summary debt-recovery proceedings shall only take place if the Recognition and Enforcement Implementation Act (*Anerkennungs- und Vollstreckungsausführungsgesetz*) of 30 May 1988 (*Bundesgesetzblatt* I, p. 662) so provides. This means that it must be possible to serve a default summons in the territory of a foreign State with which Germany has entered into an agreement to that effect (i.e. all Contracting States of the Brussels and Lugano Conventions as well as Norway and Israel), such agreement being applicable by virtue of the Recognition and Enforcement Implementation Act.

15. Underlying the former German clause and the provisions of Italian and Greek law is the idea that the service of a default summons abroad is inconsistent with the swift and essentially simplified character of summary debt-recovery procedure; moreover, the short period allowed for appeals against the default summons is incompatible with its service abroad. The full Bench of the *Areios Pagos*, in its judgment No 10/1996 (*Helliniki Dikaiosyni* 1996.1056, 1057 II), even emphasised that the real purpose of the rule contained in Article 624(2) of the Greek Code of Civil Procedure was to provide effective legal protection for debtors who were not physically based in Greece. Be that as it may, if the debtor is resident abroad when the default summons is issued, the creditor will be unable to obtain an executory title for his pecuniary claim through the simplified summary procedure. Whether this discriminatory rule accords with the principle of free movement within the territory of the European Union certainly remains a moot point.

16. ***Attachment***
The European Court of Justice identified covert discrimination in section 917(II) of the German Code of Civil Procedure in the conditions for issuing a writ of attachment. According to section 917(1) of the Code, attachment shall take place if it is to be feared that, without its imposition, the enforcement of the judgment would be thwarted or significantly hampered. Furthermore, in the words of section 917(2), the fact that the judgment would have to be enforced abroad shall be regarded as sufficient grounds for ordering attachment. This provision has caused particular difficulties in connection with enforcement in Contracting States party to the European Civil Jurisdiction Convention. In a judgment of 10 February 1994 (*Mund & Fester v. Hatrex International Transport*, Case No C-398/92, ECR 1994 I-467), the European Court of Justice ruled that the distinction made by section 917(2) of the German Code of Civil Procedure was not justified by objective circumstances and constituted covert discrimination on grounds of nationality in breach of Article 7 of the EEC Treaty. Although section 917(2) did not focus on nationality and was even applicable if the foreign-based attachable assets belonged to a German national, it was nevertheless the case that the great majority of enforcements abroad were against non-German nationals. This judgment rendered section 917(2) practically inapplicable within the framework of the European Civil Jurisdiction Convention. The implications of the judgment have now been enshrined in German law. The second sentence which was added to section 917(2) of the Code by Article 2c of the Third Amendment Act of 6 August 1998 to the Administration of Justice Act (*Bundesgesetzblatt* I, p. 2030) makes it clear that the foregoing rule does not apply in the framework of the European Civil Jurisdiction Convention and the Lugano Convention.

Chapter III

Scope and need for the creation of a uniform European Civil Code

Section One: Basic issues and progress to date

The rules of European contract law

Ole Lando, Copenhagen

I. Introduction

1. On 1 January 1900 the German Civil Code (*Bürgerliches Gesetzbuch*) entered into force. The Code unified civil law in Germany. As had already happened in France and Italy and was to be repeated a few years later in Switzerland, the achievement of national union had been the signal for the standardisation of civil law. The European Union will not manage to put a European Civil Code into force on 1 January 2000. But we might ponder the question whether the first decades of the third millennium will see the realisation of a European Civil Code or a uniform law of obligations. The European Parliament called on the Council and the Commission in 1989[1] and again in 1994[2] to undertake the necessary preparatory work for the creation of a uniform European Civil Code. In its appeal to the two institutions, Parliament stressed how important it is to standardise the law of obligations. Perhaps the first step will be a European law of contract. A draft has already been prepared, which makes it a good starting point for our discussion.[3]

II. Arguments against and in favour of a uniform law of obligations in Europe

2. ***Arguments against a standardised law of obligations***
Several arguments can be advanced against the standardisation of the law of obligations. Neither in the earlier Treaties establishing the European Communities nor in the Maastricht Treaty on European Union nor in the recent Treaty of Amsterdam has anything been said about a uniform law of obligations. The following may be the reasons for this:

[1] Official Journal of the European Communities (OJ) C 158/400 (1989).
[2] OJ C 205/518 (1994).
[3] On the follow-up project being undertaken by the Study Group on a European Civil Code, see the next contribution by Christian von Bar.

- The substantive differences between the European systems of private law are considerable, especially between the common law of England and Ireland and the civil law of the other countries. But there are wide divergences between the civil-law systems of continental Europe too.

- Standardisation of the substantive law of contract is not necessary. In the Convention on the Law Applicable to Contractual Obligations, [4] the EU Member States have already standardised the international law of contract (rules governing conflicts of laws), thereby ensuring the requisite legal consistency.

- There are countries that consist of several judicial territories, each with its own law of contract, such as the United Kingdom, Canada and the United States of America. These differences did not prevent them from becoming major industrial and commercial powers.

- Any standardisation of substantive property law will meet with fierce resistance in the countries of the EU. This not only applies to England and Ireland, where the people, and particularly the lawyers, proudly cherish their common-law tradition, but also in France, where the *Code Napoléon* is regarded as a cornerstone of the nation's cultural heritage.

3. ***Arguments in favour***

The points above may be answered as follows:

- The great differences are actually a reason for standardising the law rather than an argument against it. These differences complicate foreign trade. At least one party to an international contract has to be subject to an alien legal system and will often have to invest a great deal of time, effort and money to become familiar with the foreign law. Venturing into a foreign market is risky, and many companies, especially small and medium-sized businesses, are wary of doing so. The legal differences are therefore obstacles to the free movement of goods, people and services, obstacles which are fundamentally irreconcilable with the principle of a common market.

- The progress that has already been achieved makes the standardisation of standard law all the more essential. The Convention on the Law Applicable to Contractual Obligations is incomplete. It does not release enterprises from the trouble and cost involved in familiarising themselves with applicable foreign laws. This has been seen in many court cases, in which one litigant after the other has had to engage in expensive and time-consuming study of the substance of foreign legislation.

- The United Kingdom, the United States and Canada do comprise several judicial territories. But their legal systems are not entirely distinct. Although Scots law was originally a civil-law system, it has been strongly influenced by common law and, in terms of methodology, it falls into the same camp as English law. A similar situation applies with regard to the law of Louisiana in the United States.

[4] OJ L 266/1 (1980).

- While it is not a law of nature that political and economic unions gradually come to share the same civil law, experience has shown that it does often happen. This was seen in France, when the *Code civil* and the *Code de commerce* were introduced in 1804 and 1807 respectively, in Germany in 1900 and again in 1990; Austria (1812), Italy (1865) and the Swiss codifications of 1907-11 are further examples.

- U.S. commercial and contract law, which is standardised in many respects on the basis of the common law that applies in almost every state, has been further unified in the course of this last century. Among the unifying factors has been the introduction of the 'uniform laws'; the Uniform Commercial Code (UCC) in particular standardised important areas of domestic commercial law and the law governing the sale of goods as well as the law on negotiable instruments and real security. The requirements of inter-state trade provided the main impetus for the introduction of the UCC; which now applies in all states.[5]

- The resistance of European lawyers to the standardisation of civil law is unavoidable. But it is there to be overcome. We know of the centuries of stubborn resistance to standardisation of the laws of France before the Revolution of 1789. Corrupt lawyers, the so-called *noblesse de robe*, were loath to learn new law and to give up their local monopolies. It is also questionable whether the new *Bürgerliches Gesetzbuch* was greeted enthusiastically throughout Germany in 1900. And is it now receiving acclaim in the five new *Länder* of the Federal Republic? Allowance has to be made for scepticism and resistance. They will delay the standardisation of civil law, but that will also give its proponents time to undertake the huge and complex research and preparation effort that needs to be made.

III. The Commission on European Contract Law

4. *The Commission and its work*

In 1980 the Commission on European Contract Law began its work. It set itself the task of formulating general European principles for a common system of contract law. The Commission is an independent private association of legal scholars from all Member States of the European Community. It has begun by devoting itself to the law of contract, because the most important instrument of business management and planning in a market economy is the private contract. The Commission began by examining the effects and the performance of contracts. It also dealt with impairment of performance and especially breaches of contract. This part of the *Principles of European Contract Law* was published in English in 1995[6] and in French in 1997.[7] Part Two, dealing with the

[5] In Louisiana the UCC has only been partially incorporated into state law.

[6] Lando and Beale (ed.), *Principles of European Contract Law, Part 1. Performance, Non-performance and Remedies*, Dordrecht, 1995. A German translation of the principles (only the articles themselves) was published in the *Zeitschrift für Europäisches Privatrecht*, 1995, p. 864. See also Reinhard Zimmermann, 'Principles of European Contract Law', *ibid.*, p. 731.

conclusion of contracts, authority of agents, substantive validity and the interpretation of contracts, was published in 1999.[8] Work on Part Three, which covers general matters relating to the law of obligations, such as the assignment of claims and obligations, set-off and statute-barring, was begun in 1997 and is likely to continue through to the end of the year 2000.

5. The practice so far has been to distribute the material among five reporters, each of whom drafts a report and submits it to the other four. The work of this drafting group is then submitted to the whole Commission. At fourteen meetings of the first Commission and eight meetings of the second Commission, the principles have been discussed and developed. In addition, an editing group has dealt with questions of terminology and presentation of the material.

6. ***Sources***
The Commission does not seek to develop revolutionary new provisions but to formulate appropriate modern uniform European principles. It is not a matter of identifying rules that already apply and are uniformly interpreted in every Member State but rather of seeking the best and most expedient principle in each case. Inspiration is drawn from the legal systems of the Member States and international sources, such as the Vienna Convention of 11 April 1980 on Contracts for the International Sale of Goods (CISG). American texts, such as the UCC and the Restatements, and the Swiss law of obligations have also come under scrutiny.

7. ***Presentation***
The Commission formulates the principles in the manner of legal provisions. Since it was indispensable to address specific issues too, the principles assume the outward form of a 'Law of Contract Act'. Merely by reading through these principles, which are listed in a series of articles, one can obtain a general picture. These articles, however, have no binding force; they have to be persuasive. The U.S. Restatements furnished a methodological model which required only slight adaptation to the European situation. In this model the material for each principle is presented in three stages. At the apex is the principle itself. The principles are designed to be as brief and easily comprehensible as possible, but complex issues occasionally necessitate a more detailed formulation. The second stage is a commentary on each principle, indicating its meaning and purpose and explaining how it is put into practice. This commentary may therefore be compared with the official detailed explanatory statement that accompanies a legislative bill or even with the legal commentaries that are customary in Germany. Additional clarity is achieved through the insertion of examples to show how the principles should be applied. Some of these examples are drawn from the case law of the Member States.

8. The Commission on European Contract Law also owes it to the user of the principles to cite the source of each principle and to indicate how European its principles are. For that reason, the third stage in the process comprises a more or less comprehensive

[7] *Les principes du droit européen, L'exécution, l'inexécution et ses suites*, Version française: Isabelle de Lamberterie, Georges Rouhette and Dennis Tallon, Paris, 1997.
[8] Lando and Beale (ed.), *Principles of European Contract Law, Parts I and II.* The Hague, 1999.

comparative annotation. This explains the ways in which the legal systems of the EU Member States and, in some cases, standardised international law have solved the problem in question. This annotation takes the form of a 'reporter's note', i.e. an integrated comparative report setting out typical solutions as well as references from the various legal systems. This is where the complexity of the project emerges; whereas the authors of the U.S. Restatements are able to confine themselves in their reporters' notes to references to the relevant legislation, Europe has a host of codifications, which often diverge as soon as they go into detail, and numerous special laws, as well as collections of court decisions relating to this body of legislation. The 'annotation' is therefore ideally a small piece of comparative study on a European scale, which will often include non-European material. Apart from anything else, even the legal information it contains may well prove useful to many people.

9. ***Languages***

One difficulty for Europe is the language issue, which also affects the work of the Commission on European Contract Law. The Commission has at least one member from each State of the European Union. Every member speaks English, most of them speak French too, but none of them understands all the other nine official languages of the Community. Extensive translation of all oral or written statements would stretch the Commission's budget beyond breaking point. For this reason, the drafts are compiled as a rule in the commonest language, namely English. Discussions are also largely conducted in English, although French has also come to play an important role in the course of time. Experience has shown that legal texts devised in English are sometimes difficult to translate into the languages of the civil-law countries. Translating English sources into French has therefore proved to be a necessary test of their potential value. It is self-evident that the conferment of such elevated status on these two languages is fraught with problems. It is also clear that a European law of contract is scarcely worthy of the name unless it is available in at least the major languages of the Community and preferably in all of them. It is therefore desirable that concordant versions of the Principles of European Contract Law be drawn up soon in all nine of the other EU languages, but that is a mammoth task. The first aim will be to present a European law of contract at least in those languages which, on the one hand, are most widely spoken in Europe and which, on the other hand, have had the greatest effect on the legal language in which the main bodies of European law are formulated; I am referring here to the languages of the systems that spawned the three legal traditions represented in the European Community today. This means that concordant versions and terminological equivalents must be developed without delay in English, French and German at any rate. This is the only way to develop a truly European language of contract law, embracing common concepts and extending beyond mere translations.

10. ***First draft of a European code of contract law***

An important model for the principles of European contract law has been provided by the Restatements of the Law, published by the American Law Institute, and especially the

Restatement on the Law of Contracts, the second edition of which appeared in 1981.[9] As I mentioned above, the Commission on European Contract Law has based its work on the approach adopted in the Restatements. In so doing, the Commission has demonstrated that the principles may be regarded not only as the first draft of a legal code but also, like the Restatements, as an instrument for those who need general rules of contract law for business purposes (to formulate terms and conditions).

11. The principles, however, are not a restatement in the true sense of the term. The American Restatements do, to a certain extent, restate the common law that applies in 49 of the American states. But common law is not uniform law, and there are considerable legal disparities between states. The Restatements therefore contain many rules which are the result of political deliberations. They reflect the rules which their authors regard as the best options.

12. For the Commission on European Contract Law it was even more difficult to reflect the legal precepts that are common to all fifteen countries of the European Union. The common ground is far sparser than in the United States. What the principles of European contract law do have in common with the Restatements, however, is the fact that they are non-binding in character and can only work, as we saw above, if they are persuasive. In this respect, however, the principles can serve several purposes.

13. ***The benefits for EU law***
The contracts concluded by the institutions and other bodies of the EU with private individuals and businesses are governed today by one of the national legal systems. This sort of discrimination in favour of a single domestic legal system is not a satisfactory long-term solution. Such contracts ought to be judged on the basis of European law. Moreover, a European law of contract can serve as an additional means of interpreting those provisions of the law of obligations that have already been standardised. The Treaty on European Union establishes the criteria that a law of obligations must fulfil if it is to be consistent with the Treaties.[10] In addition, the European Court of Justice has taken the first steps towards standardisation in the domain of civil law, for example by developing rules on *force majeure.*[11]

14. According to the second sentence of Article 288 (new numbering) of the EC Treaty, the official liability of the Communities is to be judged on the basis of the "general principles common to the laws of the Member States". Such general legal principles were in short supply, and the European Court has had to create some. The judgments of the Court on the concept of loss or damage, on proof of loss or damage, on causality and adequacy have become part of the common European law of obligations, which can also have a bearing on contractual liability.[12] New issues will arise when the Directives on

[9] American Law Institute (ed.), *Restatement of the Laws, Second, Contracts* 2d, I-III, St. Paul, 1981.
[10] See Peter-Christian Müller-Graff, 'Europäische Normgebung und ihre judikative Umsetzung in nationales Recht', Part I, in *Deutsche Richter-Zeitung (DRiZ)*, 1996, p. 259; Part II, *ibid.*, 305.
[11] ECJ Case No 284/82 (*Busseni*), ECR 1984, 557, and Case No 209/83 (*Valsabbia*), ECR 1984, 3089. See also the Communication from the Commission in OJ C 259/10 (1988).
[12] See von der Groeben *et al.*,*Kommentar zum EU-/EGV*, 5th ed., 1995, Vol. V, pp. 219 *et seq.* (Article 215) and, as examples, ECJ Case No 13-24/66 (*Kampffmeyer I*), ECR 1967, 351 (concept of damage), Case Nos 6-60/74

commercial agents[13] and consumer protection have to be interpreted. The Germans will not find it difficult to transpose concepts in the Directive on commercial agents such as the precept of acting "dutifully and in good faith" (Articles 3(1) and 4(1)) into their national law, where such concepts already exist. For other Member States, however, considerable difficulties could arise here.

15. ***The Directive on commercial agents***

The Directive on the coordination of the laws of the Member States relating to self-employed commercial agents was one of the first European directives to deal exclusively with the law governing commercial contracts. As a matter of fact, the desirability of harmonisation of the law of contract is expressed in the recitals of the Directive:

> "Whereas trade in goods between Member States should be carried on under conditions which are similar to those of a single market, and this necessitates approximation of the legal systems of the Member States to the extent required for the proper functioning of the common market; whereas in this regard the principles concerning conflict of laws do not, in the matter of commercial representation, remove the inconsistencies referred to above, nor would they even if they were made uniform, and accordingly the proposed harmonisation is necessary notwithstanding the existence of those rules".

16. ***ECJ judgments***

In one respect the lack of standardisation of laws prompted the European Court of Justice to refer to national rather than European norms. For example, in determining the place of performance referred to in Article 5 of the Civil Jurisdiction Convention, the Court based its decision on the national law to which responsibility is assigned under the international private law of the forum in question.[14] It did the same thing again in its ruling on the question whether an agreement concerning jurisdiction within the meaning of Article 17 of the Civil Jurisdiction Convention had been validly concluded[15] or whether the contract with the agreement on jurisdiction had been tacitly extended. In these domains, I believe the European Court should be able to establish common rules.

17. ***Ideas for legislators***

National legislatures which are planning to reform the law of contract can benefit from the principles of European contract law. For the nations of Central and Eastern Europe which once lived under Communist legal systems, the principles serve as a source of provisions designed to operate in a market economy.

18 ***A lex mercatoria***

Moreover, the principles can assist international arbitral tribunals if they wish to apply a non-national code of law, a *lex mercatoria*. The discussion on the existence and necessity

(*Kampffmeyer II*), ECR 1976, 711, and 210/86 (*Mulder*), ECR 1988, 3244 (assessment of loss or damage), and Case No 169/73 (*Compagnie Continentale Française*), ECR 1975, 119 (cooperation of a plaintiff).

[13] OJ L 382/17 (1986).

[14] Case No 12/76 (*Tessili*), ECR 1976, 1473.

[15] Case No 313/85 (*Iveco*), ECR 1986, 3337.

of a *lex mercatoria* is one of the most important debates of our age in the domain of international commercial law from both a practical and a theoretical point of view.[16]

19. ***Opponents of a lex mercatoria***
Its opponents[17] maintain that a *lex mercatoria* cannot be valid for the simple reason that it is not backed by governmental authority. No legislature has adopted or ratified it. Moreover, they say, it is difficult, if not impossible, to define its substance and component elements. Even if some general legal principles and other 'international sources of law' could be identified as parts of a *lex mercatoria*, it would not be desirable, for political and other reasons, to use it as the basis of an arbitral award. The *lex mercatoria*, according to its opponents, is an indefinite and unbounded 'source of law'. Its 'application' would lead to nothing more than '*cadi* justice' and would pose a threat to legal consistency. Consequently, in their view, every arbitral award and every judgment by a state court must be founded on national law.

20. ***Pro lege mercatoria***
I am not convinced, however, by these rejectionist arguments.[18]

- Whether legal norms possess validity is a socio-psychological question, depending entirely on whether those empowered to apply the norms do actually apply them and not on whether they are adopted or approved by a governmental authority. In practice, arbitral tribunals have applied *lex mercatoria* in international arbitration procedures. And indeed the *lex mercatoria* has acquired a certain authority. National courts have recognised the application of *lex mercatoria* by arbitral tribunals.[19] Their application is also explicitly recognised in Article 1496 of the French, Article 1054 of the Dutch and Article 834 of the Italian Code of Civil Procedure, as well as in Article 1700 of the Belgian *Code judiciaire* and section 46(2) of the UK Arbitration Act 1996. The Uncitral Model Law of 1985 on International Commercial Arbitration, in Article 28(1), recognises the application of *lex mercatoria*. The Model Law has been put into force in fourteen countries as well as in eight U.S. states.

[16] Literature: Mann, 'Lex facit Arbitrum', in *Festschrift Domke*, 1967, p. 157; von Hoffmann, 'Lex Mercatoria vor internationalen Schiedsgerichten', in *Praxis des internationalen Privat- und Verfahrensrechts (IPRax)*, 1984, 1984, p. 106; Goldmann, 'The Applicable Law, General Principles of Law, the lex mercatoria'', in: Lew (ed.), *Contemporary Problems in International Arbitration*, 1986, p. 113; Lando, 'The Lex Mercatoria in International Commercial Arbitration', in *International and Comparative Law Quarterly (I.C.L.Q.)*, 1985, p. 747; Loewenfeld, 'Lex Mercatoria: an Arbitrator's View', in *Arbitration International*, Vol. 6, 1990, pp. 133-150; W. Lorenz, 'Die lex mercatoria, eine internationale Rechtsquelle?', in *Festschrift Neumayer*, 1985, p. 407; Mustill, 'The new Lex Mercatoria: The first 25 years', in *Liber Amicorum for Lord Wilberforce*, Oxford, 1987, pp. 149-183; Thomas E. Carbonneau (ed.), *Lex Mercatoria and Arbitration*, New York, 1990, with contributions by Goldmann, Mann, Berman and Dasser, Smit, Delaume, Highet, Park, Audit, Drobnig, Pfunder, Siqueiros, Màdl and Jünger; Lando, 'Lex mercatoria 1985-96', in *Festskrift till Stig Strömholm*, Uppsala, 1977, p. 567; Roy Goode, 'Usage and Its Reception in Transnational Commercial Law', in *I.C.L.Q.*, 1997, p. 1.
[17] See Mann, *op.cit.*, W. Lorenz, *op. cit.*, and Mustill, *op.cit.* (footnote 16 above).
[18] Goldmann, *op. cit.*, Lando, *op. cit.*, and Loewenfeld, *op.cit*. (see footnote 16 above), argue for the validity of the *lex mercatoria*.
[19] See Lando, *op. cit.* (footnote 16 above), p. 752.

- Although the body of *lex mercatoria* is still a highly indeterminate and incomplete 'legal system', it has never been entirely without substance, and in recent times its stock of norms has been considerably increased.

- There have always been legal principles that are accepted by all or most of the 'civilised' nations, such as the precept of *pacta sunt servanda* and the rule that compensation must be provided for damage or loss caused by a breach of countract for which one party may be held accountable. This common core of the leal systems also includes the principle whereby a party may terminate a contract if the other party has significantly breached it. In addition, international agreements provide a constantly expanding source of standardised law. For example, the Vienna Convention of 11 April 1980 on Contracts for the International Sale of Goods (CISG) has now entered into force in well over 50 countries. The number of bilateral, multilateral and global agreements is likewise growing in many other domains of the law of contract.

- In addition, international usage is catalogued in documents such as the Incoterms and the Uniform Customs and Practice for Documentary Credits, which were developed bythe International Chamber of Commerce and are now in widespread use. To these may be added commercial practices that have been developed in 'real life' in the various domains of international trade. Finally, the Principles of European Contract Law and the Unidroit Principles of International Commercial Contracts, which Unidroit published in Rome, with accompanying explanatory notes, in 1994,[20] must also be included in the *lex mercatoria*. Like the Principles of European Contract Law, the Unidroit Principles are intended as recommendations for the international business world and for arbitral tribunals. They contain rules on the conclusion of contracts, substantive validity and the interpretation of contracts, on content, performance, breach of contract and legal redress in the event of a breach of contract. These two sets of principles have considerably enriched the *lex mercatoria*.

- Gaps and uncertainties are also found in national legal systems. Furthermore, some principles found in the national systems of contract law are unsuitable instruments for dealing with international contracts. Examples are the doctrines of consideration and privity of contract in common law and the current principles governing breach of contract in German law.

- As far as procedure and application are concerned, the *lex mercatoria* has the advantage of providing a level playing field for all parties and all tribunals. No one is handicapped by having to cope with foreign law, and neither party has home advantage.

- The arbitral tribunal that rules on the basis of the *lex mercatoria* is not dispensing justice like a *cadi*. Its decision is always taken on the basis of the rule which the tribunal would wish to establish for international contracts if it were a legislative body; in arriving

[20] ISBN 88-86 449-0-3.

at that rule, it follows established doctrine and custom. And so it is the hope of the members of the Commission on European Contract Law that their principles will become part of that body of established doctrine.

The Study Group on a European Civil Code

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1. ***Preparation by the legal community in Europe***
   The preparatory work on a European Civil Code, whatever precise meaning one wishes to attach to that term (see point 3 below), must be performed by the community of European scholars in the domain of private law. They must take the first step, and this they have already done, as is shown by the preceding report on the work of the body known as the Lando Commission. Only legal scholars can conduct the essential basic research; only they have sufficient know-how in the field of comparative law; they alone can set up bodies that are free of particularist interests of a national, political or social nature and be unreservedly committed to the quest for the fairest and most effective legal principles. The legislators' time will come once the academic preparation has been completed. This is not to suggest, of course, that the participating legal scholars have not been seeking and nurturing contacts from the outset with the relevant political authortities, such as the national Ministries of Justice,[1] the European Commission and, of course – as the present study testifies – the European Parliament. In general terms, however, an independent commission of experts has to create a text first so that the politicians and interest groups can be given a basis on which to begin their consultations as soon as possible. How and by what means this can be achieved is the subject of the following paragraphs.

2. ***Territorial scope of the code***
   The aim of the legal community must be to formulate a text that could equally be applied to international and to national situations if it were to enter the statute books. The Parliaments may subsequently decide otherwise and may initially adopt a 'European Civil Code' for application to cross-border disputes only, perhaps for a limited time on a trial basis and mainly out of respect for national sensitivities. Let me make it crystal-clear that I should consider such a decision to be wrong from many points of view. For one thing, it would result in the coexistence of two parallel civil-law structures; alongside the European code there would remain the entirely unharmonised national civil codes and systems of private law. The need to draw a line between the respective areas of responsibility of the two structures would also raise new and complex demarcation

[1] Such contacts have already been established. The liaison officer from the German Ministry of Justice has already presented the project of the Study Group on a European Civil Code to the K4 Committee, a high-ranking EU authority in the realm of justice and home affairs, to the other Member States and to the European Commission and has asked for their support; see Schmidt-Jortzig, 'Perspektiven der Europäischen Privatrechtsangleichung', in *Anwaltsblatt (AnwBl)*, 1998, pp. 63-66 (especially p. 66).

problems, for the time is past when a logical distinction could be made between 'domestic' and 'external' matters in the countries of the EU. Another aim of a European Civil Code, moreover, must be to grasp the opportunity, which is veritably unparalleled in history, to improve and modernise private law in the areas that it covers (of which more below). It would make no sense to restrict this aim to international cases to the exclusion of others. Another point is that what we still tend to refer to rather inadvertently today as an international case today has long since become an interregional case in the EU context, and this process will continue to intensify.[2] This may be seen as merely correcting a terminological slip, but it does indicate where this development will lead. Finally and most importantly, the artificial territorialisation of private law within the European Union has to be overcome. It is essential to demonstrate, through the establishment of a set of principles based primarily on a common core of legal philosophy, that the *ius commune Europaeum* really does exist.

3. ***Subject matter***

The concept of a civil code derives from the legal tradition of continental Europe. All of the civil codes of the European continent were designed, at least when they first entered into force, to standardise the entire body of private law, including even commercial law in some cases, such as the Italian *Codice civile*. It is usually said of the German *Bürgerliches Gesetzbuch*, to take but one example, that it follows the course of people's lives from the cradle to the grave. A European Civil Code can never aspire to such comprehensive coverage, not even in the long term. For many reasons its range of subject matter must remain modest if the Code is to stand a chance of success. In the first instance, at any rate, its objective can only be the creation of a sort of basic law of property upon which the Member States of the European Union can agree without forfeiting their evolved national legal cultures (their legal identities, as some will say) at a single stroke. Unity can therefore grow from a kernel without any overambitious attempts to uproot the rich diversity of legal traditions. Nor would any harm be done to the legal systems of the British Isles. They themselves, after all, already possess partially 'codified' structures, the law on the sale of goods being one example. There are certainly strong arguments in favour of the hypothesis that the Member States' systems of family law no longer diverge so widely as has traditionally been asserted; the principle of sexual equality and the primacy of the children's well-being in family cases have been great levellers in that respect. Nevertheless, family law remains a sensitive area, and anyone venturing into it may be expected to touch numerous raw nerves. In any event, the law of succession is not yet ready for harmonisation, quite apart from the fact that it will remain out of bounds to prospective reformers anyway until the whole domain of property law has been fully explored. There is a long road ahead of us here, especially as the map still shows patches of uncharted territory in which comparative lawyers have yet to set foot.

4. And so it is that the spotlight turns to focus on the law of obligations, which should be the starting point of any effort to draft a European Civil Code. This, however, does not mean that it would be better, or that it would allay the fears that some might have of impending change, if we spoke of a European law of obligations right from the start. Europe will have to find and follow its own path. We believe that this path includes the law relating

[2] See Konstantinos Kerameus in chapter I above, point 23.

to credit securities; although this domain of the law radiates in turn into the law of property, it must nevertheless be an indispensable element in the first stage of any quest for a European Civil Code.[3] The body of law relating to cross-border security for trade credit and monetary credit is currently in an extremely unsatisfactory state.

5. ***Creation of the Study Group on a European Civil Code (1998)***
As the deliberations on these subjects proceeded, the Study Group on a European Civil Code constituted itself in 1998. The group now comprises about 50 professors from all Member States of the European Union plus some observers from applicant countries, namely the Czech Republic, Hungary and Poland. In all three of these countries, work is currently taking place on the modernisation of their respective civil codes, and all three are keen to engage in an intensive exchange of views. That is why some members of the Study Group are also members of the international consultancy teams in those countries. In the event of Scotland opting to create her own civil code – and no decision has yet been taken on this – we shall probably be able to establish close contacts with the relevant commissions there too. Everyone in today's Europe who is involved in the formulation of basic regulatory frameworks in the realm of property law must endeavour to think European, otherwise what should be joined together might once more be put asunder.

6. The initiators of the Study Group began their deliberations by examining the results of an international conference entitled *Towards a European Civil Code* which was organised by the Dutch Ministry of Justice and took place in The Hague in 1997. The conference itself had been convened in the wake of the two European Parliament resolutions of 1989 and 1994.[4] Despite some sceptical comments,[5] the basic response of the overwhelming majority of the participants to the idea of creating a European Civil Code was so positive and constructive[6] that the establishment of a European study group seemed to offer sufficient prospect of success. The first funding pledges came from three major research-support organisations - the *Deutschen Forschungsgemeinschaft (DFG)*, the *Nederlandse Organisatie voor Wetenschappelijk Onderzoek (NWO)* and the Onassis Foundation in Athens – which meant that the Study Group could start to take shape, and by the middle of 1999 it was able to begin its real work. In the long run, its success will naturally depend in part on whether the funding for which the group has applied throughout Europe actually materialises (several grant applications are pending at the present time). The current time frame of approximately six years is extremely ambitious and may prove insufficient.

7. ***Relations with other working groups***

[3] Cf. the contributions to this study by Ulrich Drobnig.
[4] For details, see footnote 1 of the preface to the present study.
[5] See for example Markesinis, 'Why a code is not the best way to advance the cause of European legal unity', in *European Review of Private Law (ERPL)* No 5, 1997, pp. 519-524.
[6] The papers presented at the conference and a summary of the discussions are reproduced in *ERPL*, Vol. 5 (1997), No 4, pp. 455-547.

One of the Study Group's aims is to evaluate the findings of the existing groups that are working in this field and to consolidate them wherever possible while preserving the identity of each group. The group that has hitherto made most progress in this domain is undoubtedly the Commission on European Contract Law, whose chairman, Ole Lando, reported on the Commission's work in the preceding contribution to this study. For that reason, it was important that the initiative to set up the Study Group came from within the Commission of European Contract Law. This means that the Study Group is able to build on the results of previous efforts, the main elements of general contract law having already been set out in the form of legal principles. The Study Group may be said to see itself as a successor organisation to the Commission on European Contract Law with the aims of considerably expanding the range of subject matter covered by the latter's working programme and finding a generally firmer structure.

8. In a spirit of cooperation and pursuit of a common goal, connections have been established with other groups. This applies, for example, to the law governing insurance contracts, a field in which Professor Basedow of the Study Group cooperates with the working party headed by Professor Reichert-Facilides of Innsbruck, and to the working party on the law of tort under the guidance of Professors Spier (Tilburg) and Koziol (Vienna). In this case too, personal links have been established in both directions, with Professor Spier serving as one of the advisers to the permanent working team in Osnabrück (see point 10 below), while Professor Kerameus of Athens was a member of the Storme Commission on the law of civil procedure. The results of the project on the law of contract, headed by Professor Gandolfi of the *Accademia dei Giusprivatisti Europei* in Pavia are also being carefully monitored. In addition, as I mentioned above, members of the Study Group belong to some Central European consultancy bodies, while countries of Central Europe are sending observers to the Study Group sessions.

9. ***Organisation of the Study Group***
The organisational structure of the Study Group, which must first demonstrate its effectiveness, of course, is as follows: a Steering Committee, comprising seven professors from various jurisdictions in the EU,[7] discusses the sequence of topics for discussion and the schedule of meetings as well as the membership of the group. All the substantive issues and texts are discussed and decided by the Coordinating Group, decisions being taken by a simple majority if a vote is required.[8] The team leaders (see point 10 below) and members of the Steering Committee also belong to the Coordinating Group. The advisers in the permanent working teams (cf. point 10 below) also send delegates to the Coordinating Group. The latter will meet at regular intervals and discuss the texts several times over.

[7] At the present time, the members are Professors Guido Alpa (Rome and Genoa), Laurent Aynès (Paris), Christian von Bar (Osnabrück), Ulrich Drobnig (Hamburg), Roy Goode (Oxford), Arthur Hartkamp (The Hague) and Ole Lando (Copenhagen).

[8] The present members, *excluding* the members of the Steering Committee and the advisers, are Professors Hugh Beale (Warwick), William Binchy (Dublin), Eric Dirix (Leuven), Christian Hultmark (Gothenburg), Konstantino Kerameus (Athens), Hector McQueen (Edinburgh), Encarna Roca y Trias (Barcelona), Jorge Sinde Monteiro (Coimbra), Lena Sisula-Tulokas (Helsinki) und (as an observer) Jerzy Rajski (Warsaw).

10. The submissions to the Coordinating Group come from the working teams. These are international working parties of young lawyers from all parts of the EU and are headed by a team leader, assisted by professors from various legal traditions within the EU who serve as advisers.[9] The purpose of this arrangement is to avoid any restriction of the team's perspective to a particular national view. Permanent working teams are currently being established at four locations: Hamburg, Osnabrück, Tilburg and Utrecht. We hope to be able to set up at least another one and perhaps even two groups in the Mediterranean region of the EU, probably in Rome and/or Athens. The details still have to be settled, however. In accordance with its rules, the Commission on European Contract Law will continue its work, which it expects to conclude around the middle of the year 2000.

11. ***Priority areas***
    Each of the permanent working teams is responsible for a group of subjects. In Hamburg the law governing insurance contracts (Basedow group) and the law relating to credit security (Drobnig group) are dealt with. Osnabrück is responsible for the domain of statutory obligations, divided into the continental categories of unjust enrichment, *negotiorum gestio* and the law of delict (von Bar group). Tilburg treats the general law of service contracts (Barendrecht group), while Utrecht deals with the law on the sale of goods (Hondius group). The subjects to be covered by the Mediterranean group or groups are to be established if possible at a conference in Rome in early July. The areas of activity under discussion are the unresolved issues of contract law, questions relating to property law and general problems of *jus personarum*. We are still at a very early stage of the planning process here. Irrespective of whether these plans come to fruition, it is certainly safe to say that the core areas of the law of obligations will be covered. Only time will tell how deeply we shall be able to go into details, particularly in the domains of the law governing special contracts and non-contractual liability.

12. In consultation with their advisers, the working teams of the Coordinating Group will initially submit position papers – a procedure that has already proved successful in the Commission on European Contract Law. These papers will serve as the basis for a debate on the main thrust of the Group's efforts, thereby avoiding duplication of effort. The team leaders' contributions to the present study will convey a first impression of the issues that are likely to be discussed by the Coordinating Group in the early stages. Once the first questions have been answered about the general thrust of its proposals, the Group will be able to begin formulating the first draft texts. Everything will have to be discussed several times, and the coordination process will have to start all over again whenever changes are made.

[9] These advisory groups are still being formed. The following are members of the group on the law of delict: Professors Blackie (Strathclyde University, Glasgow), Castronovo (Milan), Kleinemann (Stockholm) und Spier (Tilburg and The Hague); the group on unjust enrichment and *negotiorum gestio* comprises Professors Gomes (Oporto), Hastad (Stockholm), McKendrick (London), Mestre (Aix-en-Provence) and Schlechtriem (Freiburg).

13. ***The aim***
When that has all been done, the ultimate aim is to produce a professorial draft of a first basic statute on the law of property in the European Union. The articles with the actual proposed provisions (the 'black-letter rules') will be supplemented with comments, i.e. explanations on the way in which each provision is intended to operate; in this respect too, the Study Group is borrowing from the Principles of European Contract Law. The comments will be supplemented in turn by notes containing comparative references to the autonomous legal systems of the Member States. Although these initial procedures will be conducted, for obvious reasons, in English, the intention is to try from the very beginning, with the aid of the working teams, to ensure that the written texts are made available in each of the major EU languages. At the same time, there will be a need to create more extensive explanatory material in order to inject the draft texts into the European legal discussion, where they can be subjected to analytical scrutiny. The members of the Study Group are naturally willing to give information at any time on the progress of their work to bodies such as the Legal Affairs Committee of the European Parliament, the European Commission and their own national parliaments and governments. A continuous flow of information in the opposite direction would also be useful and is therefore high on our wish list.

Annex: Documentary evidence from the academic discussion on the creation of a European Civil Code

Ewoud Hondius, Utrecht

14. The bulk of the academic discussion on the creation of a European Civil Code in recent years has taken place in Germany, Italy and the Netherlands. In those countries there are even periodicals devoted to the Europeanisation of private law: the German *Zeitschrift für Europäisches Privatrecht (ZEuP)*, the Italian *Rivista di diritto europeo* and the trilingual *European Review of Private Law*, which is published in the Netherlands.

15. From the domain of monographic literature, the volume *Towards a European Civil Code*, the second edition of which appeared in 1999, merits special emphasis. This work contains analyses on a wide range of issues relating to legal policy and the mechanics of legislation. Other works deal in widely varying depth and forms of presentation with specific subjects such as building law, the law of tort or delict,[10] patent law,[11] product liability[12] or specific aspects of the general law of contract.[13] Other studies have been

[10] Christian von Bar, *Gemeineuropäisches Deliktsrecht*, Vol. I, Munich, 1996 (published in English as *A Common European Law of Torts*), and Vol. II, Munich, 1999.
[11] J.J. Brinkhof, *Europees octrooirecht*, inaugural address at the University of Utrecht. Zwolle, 1989.
[12] J.M. Barendrecht, *Produktenaansprakelijkheid: Europees Burgerlijk Recht?* Specialist's report for the Vereniging voor burgerlijk recht, Lelystad, 1987.
[13] C. Armbrüster, 'Europäisierung des Schuldrechts? - zur Reform des deutschen Unmöglichkeitsrechts im Vergleich zum Code Civil', in *Juristische Arbeitsblätter*, 1991, pp. 252-257.

devoted to the relationship between the standardisation of property law and private international law.[14]

16. In the contributions by specialists in legal history (for example the German legal historians Wilhelm Brauneder[15], Helmut Coing[16], Reiner Schulze[17] and Reinhard Zimmermann,[18] Guiseppe Gandolfi[19] from Italy, J.H.A. Lokin und W.A. Zwalve[20] from the Netherlands and Peter Stein from the UK[21]) the main theme tends to be the continuing relevance of the *ius commune* tradition to the contemporary discussion.

17. Although the idea of harmonising private law as a step towards a European Civil Code has met with widespread approval, the voice of scepticism has naturally been heard too.[22]

18. The current deliberations here are the subject of attentive interest and comment outside the European Union too, for example in the United States and Australia.[23] In addition, the Lando Commission's Principles of European Contract Law[24] and the comparable

[14] Christian von Bar (ed.), *Europäisches Gemeinschaftsrecht und Internationales Privatrecht*, Cologne, etc., 1991, and K. Boele-Woelki, *Principles en IPR - Enkele beschouwingen over de toepassing van de UNIDROIT Principles of International Commercial Contracts en de Principles of European Contract Law*, inaugural address at the University of Utrecht, 1995.

[15] Wilhelm Brauneder, *Europäisches Privatrecht: historische Wirklichkeit oder zeitbedingter Wunsch an die Geschichte?* Publication No 23, Centro di studi e ricerche di diritto comparato e straniero, Rome, 1997.

[16] Helmut Coing, *Europäisches Privatrecht*, 1985/1989; *ibid.*, 'Europäisierung der Rechtswissenschaft', in *Neue Juristische Wochenschrift*, 1990, pp. 937-941.

[17] Reiner Schulze, *Die europäische Rechts- und Verfassungsgeschichte - zu den gemeinsamen Grundlagen europäischer Rechtskultur*, Saarbrücken, 1991; *ibid.*, 'European Legal History - A New Field of Research in Germany', in *Journal of Legal History*, No 13, 1992, pp. 270-295.

[18] Reinhard Zimmermann, *The Law of Obligations - Roman Foundations of the Civilian Tradition*, Cape Town, Wetton and Johannesburg, 1990; *ibid.*, 'Das römisch-katholische ius commune als Grundlage europäischer Rechtseinheit', in *Juristen Zeitung*, 1992, pp. 8-20.

[19] Giuseppe Gandolfi, 'Pour un code européen des contrats', in *Revue trimestrielle de droit civil*, 1992, pp. 707-736.

[20] J.H.A. Lokin and W.J. Zwalve, *Hoofdstukken uit de Europese Codificatiegeschiedenis*, 1st ed., Groningen, 1986.

[21] Peter Stein (ed.), *Il futuro codice europeo dei contratti*, Milan, 1993.

[22] Pierre Legrand, '*Against a European Civil Code*', in *Modern Law Review*, Vol. 60, Issue 1, 1997, pp. 44-63 ; see also Markesinis, footnote 5 above.

[23] For details see Martin Vranken, *Fundamentals of European Civil Law*, Blackstone, London, 1997 (290 pp.).

[24] Hugh Beale, 'Towards a Law of Contract for Europe: the Work of the Commission on European Contract Law', in Günter Weick (ed.), *National and European Law on the Threshold to the Single Market*, pp. 177-196; *ibid.*, 'The "Europeanisation" of Contract Law', in R. Halson (ed.), *Exploring the Boundaries of Contract*, Dartmouth, 1996, pp. 23-47; Carlo Castronovo, 'I "Principi di diritto europeo dei contratti" e l'idea di codice', in *Rivista del diritto commerciale e del diritto generale delle obbligazioni*, 1995, pp. 1-38; M.J. Hoekstra, 'De UNIDROIT Principles of International Commercial Contracts en de Principles of European Contract Law: een vergelijking', in *Europees privaatrecht 1996*, Lelystad, 1996, pp. 3-43; Isabelle de Lamberterie, Georges Rouhette and Denis Tallon, *Les principes du droit européen du contrat/L'exécution, l'inexécution et ses suites*, La documentation Française, Paris, 1997; Ole Lando, 'Principles of European Contract Law', in *Liber Memorialis François Laurent*, Brussels, 1989, pp. 555-568; *ibid.*, 'Principles of European Contract Law/An Alternative or a Precursor of European Legislation', in *Rabels Zeitschrift für ausländisches und internationales Privatrecht*, 1992, pp. 261-273; Ole Lando and Hugh Beale (ed.), *The Principles of European Contract Law. Vol. I: Performance, Non-*

Principles of International Commercial Contracts, which were drawn up in the Unidroit framework,[25] have also generated a great deal of detailed discussion.[26]

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[26] See also Klaus Peter Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*, Berlin, 1996.

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A European Civil Code, international agreements and European directives

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1. ***The problem***

Today's European Union has long ceased to be an area in which the various national systems of private law coexisted entirely independently of each other. A huge number of long-established international agreements (EC regulations play only a subordinate role) and European directives are now in force as instruments of legal standardisation or at least harmonisation. This wealth of sources will naturally have to be exploited to the full as we try to create a European Civil Code. Both types of instrument, i.e. the international agreements and the numerous directives which affect the law of property, facilitate the tasks that lie ahead of us on the one hand. On the other hand, however, they compel us to confront a number of difficulties that have hitherto received little attention. The fact is that the existing rules enshrined in the agreements and directives need to be systematically gone over with a fine-tooth comb, incorporated into national law where necessary, supplemented in content and refined in form.They must be coordinated and dovetailed with each other, cleansed of all redundant regulation, inconsistency and terminological insularity, so that they can ultimately be fitted into a systematically coherent structure, into the 'overall picture' of a codified system. It is unlikely that anyone at the present time is able to foresee all the difficulties that will have to be surmounted on the way to this goal. As has been proved before, success can only be achieved by means of a permanent, institutionalised exchange of views and ideas between specialists and generalists.

2. ***The instrument of the international agreement***

International agreements only help to standardise the law for the benefit of the entire European Union if all Member States of the EU accede to them or ratify them *en bloc*. This seems to be stating the obvious, but it has to be emphasised, because there are many areas of international law in which several multilateral conventions coexist, each with a different selection of signatories from the EU. Such conventions are inclined to cement legal differences within the EU along entirely new dividing lines instead of creating true legal unity within the territory of the Union. Generally speaking, but particularly in view of the aim of creating a European Civil Code, we must urge legislators throughout the

Union to ensure that the Member States either accede to future international agreements *en bloc* or not at all. In many respects this problem remains as acute as ever it was. I could mention, for example, the struggle over the Council of Europe's Lugano Convention of 21 June 1993 on Civil Liability for Damage Resulting from Activities Dangerous to the Environment,[1] other international agreements from the realm of environmental liability[2] and the New York Convention on the Limitation Period in the International Sale of Goods,[3] which is a parallel agreement to the UN Vienna Sales Convention. In the domain of environmental liability, the EU's own projects (on which the Commission is likely to present a White Paper very soon) are in competition with the planned Council of Europe convention, which is probably a considerably more radical project in terms of content. And as for the Convention on the Limitation Period, the discussions within the Commission on European Contract Law have highlighted all too clearly the weaknesses of the New York text. Europe must pool its efforts to a far greater extent than hitherto, particularly in its dealings with non-EU States, unless it wishes to see new entrenchments cut across its territory. What rhyme or reason is there, for example, in the fact that the Unidroit Ottawa Convention on International Factoring[4] and the parallel Convention on International Financial Leasing[5] entered into force on 1 May 1995 for France, Italy and Nigeria? The history of the past twenty years is littered with absurdities of this type.

3. International agreements, moreover, are often incomplete. They not only tend to focus on a narrow subject area, thereby excluding peripheral matters (just as the UN Sales Convention of 1980, for instance, excludes the sale of rights and accounts receivable), but they also make a regular habit of circumventing all issues of fundamental importance to the private-law system in general. Some examples that spring to mind are the rules on restitution in the case of invalid contracts, the difficult concurrence problems between contractual and delictual liability (a particularly important problem in transport law), the relationship between the law of obligations and the law of property or between legal grounds and court orders, and so forth. This means that standardisation is often contrived or superficial. With the exception of private international law, the private law that has been standardised by international agreements does not generally enjoy a good reputation; it is regarded as a special type of law which cuts no ice with the vast majority of lawyers. To the extent, however, that global and European conventions contain acceptable rules, as is the case with the UN Sales Convention, these rules will be incorporated in a future European Civil Code. In addition, when the time comes for a European Civil Code to enter into force, the international agreements on civil law from which the present European rules have been derived can cease to have effect, either for all contracts within the single market or only for cross-border contracts, which would constitute real progress

[1] European Treaty Series No 150; the text in English is available on the Council of Europe website at http://conventions.coe.int

[2] These are summarised in von Bar, *A Common European Law of Torts,* Vol. I, 1996, points 381-382.

[3] The English text of this Convention is available on the Uncitral website at http://www.uncitral.org/english/texts.

[4] Convention of 28 May 1988; the English text of the Convention is available on the Unidroit website at http://www.unidroit.org/english/conventions/c-fact.htm

[5] The English text of the Convention on International Financial Leasing is available on the Unidroit website at http://www.unidroit.org/english/conventions/c-leas.htm

towards the aim of a tidy legal system. However, these international agreements would naturally remain applicable to transactions between EU and non-EU countries.

4. ***International agreements and European directives***
It not only happens, however, that international agreements come into conflict with each other on the one hand and with legislative policy within the EU on the other hand; Europe's lawyers are also increasingly confronted with the problem of EU legislators' desire to supplement international law with internal provisions of their own. This again creates numerous coordination difficulties, both in terms of substance and in terms of pure and simple implementation rules, because solicitors, for example, under the pressure of time that is part and parcel of their everyday work, are often scarcely able to pick their way through the current chaotic tangle of sources. A particularly glaring example is the law on the sale of goods; it has to be said that the current German law on the sale of goods, for example, is in a truly intolerable state. First of all, in an international context, there is a need to get to grips with and review a conflict of laws between the particular rules to be applied under the Convention on the International Sale of Goods (CISG) and the general rules of private international law that are contained in the Convention of Rome on the Law Applicable to Contractual Obligations. Secondly, domestic legal practitioners have to juggle with four different regimes, namely the law on the sale of goods laid down by the CISG, the sales law contained in the German Civil Code, the sales law in the German Commercial Code (*Handelsgesetzbuch*) and the plethora of special laws, some of domestic origin and some deriving from the transposition of Community legislation, in the domain of consumer sales law. In most of the other jurisdictions in the EU, the law on the sale of goods is scarcely any clearer. Partial and regional standardisation - as in Scandinavia, for instance – only seems, from a European perspective, to worsen the overall chaos.

5. ***UN sales law, EU consumer protection and autonomous national sales law***
One of the major tasks in the domain of European sales law has already been referred to in essence. It is first and foremost a matter of incorporating UN sales law, the provisions of European directives and national sales law into a general system that is free of duplication and contradictions. UN sales law, of course, relates to the international sale of goods (CISG, Article 1), excluding consumer sales contracts (CISG, Article 2(a)). European sales law, however, is based on precisely the opposite approach, making no distinction between cross-border and purely national cases and dealing exclusively with consumer sales contracts.

6. A future European Civil Code will undoubtedly have to deal with sales law as it relates to both business customers and consumers. For that reason, as far as the mechanics of the Code are concerned, it will be advisable on the one hand to create legal principles that apply to all sales contracts and on the other hand to create principles which apply only for the benefit of consumers and which are therefore embodied in mandatory or semi-mandatory provisions. Even the first of these recommendations will be far from easy to put into practice for several reasons, the first being that the UN Sales Convention requires careful analysis so that two questions can be answered: are its rules entirely suitable for

purely domestic cases as well as international transactions, and which of its rules represent genuine sales law and have a bearing on the law of contract in general, e.g. on the law relating to the conclusion of contracts or to impairment of the performance of obligations?

7. ***The concept of the consumer***
The next requirement is a neat and uniform criterion for the definition of consumer sales law and indeed, if possible, for the law governing consumer contracts in general. Even in the case of this relatively straightforward matter we are still miles away from the formulation of a uniform definition. The UN Convention on the International Sale of Goods (CISG) uses a different definition to the one contained in the proposal for a directive on sales of consumer goods and associated guarantees,[6] and the latter definition differs in turn from the far broader concept of the consumer as formulated in the Rome Convention on the Law Applicable to Contractual Obligations.[7]

8. ***The general law governing consumer contracts***
The next step will therefore comprise an examination, based on a fairly up-to-date comparative legal inventory and taking account of the existing and proposed EC Directives, with a view to determining which general rules can be developed for consumer sales law – and *only* for such law – within a European Civil Code. Consideration should be given, for example, to the formulation of common principles designed to afford protection against overhasty conclusion of a contract, to general rules on the law relating to standard conditions of business and to rules governing guarantees and customer service. The Commission on European Contract Law has already been dealing with some aspects of these problems,[8] while others are regulated by the EEC Directive on unfair terms in consumer contracts or in the aforementioned proposal for a consumer sales directive. But is the restriction to consumer *sales* law really warranted from a practical point of view? This will have to be answered in the negative, for there have long been special rules on consumer contracts at the European as well as the national level in the domains of services, credit agreements and personal security (especially suretyships). In other respects it will be a matter of continuing and, where necessary, expanding the efforts that are already under way to dovetail the system of European directives with UN sales law. I am thinking here, for instance, of warranty law, where, although in Article 2(1) of the proposed EC consumer sales directive law ("Consumer goods must be in conformity with the contract of sale") the concept of a

[6] Article 2(a) of the CISG states, "This Convention does not apply to sales of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use". Article 1(2) of the amended proposal of 19 January 1999 for a European Parliament and Council Directive on the sale of consumer goods and associated guarantees, COM/99/0016 final - COD 96/0161, lays down that "Consumer means any natural person who, in the contracts covered by this Directive, is acting for purposes which are not directly related to his trade, business or profession".

[7] Article 5 of the EC Convention on the Law Applicable to Contractual Obligations (Rome, 1980) is worded as follows: "This Article applies to a contract the object of which is the supply of goods or services to a person ("the consumer") for a purpose which can be regarded as being outside his trade or profession, or a contract for the provision of credit for that object".

[8] For details see Ole Lando's contribution to Part I of the present study, points 31-33.

defect is studiously avoided, Article 2(2) is recognisably based on Article 35 of the CISG and on section 14(2) of the UK Sale and Supply of Goods Act 1979, as amended in 1994.[9]

9. ***Advertising statements***
The proposed directive on sales of consumer goods and associated guarantees sets new standards in many respects. Take, for example, the legal remedies for purchasers or the importance the proposed directive attaches to advertisers' statements. On the latter point the authors of the proposal were able to use Article 7:18 of the Dutch Civil Code as a model. The Principles drawn up by the Commission on European Contract Law also contain a rule to the same effect,[10] although that will certainly need to be re-examined to establish whether the text needs to be adapted to the new Community legislation or whether it can be absorbed in its present form into a European Civil Code.

10. ***Gaps***
But let us not be fooled. Despite the numerous advances that the European directives have brought about, the cover they provide is still patchy in many respects. Strategies have certainly been devised already by the Commission on European Contract Law to close some of the gaps, but market operators in Europe will still have to be prepared for some sizeable black holes. These occur in areas such as liability for consequential loss arising from defects and the right of reclamation in respect of performances already delivered under an invalid contract. All issues overlapping into other legal areas have been omitted from the directives. The European law of contract has also come more and more to be nurtured and developed exclusively from the consumer's perspective. That, however, is definitely too narrow and, unless the EU turns its attention very soon to a general examination of the law of contract, and especially sales law, in all its facets, this narrow approach will demolish the structure of the existing national systems.

[9] I am indebted to my colleague Professor Hondius of Utrecht for drawing my attention to this connection.
[10] Art. 6:101 Abs. 2 PECL: "If one of the parties is a professional supplier which gives information about the quality or use of services or goods or other property when marketing or advertising them or otherwise before the contract for them is concluded, the statement is to be treated as giving rise to a contractual obligation unless it is shown that the other party knew or could have not have been unaware that the statement was incorrect."

Section Two: Specific aspects

The law governing service contracts

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I. The need for European legislation

1. ***Lack of a general regime governing service contracts***

None of the Member States can claim at the present time to possess a general legal regime governing service contracts or, to put it another way, internal legal uniformity. The lack of a uniform legal framework for service contracts can be partly explained at the national level by the fact that, when the major civil codes were created, particularly the French *Code civil* and the German *Bürgerliches Gesetzbuch*, the provision of services played a considerably less important role than is the case today. Consequently, there was not sufficient need for a set of rules at that time. The types of contract that existed in those days almost invariably related to short-term obligations. Long-term obligations, which play a particularly prominent role in the law relating to service contracts, are actually a result of twentieth-century developments. That is why the great codifications scarcely contain any provisions concerning them. In the century that is just ending, especially since the end of the Second World War, long-term service contracts have been growing in number and significance. As always when a new type of contract emerges, specific rules had to be developed. That is why statutes have sprouted autonomously, each developing independently of the others, in various niches of the law governing service contracts. A good example is the wide range of terminology used to describe a duty to provide information. In Germany, for example, it may be known as a duty to advise or consult with the other party (*Beratungspflicht*), to provide him with clarification (*Aufklärungspflicht*), or to inform (*Auskunftspflicht* or *Informationspflicht*), instruct (*Belehrungspflicht*) or warn him (*Warnungspflicht*). These are not specific legal concepts with a precisely defined meaning; each legal scholar uses his own preferred version, and even case law is inconsistent. The other Member States suffer likewise from the lack of a sound dogmatic framework for the law governing service contracts.

2. ***Impairment of the single market***

This diversity of legislation is impairing the development and expansion of the single market. Back in chapter II of this study we explained that, in the absence of a choice-of-law clause, the applicable law, as a rule, is that of the state in which the contractor's

registered office is located. This can result in a customer being totally unfamiliar with the statutory regimes that apply to his international contracts. Moreover, while sales law in most of the EU Member States can be traced back to Roman law, the law governing service contracts has no such common historical tradition. In other words, the customer cannot even rely on the foreign rules being at least similar to those of his own country. Such a large degree of legal uncertainty represents a major obstacle to the operation of the single market.

3. ***Modern information and communications technology***
Another reason why there is a need for a European law governing service contracts is that, as a result of the use of modern information and communications technology (the Internet and electronic mail), it happens increasingly often that contracts materialise within the Community without parties being aware that what they have concluded is a cross-border contract. Many companies – certainly the large corporations – give no indication at all in their website names and Internet addresses of the country in which their headquarters are situated; all we read is 'com'. This has made it almost impossible for their contracting partners to discover which law applies to their contract.

4. ***Consumer protection***
Another reason for adopting a European approach is the need to protect consumers and other consumer-like customers from overpowerful contractors. Besides providers of financial services, these include contractors such as telephone and Internet providers and providers of passenger transport services (airlines, bus companies or rail operators). It also goes without saying that more and more cross-border construction and medical contracts are being concluded. In both of these areas, the need to protect consumers seems to be self-evident. This need must be satisfied in the form of unilaterally mandatory rules in their favour.[1]

II. Prospects for European legislation

5. ***Existing regulatory approaches***
It could be questionable whether, in view of the lack of uniform national frameworks for service contracts and in the absence of a common legal tradition, there is any possibility at all of creating a European regime governing the provision of services. We believe it is possible and, to substantiate this view, we would point first of all to the steps that have already been taken in this direction. The Directive on unfair terms in consumer contracts [2] is applicable throughout the entire domain of the law of contract and is hence applicable to service contracts too, with the reservation that it only applies to contracts with consumers. The same applies to some other general directives, such as the Directive to protect the consumer in respect of contracts negotiated away from business premises,[3] the

[1] If the criteria laid down in Article 5 of the EEC Convention on the Law Applicable to Contractual Obligations are not fulfilled – as is usually the case – the law of the country in which the contractor is based – with which the customer can scarcely be familiar – is applicable to contracts with consumers.
[2] Directive 93/13/EEC of 5 April 1993, OJ L 95, pp. 29 *et seq.*
[3] Directive 85/577/EEC of 20 December 1985, OJ L 372, pp. 31 *et seq.*

Directive on the protection of consumers in respect of distance contracts[4] und die Directive on cross-border credit transfers.[5] In the domain of service provision, in addition to the directives concerning the financial services of banks and insurance undertakings,[6] we could mention the Directive on package travel,[7] the Directive on self-employed commercial agents,[8] the proposal for a Directive on electronic commerce[9] and the Directives relating to procedures for the award of public service, supply and works contracts,[10] to procurement procedures in the water, energy, transport and telecommunications sectors[11] and to the rights of telecommunications users.[12] So as far as the law governing services is concerned, there are already numerous 'European islands' within the national legal systems.

6 ***Lack of a broad perspective***

Although there have certainly been a number of moves towards a European regime governing the provision of services, this area of the law remains devoid of a broad perspective, even at the European level. We believe that this perspective can be provided within a European Civil Code. The lack of a broad perspective at the European and even at the national level, coupled with the absence of a common European tradition, complicates the quest for a set of European rules, because it is not possible simply to draw upon existing national solutions. This situation, however, can also be seen as an opportunity to make a fresh start with an approach that transcends the national systems. The degree of willingness to sacrifice a national rule is inversely proportional to the value attached to that rule within the country in question. Another important consideration is that prompt action on a European scale can prevent a situation in which each Member State continues to act at a purely national level. The long-term result of this would be further splintering of the legal framework, and it would also considerably complicate any subsequent efforts to harmonise the law governing the provision of services. From that point of view, action in the European framework is not only advisable; it also needs to be taken quickly.

7. ***The time for preparatory work is ripe***

In short, the time has come to set to work with a view to creating a uniform European system. We believe that the first step should be to conduct the requisite research into the various types of contract that are regulated by the national civil codes. The reason for this is that a mere comparison of laws would not reveal the whole picture from each country's

[4] Directive 97/7/EC of 20 May 1997, OJ L 144, pp. 19 *et seq.*
[5] Directive 97/5/EC of 27 January 1997, OJ L 43, pp. 25 *et seq.*
[6] See Jürgen Basedow's contributions to the present study.
[7] Directive 90/314/EEC of 13 June 1990, OJ L 158, pp. 59 *et seq.*
[8] Directive 86/653/EEC of 18 December 1986, OJ L 382, pp. 17 *et seq.*
[9] Proposal for a European Parliament and Council Directive on certain legal aspects of electronic commerce in the internal market, presented by the Commission on 18 November 1998, COM (1998) 586 final.
[10] See for example the most recent amendment of these directives, namely Directive 97/52/EC of 13 October 1997, OJ L 328, pp. 1 *et seq.*
[11] Directive 93/38/EEC of 14 June 1993, OJ L 199, pp. 84 *et seq.*
[12] See for example Directive 98/61/EC of 24 September 1998, OJ L 268, pp. 37 *et seq.*, and Directive 97/33/EC of 30 June 1997, OJ L 199, pp. 32 *et seq.*

perspective. For example, the nearest equivalent to the English term *solicitor* is the German *Rechtsanwalt* or the French *avocat*, but they are not exact equivalents, because the solicitor performs duties that are incumbent upon notaries general in other countries. The crucial point is that the various services should be analysed from a functional point of view. We believe that most services can be reduced to quite a limited number of basic functions, the main ones being analysis and advice, treatment, transport (of persons, goods and information), education, design, construction, processing (of materials and information), representation, custodianship and administration. The types of contract that exist in practice usually relate to one or more of these basic functions. A solicitor, for example, analyses and processes information, advises his client, designs and constructs a plan of approach, has custody of the case file and represents his client inside and outside the courtroom. The solicitor, however, is not the only contractor who has to examine received information and fill in any gaps, investigating as thoroughly as necessary in order to do so. These or similar duties are also performed by mortgage advisers, PR consultants, doctors and even TV repairers, electricians and painters. And although a contract with a doctor and a contract with a hairdresser are subject to quite different criteria, they both require the informed consent of the client to the planned intervention. A doctor and a hairdresser must inform their patient or customer of the way in which they intend to fulfil the contract and of any risks inherent in the proposed treatment. So while the *purposes* of the two contracts bear no comparison, the types of function required for their performance are often quite similar.

8. ***The aim of regulation***

We therefore believe that it is necessary to focus on the range of services in its entirety. We expect that the adoption of such a perspective will pave the way for the formulation of a set of general provisions relating to service contracts, which will then be supplemented by special rules for individual types of contract. The aim is to produce rules, either in the general provisions governing service contracts or perhaps even in the general provisions of the law of obligations, which cover at least the duties of disclosure and cooperation, quality standards for the evaluation of services and the conditions governing the termination and adjustment of continuing or recurrent obligations. Such rules would also be expected to create a better and clearer understanding of the position of non-contracting third parties and of the way in which contributory negligence operates in the law of contract. A broad perspective encompassing all services is the only way to ensure that the modern law of obligations is examined in sufficient theoretical depth and that such an examination proceeds from a completely new starting point.

The law governing insurance contracts

Jürgen Basedow, Hamburg

I. Creation of the single market

1. ***Background***
As I outlined in chapter II, freedom to provide services, and hence the single European insurance market, cannot be said to have become a reality – certainly not as far as policies for the general public are concerned. Legal divergences, examples of which were presented in chapter I, deter people from concluding cross-border insurance contracts. The attempt that was made in the insurance directives of the second generation to achieve convergence through private international law[1] ended in failure, as Fritz Reichert-Facilides has rightly and clearly stated.[2] Unlike many other areas of private law, the law governing insurance contracts has not reached the stage at which the main tasks are to perfect the single market and eliminate the psychological barriers of legal fragmentation that prevent economic players from making use of the internal European market. By contrast, in the domain of insurance policies for consumer risks and minor commercial risks, the original aim of creating the single market in the first place has yet to be achieved and therefore remains on the Community agenda.

2. ***Objectives***
The next steps in this process must be directed towards the following objectives: firstly, insurance companies must be empowered to form risk pools comprising inhabitants of various Member States. The aim of strength in numbers, which is at the heart of the insurance business, must not be frustrated by national borders. The policies of the European risk pool must essentially be governed by the same product-related rules, in other words by the same law of contract.

3. Secondly, prospective customers must be able to choose from a range of offers from various Member States, and these offers must be comparable with each other. The input of information and advice required so that this comparability can be achieved must be

[1] See footnote 37 of my contribution to chapter I.

[2] Fritz Reichert-Facilides, 'Europäisches Versicherungsvertragsrecht', in *Festschrift für Ulrich Drobnig*, 1998, pp. 119 and 131.

proportionate to the value of the policy. While it may be worthwhile to involve a specialised insurance consultant in the case of insurance cover against interruptions of business or industrial fires, in the case of a private third-party indemnity or household contents policy this would be an unwarranted expense and cannot be imposed as a compulsory element of the comparability assessment.

4. Thirdly, account must be taken of the fact that all parties have an interest in continuity of cover in cases where 'Euro-mobile' policyholders who live in various Member States in the course of their lives wish to renew or extend their policies with the same insurance company. While the present legal position means that contracts are governed by a different legal system once the policyholder has moved to another Member State, any future system must safeguard the interests of both parties in contractual continuity within the single European market.[3]

II. The first option: free choice of law

5. ***A system based on transport and large-risk cover***
European legal policy can take two routes towards these objectives. The first is based on the legal position relating to transport risks and large risks and involves authorising a free choice of law. The likely result of this is that insurers would include a clause in their policies stipulating that the contract would be governed by the law of the insurer's country of registration, which would effectively mean that one and the same system of contract law applied to the entire risk pool. This would achieve the first of the objectives enumerated above.

6. ***Consumers***
This first route, however, would be considerably less effective in terms of the second objective, namely freedom to choose between comparable offers. How is the European consumer to decide on the relative merits of a private third-party indemnity policy governed by German law and a competing product from an English company which would be governed by English law? Even experts in comparative law would have to expend an inordinate amount of time and effort in order to compare such policies. Overcoming the conflict of laws in this way means that the risk of ignorance of the law, which current international insurance law assigns to the insurer, is offloaded onto the consumer. Word would soon get round, and the likely result would be extreme consumer resistance to foreign companies' policies and certainly no appreciable increase in the volume of cross-border insurance business under freedom to provide services.

7. Moreover, any shifting of the risk would run directly counter to the aim of a high level of consumer protection enshrined in Article 95(3) of the EC Treaty (new numbering). In particular, consumer protection would be reduced by the fact that, in the event of disputes arising from the insurance contract, a split would occur between jurisdiction and the

[3] On this point, see Jürgen Basedow, 'Das österreichische Bundesgesetz über internationales Versicherungsvertragsrecht – eine rechtspolitische Würdigung', in Fritz Reichert-Facilides (ed.), *Aspekte des internationalen Versicherungsvertragsrechts im europäischen Wirtschaftsraum*, 1994, pp. 89, 91-92 and 99-100.

applicable law, because whereas, under the Brussels and Lugano Conventions,[4] the courts in the policyholder's country have concurrent (Article 8) or even exclusive (Article 11) international jurisdiction in insurance matters, if the burden were shifted they would presumably always have to apply foreign law, namely the law of the insurer's country of registration, which would be applicable under a choice-of-law clause in the policy. There is no Member State, however, in which the legal profession possesses enough specialised knowledge to conduct such proceedings in accordance with foreign insurance law, and court fees for the application of foreign law would be disproportionately high.[5] Authorisation of a free choice of law therefore has to be rejected for the domain of minor commercial risks and consumer risks.

III. The second option: harmonisation of substantive contract law

8. ***Early initiatives of the European Commission***

The second route to completion of the single insurance market involves harmonising the body of substantive law governing insurance contracts. Towards the end of the seventies the Commission of the European Communities did explore this avenue,[6] but, in the circumstances that obtained in those days, the aim of harmonising the law of contract turned out to be overambitious, with the result that the Commission settled in the meantime for a solution which focused on resolving conflicts of laws in its second generation of insurance directives.[7] Finally, in 1993, under the influence of the subsidiarity debate, it withdrew its proposal.[8]

9. ***Renewed efforts***

Renewed efforts to harmonise the substantive provisions of the national legal systems are now favoured by the Economic and Social Committee, which stated in a published opinion that "a whole series of obstacles hampering completion of the single market in this field can be traced back to the absence of Community legislation on inurance contracts (a minimum level of harmonisation of substantive law)".[9] In the same vein, a resolution adopted by the European Parliament towards the end of 1998 expresses the

[4] Brussels Convention of 27 September 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, as amended by the third Accession Convention (Spain and Portugal) of 26 May 1989, OJ L (1990) 285, p. 1 - see also the fourth Accession Convention (Austria, Finland and Sweden) of 29 November 1996, OJ C (1997) 15, p. 1; Lugano Convention of 16 September 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, OJ L 319, p. 9.

[5] For details, see Ernst Steindorff, 'Rechtsangleichung in der EG und Versicherungsvertrag', in *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (ZHR)*, No 144, 1980 pp. 447 and 450-451.

[6] Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts, OJ C (1979) 190, p. 2; see also the so-called Schwartz Document – 'Errichtung des gemeinsamen Marktes für Schadensversicherungen' in *Zeitschrift für die gesamte Versicherungswissenschaft (ZVersWiss)*, 1972, pp. 101 *et seq.*

[7] For details see footnote 37 of my contribution to chapter I.

[8] See OJ C (1993) 228, pp. 4 and 14.

[9] The opinion appears in OJ C (1998) 95, pp 72 *et seq*. The quotation here is from point 2.1.9 on p. 77.

view "that the harmonisation achieved in the sphere of general law of contract through Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts[10] is not enough to present insurance undertakings wishing to provide services in a Member State other than that in which they are authorised from being unfairly required to comply with national legislation by a reference to the general good and that the efforts which began ten years ago to approximate the most important provisions of the law of insurance contracts and insurance conditions should therefore be resumed".[11]

10. ***Advantages of the harmonisation of substantive law***

The harmonisation of key elements of the law governing insurance contracts would effectively ensure that prospective clients could rely on the comparability of the insurance policies offered to them by companies from various Member States. Whether each prospective client actually does compare them in detail is less important, because this justified trust in the *comparability* of the policies on offer enables him to focus on the main points of the proposed contracts, especially the principal risk limits and the amount of the premium, and to choose between the various offers on that basis. In the best-case scenario of complete standardisation of the law by means of a comprehensive EC Regulation, this option would actually lead to the same practical result as allowing a free choice of law, namely the standardisation of the law of contract governing the policies of any given risk pool. But even without such total standardisation, every step in this direction can reduce the risks currently posed by differing interpretations and assessments of insurance policies. Finally, the harmonisation of substantive law would serve the interests of the 'Euro-mobile' population in that it would give them continuity of cover. As long as European law on international insurance contracts remains unchanged, nothing will alter the fact that every time a policyholder moves between two Member States, a different legal system will apply to the policy as soon as it is next renewed. This would be easier to bear if the policyholder could at least rely on the fact that the main substantive rights and duties to which his contract gives rise will remain unchanged.

[10] OJ L (1993) 95, p. 29.

[11] Minutes of the plenary sitting of 22 October 1998: resolution on the draft Commission interpretative communication on freedom to provide services and the general good in the insurance sector. EP Doc. A4-307/98 (SEC (97) 1824-C4-0049/98); see also '"Allgemeininteresse" im Versicherungswesen' in *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)*, 1999, p. 36.

IV. Résumé

11. All in all, the second option, in other words another attempt to harmonise the substantive law governing insurance contracts, has the greater merit. Since, as outlined above, the single insurance market has yet to become a reality in the domain of minor commercial risks and consumer risks, the subsidiarity principle cannot be used as an argument against this proposal; over the past decade, the individual Member States have clearly not managed to create this single market by means of appropriate measures to harmonise their laws on insurance contracts. Under the present circumstances the chances that a fresh attempt at harmonisation will succeed are undoubtedly higher than in the past. The introduction of a single currency and electronic information and communication media are particularly conducive to the future development of competition throughout Europe in non-physical services such as insurance. The benefits of such competition should not be put at risk by a fragmented legal system.

Statutory obligations

Christian von Bar, Osnabrück

I. The need for standardisation

1. ***The significance of the law of tort***
   Alongside the law of contract, the law of tort or delict is one of the two great pillars of the law of obligations. The law of contract cannot exist without the law of tort, and the law of tort cannot exist in a market economy without the law of contract. After all, it would make no sense to establish a law on the acquisition of property without a law on the protection of property, any more than a law protecting property would make any sense in the absence of a law governing the acquisition of property. Considered from that point of view, the law of contract and the law of tort are two sides of the same coin.

2. Whereas the law of contract typically operates *inter partes*, the law of tort provides 'comprehensive cover' against injury from any quarter. The law of tort compensates for injury irrespective of whether any special legal relationship existed between the litigant parties prior to the injurious act. It covers people in every conceivable role: as road users, consumers, patients and neighbours, as victims of environmental pollution, as sportsmen and –women, as residents and tourists, as victims of arbitrary acts by public authorities[1] or of hooliganism, as victims of the media or as victims of their own parents. There is scarcely a domain of private, professional or public life to which the law of tort could not apply.

3. ***Torts with major and minor economic significance***
   From a functional perspective, which would admittedly be difficult to translate into judicial practice, a distinction can perhaps be made between torts with a major economic impact and those which are less significant in economic terms. The fact that the more economic side of the law of tort in its present fragmented state is obstructing the development of the internal market is beyond any doubt. The law of product liability is clearly only one of many examples. Divergences between the various laws of tort and

[1] Although the liability of the public authorities is subject to a special regime in several legal systems, in many countries (e.g. under Belgian and English law) it is quite simply judged on the basis of the general law of delict or tort.

delict distort competition in the entire services market[2] no less than the divergent laws of product liability were doing until quite recently in the market for goods. Other examples are easily found. One need only think of liability for employees and subcontractors, of the vast realm of environmental liability,[3] of media liability, of third-party liability in occupations involving property management, of the laws protecting companies against interference in the pursuit of their business, of the liability for breach of warranty of authority,[4] of liability for endangering the credit of a person or company or for false indications of origin on goods and for all kinds of mercantile torts.

4. The broad spectrum of the law of tort naturally includes materials that are of such minor economic significance that they have no direct bearing on the functioning of the single market. Parents' liability for their children springs to mind, as does the liability of private individuals for their animals or for the safety and security of their land and of the house that is built on it. But even here, the existence of third-party liability insurance certainly establishes indirect connections with the single market.

5. ***The law of tort as a coherent whole***
Far more important from a judicial point of view, however, is the fact that, from the outset, the *entire* law of tort must be constantly developed and renewed on the foundations of a single basic norm.[5] The law of tort or delict may, like the law of contract, be actually divided or potentially divisible into a general and a special part, but this division is (or would be) reflected in quite different structures to those of its contractual counterpart. Whereas, for example, sales, service and works contracts are distinguished by judicial criteria, the distinction between forms of liability such as product, road users' and environmental liability is based solely on factual criteria,[6] and there are many different types of overlap. The law of tort is truly an area in which everything is inextricably intertwined.

6. ***Insurance, legal advice and mobility***
Another factor is that the modern law of tort or delict operates against a background of an extensively developed insurance system, especially in the domain of third-party liability. In Germany, for example – or so it is said, at least – deliberations on the role of insurance

[2] In this context, a twofold function can devolve upon the law of tort or delict, depending on the relevant rule governing the concurreence of offences. On the one hand it supplements the rules of contractual liability in the relationship between the parties, and on the other hand it often exclusively governs relations with non-contracting third parties on whom a defective performance has injurious effects.

[3] For details of the efforts of the Council of Europe and the EU to achieve harmonisation of the laws on environmental liability, see von Bar, *Gemeineuropäisches Deliktsrecht*, Vol. I, 1996 (published in English as *A Common European Law of Torts*), points 379-383 and 387-389, and Vol. II, 1999, point 399. See also Wolfrum and Langenfeld, *Umweltschutz durch internationales Haftungsrecht*, Berlin, 1999.

[4] Unlike Germany, which regulates this type of liability in section 179 of the *Bürgerliches Gesetzbuch*, many countries, such as Belgium, France and Luxembourg (Articles 1382 and 1383 of the *Code civil*) deal with it in the framework of the general law of delict.

[5] See chapter I above. On account of the huge importance of the *tort of negligence*, this ultimately applies even to common law.

[6] Here too, of course, the exception proves the rule, because a different situation exists, for example, in French law relating to motorists' third-party liability, where it is now assumed that the relevant 1985 Act created an autonomous liability regime.

have led to the establishment of ceilings on strict liability and the exclusion of general damages (*solatium*) from the domain of strict liability. If that is true, variations in the law of tort and delict must considerably hamper the European market in third-party liability insurance. In addition, given people's mobility within the EU today, accidents in foreign countries are on the agenda. The difficulties encountered by citizens of the EU when, having had an accident abroad, they try to obtain legal advice in their native countries are nothing short of grotesque. Solicitors who specialise in private international law are a rarity; solicitors who can provide reliable information on the law of tort or delict in a particular foreign country, if only in connection with the simplest of road accidents, are all but non-existent. Having an accident in another Member State can still all too easily mean receiving no damages at all for the purely practical reason that injured parties are deterred by the severe difficulty and enormous expense of pursuing the available remedies. Standardisation of the international law of delict (i.e. private international law relating to torts) in a 'Rome II' Convention, which is presently under discussion, would undoubtedly represent substantial progress. Likewise, the repeal of the old Article 38 of the Introductory Act to the German Civil Code[7] is an extremely welcome measure.[8] However, it does nothing to alter the inadequacy of mere harmonisation or convergence of the provisions governing conflicts of laws.

7. ***Comparison with countries possessing more than one legal system***

One of the main arguments of the opponents of a uniform European Civil Code is the familiar one about a large number of highly successful multi-system countries. So why, they ask, can we not continue to permit 'competition between legal systems' in Europe? This argument is even less convincing in the context of the law of tort than elsewhere. In countries such as the United States, the inter-state divergences in the law of tort only affect marginal matters, even where – as is usually the case – there is no federal legislation; there have always been textbooks and other teaching material which cover the entire territory of the United States, and the courts in the constituent states have always cited each other's rulings. In the long run, no country with more than one legal system can sustain significant divergences in such a socially and politically sensitive field as the law of tort. Even in the United Kingdom, leading judgments such as *Donoghue v. Stevenson*[9] very soon led to decisive convergence of the Scottish and English law of tort. Nowadays it is far from easy to specify the precise differences that remain between these two jurisdictions; here too, the divergences have long been restricted to marginal matters.[10]

[7] See my contribution to chapter II above.

[8] One example of the grotesque consequences of this provision in its previous form, which is still applicable to old cases, is this: if a young French child were injured by a German vehicle in France, it could easly happen under section 7(2) of the German Road Traffic Act (*Straßenverkehrsgesetz*) that the child's family would receive no damages if their solicitor had preferred charges in Germany. If, on the other hand, the solicitor had preferred charges in France, the child's family would receive full damages, including general damages. This French decision would be recognised in Germany. A solicitor who had preferred charges in Germany could therefore have become liable for damages arising from a breach of his contractual obligations.

[9] [1932] AC 562 (HL); for details see von Bar, *A Common European Law of Torts*, Vol. I, point 274.

[10] See von Bar, *op. cit.*, points 299-301.

8. ***Creation of terminological unity in Europe***
One very important reason why a European approach is necessary in the domain of the law of tort has been almost entirely overlooked in the discussion to date, namely the fact that the instrument of the harmonising directive is creeping ever closer to the limits of its potential. In the domain of non-contractual liability, this has much to do with the absence of common European terminology. By force of circumstances, almost every directive relating to the law of tort has to operate with expressions such as 'loss or damage', 'negligence' (or 'no-fault' liability), 'breach of duty', 'causality', 'joint and several obligation', 'statutory limitation', etc. As long as these terms do not have the same substantive meaning each time they are used, they must inevitably lead to confusion. The failure of all previous attempts to create a services directive owes much to this terminological disunity.[11] Unless efforts are made to harmonise the core elements of the law of tort and delict, any other harmonisation attempts, even those that relate to a single sector, will be doomed to failure in the longer term.

9. ***Deficits in the cross-sectoral harmonisation of laws***
A differential diagnosis of the provisions of existing directives and draft directives shows that European legislators, precisely because they would not or could not focus on the entire law of obligations or even the entire law of tort and delict, have constantly run the risk of sowing the seeds of new problems. Statutory limitation periods and time limits for forfeiture must be coordinated; it is unacceptable to draw up rules for each individual sector if they neither harmonise with the rules governing the other sectors nor address the problem of coordination between the law of contract and the law of tort. Quite similar considerations apply to questions of group liability (partial or joint and several liability?), to questions relating to rights of recourse against co-debtors, to contributory negligence, to damages and damage assessment, to liability for others, to distribution of the burden of proof and so on. There is every reason to fear that the 'pulverising' effect of sectoral harmonisation on the whole system of private law will continue unabated until a more fundamental approach is finally adopted. What is regarded as a success in the harmonisation of a particular aspect of the law has all too often resulted in imbalances within the legal system as a whole, promoting a development which has further fuelled the 'decodification' process, as they say in Southern Europe. New, tightly circumscribed special laws are emerging everywhere; the codifications, on the other hand, are starting to be bled dry.

10. ***The other statutory obligations***
Very similar considerations basically apply to the other types of statutory obligation, the only difference being that practically no groundwork has been done in the context of European directives in terms of provisions relating to unjust enrichment and *negotiorum gestio*. This need not be perceived as a disadvantage, because it means that these areas are largely blank pages, on which it will be easier to write.

11. Be that as it may, it seems evident to me that the link in terms of subject matter between these areas on the one hand and the law of contract and of tort on the other will make it

[11] For details see von Bar, *op. cit.*, points 396-398.

imperative to devote attention to unjust enrichment and *negotiorum gestio* too. It may perhaps be debatable whether the latter domain actually has to feature as an autonomous category within the system, but the potential for social conflict that it harbours demands a legislative response. Many things would remain unacceptably incomplete and uncoordinated. A law of contract will remain a mere torso if the courts do not know how the restitution of performances rendered under a rescinded contract is to be effected. There are obvious connections between the *condictio* based on encroachment by the defendant and the law of tort, connections which extend right into the concept of loss or damage and the law governing damages in the narrower sense. On the other hand, unjustified management and presumptive management of another party's business are in some respects special torts, although – as can easily be demonstrated by the law governing liability for breach of warranty of authority – this does not rule out direct links with the law of contract either.

II. Scope for standardisation

12. ***The core elements of a tort or delict***
In response to the question as to how the substantive standardisation of the principles underlying the law of tort should be tackled, there is no perfected strategy. It will have to be developed first in the framework of the Study Group on a European Civil Code. Everything that follows here is therefore based on the premise that a general European discussion on this subject will take place, ultimately producing a clearer understanding of the issue. As far as the law of tort is concerned, however, there is perhaps already enough of a basis for us to venture the hypothesis that the first steps in this attempt should consist in the formulation of a basic norm for the general tort of negligence at least; whether particular torts, such as wilful damage, require a regime of their own remains to be seen. That basic norm in turn will have to reflect the elements of a tort or delict that are found in every legal system, namely breach of duty, causality and recoverable loss or damage.

13. ***The next steps***
On the basis of these three core elements, it will be possible, or so it seems to me from a present-day perspective, to advance step by step. Although it is true that the three core elements of a tort merge almost imperceptibly into each other, a series of autonomous common European rules can be formulated on each of them. The key to breach of duty, for example, is deviation from the proper standard of care, which is ascertainable in turn from the circumstances of the case in hand or from statutory provisions. The next intellectual step consists in identifying the sorts of case in which this deviation from the standard would not be sufficient in itself to establish liability but would need to coincide, whether as a rule or in exceptional cases, with culpable negligence in order to give rise to liability. Conversely, there could conceivably be cases in which, despite an established deviation from the proper standard of care and despite the presence of negligence, full liability - perhaps even partial liability – would not be incurred. Combinations are also conceivable (in connection with the liability of minors for their own actions, for instance), and it is equally conceivable that, in special cases, such as those relating to the

personal liability of employees, the law would require at least contributory negligence before a party could be held liable.

14. ***Strict liability***
On the other hand, there are many cases, of course, in which liability does not depend on a breach of duty but is determined by the fact that a person has run a particular risk or is accountable in law for the malfunctioning of a piece of machinery or equipment or the misconduct of a person under his control by dint of his position of responsibility. In this domain of strict liability (known as 'endangerment liability' (*Gefährdungshaftung*) in Germany), it will be clear how detailed the law can become. In some of these areas, such as liability for a motor vehicle, the establishment of rather general ground rules may have to suffice, whereas comprehensive rules can be devised in other areas, such as that of vicarious liability.

15. ***Causality***
It should be relatively easy to deal with causality (or accountability) in a separate section. The facts of such cases are, of course, anything but straightforward, but the problems can be isolated and therefore treated as a category in their own right. The new Dutch Civil Code is a fertile source of ideas in the domain of causality.

16. ***Loss or injury and damages***
In the sphere of loss or injury, my feeling - at the present time anyway – is that the Italian concept of *danno ingiusto* can be a suitable starting point from which to work towards the problem areas, especially that of the law governing liability for so-called pure economic losses. What seems doubtful to me, however, is whether a separate set of legal provisions on the legal consequences of torts is necessary or desirable. It will probably be a question of seeking harmonisation with the law of contract – an aim, incidentally, that must also be pursued in numerous other areas, such as statutory limitation, the question whether liability should depend on the foreseeability of the extent of a loss or injury, the law relating to joint and several liability, etc.

17. ***Other material***
It was a conscious decision of the Study Group to adopt a parallel approach to its work on non-contractual obligations wherever possible. In this domain we shall presumably have to distinguish at the start between quasi-contractual and quasi-delictual material – a distinction that all the legal systems already make in practice – and proceed cautiously from there towards the question whether general rules can be developed on the basis of that distinction and, if so, what those rules should be.

18. ***Conclusion***
The law of tort may be seen as a branch of the law that is closely related to the protection of fundamental rights. The protection that a bill of rights affords citizens in their relations with the state is afforded to citizens in their relations with each other by the law of tort, through which the state acts as a shield to guarantee the fundamental rights of its citizens. The European Union, for its part, is founded on common laws and values. Within such a

community there must be a realistic prospect of establishing a set of common rules on statutory obligations too.

The law governing credit security

Ulrich Drobnig, Hamburg

In view of the considerable differences that emerged from the summary in chapter I between the law relating to personal security and the law relating to real security in the Member States, it is only right and proper that the possibility and necessity of a uniform set of rules for both basic types of credit security should be examined separately.

I. Personal security

1. ***Three key areas***

The comparative review of the law relating to personal credit security highlighted three key areas; the scope and need for uniform European regulation in each of these areas must be examined separately.

The first area is the traditional law of suretyship, which is enshrined in most of the civil codes of continental Europe in largely congruent terms. Even the corresponding unwritten rules of the Scandinavian countries and the Anglo-Irish legal tradition are mainly consistent with the traditional codified law of suretyship.

Today, however, the traditional law of suretyship is being altered and supplemented in widely varying degrees by special rules in favour of consumer sureties, which is the second of the key areas.

Lastly, the contract of indemnity has emerged as a form of personal security in its own right, distinct from the secured claim. In scarcely any of the civil-law countries of continental Europe is it codified, nor has it established itself to the same extent in every country as a separate legal institution.

2. ***The need for uniform regulation***

The three basic types of personal security can be lumped together when it comes to examining the need for uniform regulation.

The most pressing needs are those of cross-border business within the single European market. Large and medium-sized enterprises will generally establish a subsidiary in their targeted market when thy wish to step up their production and sales activity outside their country of registration. Since, for business reasons, these subsidiary companies are often equipped with few capital resources, credits granted to them by the banks in the countries

where they are based are very often secured through contracts of suretyship or indemnity whereby the foreign parent company or its managing director or main shareholder stands guarantor. Contracts of indemnity also play a significant part when companies bid for cross-border contracts, when they carry out major investment projects and when they finance their foreign trade.

By contrast, consumers' personal credit security plays a far less important, though by no means insignificant role. Particularly when venture capital is needed for new small businesses or for self-employment or other independent activities, family members or friends will often stand surety for a start-up loan.

The main practical need is undoubtedly for uniform rules governing personal credit security for cross-border business transactions.

3. ***The 'traditional' law of suretyship***

According to the comparative survey in chapter I, there is a very real possibility that uniform rules can be developed at a European level for the 'traditional' law of suretyship. For all the differences that exist in terms of detail, the survey did reveal a high degree of consistency in the ways in which the Member States resolve the main issues.

It should also be pointed out that work on uniform suretyship rules was started back in 1970 or thereabouts by the Commission of the European Communities on the basis of previous preliminary studies. These comparative studies had been compiled for the Commission by the Hamburg-based Max Planck Institute for Foreign Private Law and Private International Law, which examined the suretyship law of the six founding members of the EEC, while Professor Hartley compiled an accompanying study on the relevant rules of Anglo-Irish law. A working party set up by the Commission, in which I took part as a specialised consultant, had already agreed on a preliminary draft directive on the subject. Shortly after the accession of the United Kingdom to the European Communities, however, the work was discontinued. These early efforts have at least created foundations on which it will be possible to build, although account will naturally have to be taken of new case law and legislation, particularly the new Dutch Civil Code, the relevant property-law provisions of which entered into force in 1992. And, of course, consideration will also have to be given to the legal systems of the countries which subsequently acceded to the Community and whose systems did not feature in the original studies, namely Greece, Spain, Portugal, Austria and the three Scandinavian countries.

4. ***Special rules for consumer suretyships***

Special statutory provisions designed to protect consumers who have assumed a suretyship and special rules that have been developed for such cases by the courts in some countries raise a fundamental question of legislative methodology from the outset, namely whether special rules for consumers should be incorporated into the planned European Civil Code at all. Or should they rather be collected together in a separate body of rules on consumer protection, possibly in conjunction with special procedural rules devised specifically for the field of consumer protection, such as provisions enabling consumer organisations to bring representative actions? This question cannot, of course,

be answered separately for individual problem areas; a general solution needs to be found for a future European Civil Code. Personally, I favour the integration of consumer protection into a European Civil Code for several reasons: firstly, it is largely a matter of merely adapting the general provisions and rules that already exist in private law. In the interests of a unified and realistic code of civil law, this domain, which certainly features prominently in the everyday administration of justice, must not be omitted. On the other hand, it would also help to make the special rules of consumer law more comprehensible and easier to manage if they were embedded in the general context of civil law, which is precisely the context in which they have been developed. Moreover, legislative experience in the Netherlands demonstrates that the integration of such laws into a general civil code is certainly possible in terms of legal methodology.

No definite answer can yet be given to the question whether it is possible to develop uniform rules for consumer suretyships. It will require comprehensive and precise examination of court judgments in typical cases involving consumer suretyships in all the Member States.

5. ***Contracts of indemnity***

The remarks contained in point 3 above with regard to 'traditional' suretyships largely apply to the standardisation of the law governing contracts of indemnity too. The contract of indemnity was included in the comparative studies on the law of the six founding Member States of the EEC and the accompanying study on Anglo-Irish law. On the basis of this comparative groundwork a proposal for a uniform regime for contracts of indemnity was also drafted and discussed.

Since then, besides more recent legislation, the regimes of the present Member States that had not yet acceded to the Community at that time and a considerable body of case law, we have also seen the addition of international instruments and proposals relating to the distinct institution of the contract of indemnity. In international trade, the main concern has been to develop sanctions against obviously unwarranted applications by beneficiaries to guarantors under contracts of indemnity, in other words to restore to a limited extent the accessory nature of the guarantor's liability for the secured claim. The standards that have been developed through the judgments of national courts display a high degree of consistency.

It must therefore be concluded that the prospects for the development of generally acceptable rules on contracts of indemnity are good.

II. Real credit security

6. ***The need for a European Civil Code***

A need for uniform rules on real credit security can arise as a result of two factors, one of which is more significant than the other. The first factor is of a general economic nature. A debtor can obtain credit more cheaply if it is secured, because the creditor, by virtue of the lower risk of non-satisfaction, will charge a lower interest rate on a secured loan. This

practical experience of the German credit market is confirmed by comparative observation: the poorer the quality and reliability of the credit security that is available within a country, the higher the probable cost of credit in terms of the interest rate. The participants in a single market must press for the creation of a level playing field for all market operators through the removal of anything that artificially distorts competition. Such sources of distortion include disparities in the forms of security that are permitted in different countries and variations in the legal quality of the available security.

Besides this general economic aspect of the need for standardisation, there is also a legal aspect, which is admittedly restricted to a particular group of security types. The group in question consists of security interests in movables transferred from one EU Member State to another. This may entail only one cross-border transaction, particularly in the case of the export of goods, including capital goods, to another Member State. But it can also involve a constant or occasional crossing of borders, especially in the case of vehicles being used for regular or occasional cross-border transport or simply private individuals driving across internal borders on an occasional basis. Vehicles, ships and aircraft, however, whether operated by companies or private individuals, generally return to their home base after each journey.

In both types of case, in other words whether one round trip is made to export goods or whether frequent trips are made from a home base to a foreign country and back, there arises what we might call a mobility conflict. According to the traditional and generally recognised principle of the *lex rei sitae*, the law of property that applies to an object changes every time it crosses a border; on crossing the national border between the exporting country or country of origin *A* and the importing or recipient country *B*, the object ceases to be subject to the law of *A* and becomes subject to the law of *B*. The rights *in rem* that attach to the object become subject to a different system of property law. This will determine whether rights *in rem* which were legitimately established in country *A* are recognised at all in country *B* and, if so, what implications those rights could have in the law of *B*.

Uniform laws governing real security would overcome both of the present weaknesses: on the one hand, they would remedy the inequality of the legal conditions governing competition, thereby resulting at least in a convergence of interest rates for secured credit; on the other hand, they would make it far easier to maintain and assess the effects of credit security when collateral crosses national borders and hence reduce the cost of credit.

7. ***Earlier proposals for uniform rules***

The need for uniform rules that was demonstrated in point 6 above is substantiated by a number of proposals that various bodies have developed from several different starting points and have presented in the course of the past thirty years.

The first two proposals, dating from the mid-sixties and early seventies, were restricted to developing solutions to the mobility conflicts referred to in point 6 above. Accordingly, what the proposals contained were conflict rules on recognition of the extraterritorial

effects of non-possessory security and of simple retention of title.[1] The implementation of these drafts, however, would only have removed one of the two weaknesses deriving from the current divergences between the national legal systems (see point 6 above).

A more in-depth approach, albeit restricted in its subject matter to a single form of security, was adopted in subsequent discussions within the Commission of the European Communities in 1979 and 1980. A uniform regime governing the effects of a retention of title was proposed. Under this proposal, a retention of title agreed in writing was to take effect without the need for registration; the same was to apply in the event of extension by assignment of a claim to the future selling price of the reserved object, with no need to notify the second purchaser.[2] Only now, 20 years later, has the European Commission begun to follow up its original interest in this matter (see point 8 below).

Mention should also be made of a model law on security interests that was drawn up by the European Bank for Reconstruction and Development in London in 1994 with the aim of providing legislators in the new democracies of Eastern Europe and the Balkans with a suggested framework for a modern statutory regime. The model law essentially follows the basic aim of Article 9 of the U.S. Universal Commercial Code (UCC), namely the creation of a uniform law of credit security; like the UCC provisions, the model law also replaces retention of title with a non-possessory security interest of the seller.

8. ***New proposal for the regulation of simple retention of title***

A proposal for a directive combating late payment in commercial transactions[3] was published in April 1998 and amended in October of the same year; Article 4 of the proposed directive contains provisions designed to harmonise the Member States' legislation on simple retention of title. Paragraph 2 requires Member States to recognise the validity of a uniform clause, which the draft reproduces in the eleven official Community languages – "The goods remain the property of the seller until payment" – or of any clause having equivalent effect. The seller must communicate this clause in writing to the buyer no later than the date of delivery of the goods; the notification may be made in the seller's standard contract, on the invoice or on a delivery note accompanying the goods. No additional formalities may be imposed (paragraph 1). Once the due date has passed without the buyer having paid, the seller may claim that the goods in question be returned to him; this claim may be made in the framework of bankruptcy proceedings or a similar procedure (paragraph 3).

Matters that are not covered by the proposed directive, such as problems relating to the protection of third parties acting in good faith and the effects of a connection between the reserved goods and other movables or land holdings, are left to the Member States (paragraph 4).

[1] See Kieninger, *op. cit.*, pp. 216 and 221-222; see also Drobnig, *Generalbericht*, pp. 32-33 (cf. bibliography at the end of my contribution to chapter I).
[2] See Kieninger, *op. cit.*, pp. 223-226; see also Drobnig, *ibid.*, pp. 33-34.
[3] Amended proposal for a European Parliament and Council Directive, dated 30 October 1998, OJ C 374, p. 4.

9. ***Scope for standardisation: collateral in the creditor's possession***
The rules governing possessory pledges in the Member States of continental Europe as well as in the three Scandinavian Member States and the common-law countries of the British Isles not only concur in their basic features but also in many details. For that reason it should be relatively easy to devise generally acceptable uniform rules on possessory pledges. Unfortunately, however, this type of real security is still of such minor importance in practice in each of the Member States that the actual effect of standardisation would be modest. On the other hand, the possessory pledge, because of its long history and proven value, still constitutes the basic model for 'natural' credit security today; the rules that do not focus on the possessory status of the collateral can certainly be applied to other types of credit security.

10. ***Scope for standardisation: securing monetary credit by means of collateral in the debtor's possession***
As we saw in chapter I, practical interest and demand are focused today on the legal regulation of the types of loan security in which the collateral can remain in the possession of the debtor. In the case of floating assets it should be possible to design the security interest in the form of revolving collateral so that the individual components of the collateral can be used or sold and replaced.[4]

The comparative summary in chapter I above certainly showed that the Member States have developed a large number of highly diverse non-possessory security instruments through their statutes and case law, some of them based on the non-possessory pledge and others on a form of security ownership to which a lesser degree of protection attaches than is the case with full ownership. What is particularly striking, however, is the wide variation in the Member States' willingness to authorise the use of revolving collateral, the general tendency being to impose either severe restrictions or a total ban.

The conceptual basis of a uniform set of rules should be a non-possessory pledge; this would serve to maintain and reinforce the desirable unity of security interests in the same way as the traditional possessory pledge has done. The equitable lien, in the form of the German and Greek security transfer, should also be replaced by a non-possessory pledge. In so far as the rules governing possessory pledges do not relate directly to the assignment of the collateral and its possession by the creditor or by a third party acting on his behalf, they too can be adapted to suit modern requirements and extended to cover non-possessory pledges. The latter, however, must be the starting point for the new regime, as befits its modern-day predominance.

The question whether the application of the publicity principle, through entry in a register or in some other form, is necessary and desirable will require closer scrutiny. This must include an examination of the implications of actual entry in a register under the existing registration systems; it must also include investigation as to whether substitute rules have not developed anyway in the commercial sector – such as an assumption that particular

[4] A good review of this subject, with a comparative dimension, is provided by E. Gabrielli, *Sulle garanzie rotative*, Naples, etc., 1998.

commodities and goods are typically bought on credit or used as collateral and are therefore encumbered as a rule by security interests. Should a decision be taken in favour of a register, consideration would have to be given to whether or not a European central register would be necessary or at least desirable.[5]

In view of the desirability of global security instruments, careful consideration should be given to the idea of institutionalising these in the form of company mortgages. The first option to be examined in this context would be the 'comprehensive' company mortgage that has been introduced in Sweden and Finland, which is almost unlimited in its coverage. At the same time, however, it will be necessary to recognise the possible risk involved in the use of this instrument in terms of putting the funding of a company entirely into the hands of a single bank and to assess how real that risk is.

Modern flexible rules will have to be developed for the realisation of collateral security. The aim must be to strike a good balance between a creditor's interest in the rapid realisation of his security and the legitimate interest of the debtor in protection from an unscrupulous creditor.

11. ***Scope for standardisation: security in the form of claims***

The coexistence of the pledging of claims and assignment for security purposes seems to be superfluous. Since pledging of claims is unknown in the Anglo-Irish legal tradition for understandable reasons and contemporary legal developments have tended to favour assignment, concentration on the latter institution commends itself. On the other hand, assignment for security purposes, like security transfer, should be reduced to its core function in security title law, namely as a pledge of rights.

As with non-possessory pledges in the form of property, the question also arises here as to whether the pledge of a claim requires disclosure, be it by entry in a register or by notification to the third-party debtor. Requiring both, as English and Irish law do, seems unnecessary, at least in terms of the publicity principle. Notifying the third-party debtor can obviously provide only a very indirect type of publicity; it is, of course, possible that the third-party debtor will be asked by interested parties about the existence of such notification. In the case of the blanket assignment of all accounts receivable, however, such questioning will scarcely be practicable.

If the economic demand for blanket security is to be satisfied, it should be possible to pledge future claims too, in other words claims for which no legal basis exists at the time when the security is created.

12. ***Scope for standardisation: security for trade credit***

[5] A few proposals have recently been made on this subject. See Mouly, 'La publicité des suretées réelles mobilières' in *European Review of Private Law*, No 6, 1998, pp. 51 *et seq.*, as well as Dolan and Vegter, 'A voluntary filing system for secured financing transactions in the European Union' in *ibid*., pp. 195 *et seq.*

Retention of title by the seller has become established in almost every Member State as a special form of security for trade credit. Its basic form, simple retention of title, which is limited to securing the purchase price of a specific item, remains effective in most countries even if the buyer goes bankrupt. The draft directive combating late payment contains rules governing simple retention of title; if these are adopted, that would create the basic framework for standardised retention of title, at least in commercial transactions within the single market. The same line of approach can subsequently be extended into the domain of private transactions.

As a means of securing the funding of routine business operations, there should also be a legal basis for a revolving retention of title, in which the components of a generically defined mass of collateral would be exchangeable. For the same reason there is also a need for extended retention of title (extension of security to future rights in respect of the purchased goods), but not necessarily for broadened retention (broadening of security to cover other claims against the buyer besides the purchase price of the goods). The extension of the seller's retained title to payment of a future purchase price if the goods are sold on should be made possible through the application of the rules on the pledging of claims (see point 11 above). Separate rules would have to be formulated to enable sellers to extend their title to cover any new goods resulting from the processing of the purchased goods.

Finally, consideration should be given to the question whether retention of title as such should be preserved or whether it would be better to replace it with a system whereby the seller receives a non-possessory pledge in respect of the purchased item. Such a substitute for security through ownership would only be acceptable, however, if the pledge held by the seller, following the model of Article 9 of the U.S. Universal Commercial Code, were endowed with rather more potent effects than a normal pledge. This type of switch to a reinforced pledge would enable both the conditional purchaser and his creditors, in accordance with the German 'example' of inchoate title, to make legal use of the conditional purchaser's rights in respect of the goods in question.

Chapter IV

The competence of the EU to create a uniform European Civil Code

The competence of the EU to create a uniform European law of obligations and property and the potential legal bases

Winfried Tilmann, Düsseldorf, and Walter van Gerven, Leuven and Maastricht

I. Introductory remarks

1. ***Temporal dimension, version of the Treaty***
The competence of the European Union to create a European law of obligations and property and the legal bases on which it could do so would depend on the time at which such a project was implemented. We assume that the Treaty of Amsterdam will have entered into force by then. We also consider it likely that further amendments will have been made to the Treaty Establishing the European Community by that time, especially to Part Three (Community Policies), Title IV (Visas, asylum, immigration and other policies related to free movement of persons). The Community may be expected, for example, to have extended the catalogue in the new Article 65 of the Treaty, which presently covers only some of the aspects of judicial cooperation in civil matters.

2. ***Prognosis***
Since our reply to the competence question relates to an unknown future time, and since it is impossible to predict reliably from our present perspective the powers that the Community will have when that time comes, there are only two options open to us as we try to address this question:

- We could base our assessment on the present legal position. This, however, will possibly, or indeed probably, have changed by the time a codification of European private law has been completed.

- We could try to list the future bases of Community authority as a combination of present and potential legislation that appears realistic. This response, however, would be speculative and therefore unsuitable.

3. ***Pragmatic solution***
So that we can provide Parliament with a useful answer to the competence question, the opinion we shall now deliver is based on practical considerations.

- The starting point must be the identification of the actual need for standardisation or harmonisation of private law. The Community develops its law in accordance with real needs, as can be seen, for example, from the factual background to the creation of its present powers.

- Secondly, we shall review the potential instruments (enabling legislation) of standardisation or harmonisation and discuss the advantages and disadvantages of each.

- We shall then examine the extent to which Article 95 of the EC Treaty (the Amsterdam version; formerly Article 100a), in accordance with one of several views that are represented in this debate, is a suitable basis for the standardisation or harmonisation of European private law (point 49 *et seq.*) as well as exploring the legal or strategic reasons why another school of thought advocates the option of a treaty outside the present framework of EC law (point 82 *et seq.*).

With regard to the temporal dimension of the project (see point 1 above), the following is our answer to the question of the legal powers of the Community at the present time:

First of all, legal scholars and practitioners should draw up a model code. As this work nears completion, a decision should be take in the light of the prevailing political and legal conditions as to which of the available legal bases should be used.

II. Areas of the law of obligations and property in which the need for standardisation or harmonisation is greatest

4. ***Standardisation and harmonisation of the law of obligations***
We shall now examine some aspects of the law of obligations in terms of the legal and economic need for standardisation and harmonisation.

5. ***Legitimate restriction of access***
We shall begin by dealing with the main obstacles to the fundamental freedoms enshrined in the Treaty (free movement of goods, freedom to provide services, freedom of establishment, free movement of capital and free movement of persons) which are recognised as legitimate restrictions of access to these rights.[1] These exceptions are listed, for example, in Article 30 of the EC Treaty (formerly Article 36), while others have been recognised in judgments of the European Court as unwritten exceptions to Article 28 (formerly Article 30) of the Treaty. Of the catalogue contained in the new Article 30, special mention should be made here of the protection of industrial and commercial property. In this domain, the First Council Directive to approximate the laws of the Member States relating to trade marks (89/104/EEC) was based on Article 100a (now Article 95) of the Treaty, because the trade-mark rules contained in it are designed to promote the establishment and functioning of the single market (cf. the first recital of the Directive). Regulation (EC) No 40/94 on the Community trade mark is based on Article

1 Mestmäcker, 'Zur Wirtschaftsverfassung in der Europäischen Union', in Hasse, Molsberger and Watrin, *Festgabe für Wilgerodt*, 1994, pp. 263 and 287 *et seq.*

308 of the EC Treaty (formerly Article 235), while Regulation (EEC) No 2081/92 on the protection of geographical indications and designations of origin for agricultural products and foodstuffs is based on Article 37 (formerly Article 43).

6. Most prominent among the unwritten exceptions to Article 28 of the EC Treaty are rules governing consumer protection and the case law designed to suppress unfair competition. Since these are recognised as legitimate access restrictions, harmonisation measures in this domain focus on the establishment and functioning of the single market (Article 95(1) – new numbering – of the EC Treaty). The Community, of course, has adopted numerous harmonisation instruments on the basis of Article 95: Directives 85/374/EEC (product liability), 85/577/EEC (contracts negotiated away from business premises), 87/102/EEC (consumer credit), 93/13/EEC (unfair terms in consumer contracts) and 94/47/EEC (time-sharing), to name but a few. From the realm of competition law, mention should be made of Directive 84/450/EEC concerning misleading advertising and Directive 97/55/EC, which amended the said Directive 84/450/EEC so as to include comparative advertising.

7. ***Contracts relating to the exercise of fundamental freedoms***
In addition to the differences in the national provisions governing these legitimate restrictions on the exercise of fundamental freedoms ('protected areas'), divergences between the systems of private law in the Member States can also obstruct the fundamental freedoms enshrined in the Treaty; wherever this happens, harmonisation is imperative. Besides the restriction of the free movement of goods, freedom to provide services, etc., consideration must also be given to the ways in which the differences between national provisions can distort competition.

8. For this reason, the standardisation and harmonisation of laws must focus especially on the main types of contract that are used for cross-border business transactions. These include sales contracts, which relate to the free movement of goods, and service contracts in the widest sense, which come under the heading of freedom to provide services.

9. Standardisation or harmonisation extending beyond the domain of consumer rights is also needed for other contract types governed by the law of obligations. These include special types of service contract, such as contracts for professional services, bank agreements and insurance contracts, and contracts relating to capital and payment transactions. Special legal bases exist in the domains of agriculture (Articles 35 and 37 of the EC Treaty), company rights (Article 48(2)) and transport (Article 71).

10. Another area where standardisation or harmonisation should be considered is that of the provisions of private law relating to the general and special law of contract, which have a bearing on every contract type governed by the special law of obligations.

11. ***Statutory obligations relating to the exercise of fundamental freedoms***
Lastly, great importance attaches in the context of cross-border business transactions to the provisions of private law that relate to the breakdown of a business relationship or to

loss or damage resulting from a business relationship. A survey of small and medium-sized enterprises has revealed that the greatest deterrents to these companies' involvement in intra-Community trade are the diversity and complex details of the Member States' rules on liability and on restitution in respect of abortive contracts.

12. The harmonisation of provisions in the law of contract and tort and the law relating to *negotiorum gestio* and unjust enrichment would create greater uniformity and transparency, thereby removing a formidable obstacle to the exercise of the fundamental freedoms enshrined in the EC Treaty.

13. ***Standardisation and harmonisation of property law***
In the next few paragraphs we shall present the aspects of property law that need to be unified. We shall go into more detail in presenting the standardisation and harmonisation regimes that could be adopted in this domain than in the case of the law of obligations, since the contracts relating to intra-Community transactions in goods and services under the law of obligations are widely familiar.

14. ***Industrial and commercial property***
In the realm of property law too, the standardisation or harmonisation of legal provisions is most urgently needed in the so-called 'protected areas' where the exercise of the fundamental freedoms enshrined in the Treaty is restricted. This applies especially to industrial and commercial property and copyright law (Article 30 of the EC Treaty).

15. ***Two selected domains: security and assignment***
Legal standardisation or harmonisation is also necessary in those areas of the Member States' property laws in which the diversity of provisions is perceived as a barrier to cross-border transactions. We have selected two such areas, the relevance of which to the functioning of the single market will be immediately apparent, although this does not mean that we seek to exclude from the outset any provisions from other areas of property law that need to be standardised or harmonised. Our selected areas are:
    - the use of property rights as security, and
    - the assignment of property rights.

16. ***The use of property rights as security***
What makes a uniform European law of property particularly necessary in an economic and monetary union is the fact that property can be used to secure capital interests.[2] All forms of security interest in movables or immovables entitle the creditor to obtain satisfaction from the object used as collateral (*in rem* protection), so that, in the event of the debtor going bankrupt or experiencing a financial crisis, the creditor would be in a better position than creditors with unsecured claims. The law of property gives him a privileged claim to satisfaction from the collateral.

[2] The following comments are based to a great extent on the Dahlhuisen article, 'Security in Movable and Intangible Property. Finance sales, future interests and trusts', in Hartkamp, Hesselink, Hondius, du Perron and Vranken, *Towards a European Civil Code*, 1994, pp. 361 *et seq.*

17. Some security interests require registration (in Germany this applies to mortgages and to the *Grundschuld* (land charge)) or transfer of possession (which applies to pledges in Germany). Security interests in movable property which involve a transfer of ownership are largely unsuitable for business purposes because they deprive the debtor of the use of the collateral. There is, nevertheless, a need for the harmonisation of laws relating to registered interests, especially in immovable property, and to security interests which require the transfer of possession to the creditor.

18. The greatest need for legal harmonisation, however, relates to those property rights (security rights) which can be created without possession being transferred. In the business world the demand for such security comes from debtors who seek to obtain working capital for their business, especially in order to finance the procurement of capital goods, and from creditors who, for the most part, wish to secure payment for their goods, full ownership of which will not pass to the buyer until the latter has paid the purchase price. Both of these forms of security interest are designed to ensure that the debtor's use of the property in his business operations is not impeded. This leads to the abstraction of the security interest from the actual object and to its attachment to other objects, as is manifested not only in the floating charge in English law[3] but also in the conditional property transfers that feature in the legal systems of other Member States (Germany, the Netherlands and, to a lesser extent, France, Italy and Belgium).[4]

19. Property rights used as security often operate in conjunction with contractual agreements. Mention should be made in this context of rights of retention,[5] set-off rights,[6] differential-purchase or repurchase options[7] and automatic terminations.[8] In a uniform European law of property, the provisions relating to security interests must therefore include these contractual arrangements.

20. Foremost among the various security interests is the so-called financed purchase, in which ownership of the goods is retained by the seller and passes to the buyer on fulfilment of a condition (payment). This type of security can lead to disparities, because ownership is not transferred until every last penny of the debt has been paid, which poses an overkill problem. Retention of title and hire purchase belong to this category, as do financial leasing and factoring. The person providing security (the purchaser of the reserved item) does, however, have a conditional property right, which can afford him protection even if the recipient of the security (the seller) experiences a financial crisis.[9] In view of the widespread use of these forms of non-possessory security, harmonisation at the European level appears to be essential.

[3] Dahlhuisen, *op. cit.*, pp.362-363
[4] Dahlhuisen, *op. cit.*, pp. 379-383
[5] Dahlhuisen, *op. cit.*, p. 364
[6] Dahlhuisen, *op. cit.*, p. 365
[7] Dahlhuisen, *op. cit.*, pp. 365-366
[8] Dahlhuisen, *op. cit.*, p. 366
[9] Dahlhuisen, *op. cit.*, p. 368

21. Such standardised laws could cover the following matters:
    - disclosure or registration of security interests,
    - reconciliation of interests between providers and recipients of security, and
    - reconciliation of interests among recipients of security.[10]

22. Repurchase agreements, financial leasing and factoring are among the most important types of financed contract in which property rights are used as security. In a repurchase agreement (repo), the owner sells and transfers his security and receives the agreed price. At the same time a repurchase is arranged for a later date and a repurchase price is fixed. The difference between the selling price and the repurchase price is based on the market rate for loans of that nature and represents a standard interest rate corresponding to the customary interest charged for such financial instruments but one factor lower, because the financing party has security.[11]

23. In financial leasing the lessor remains the owner, but the lessee uses the object in exchange for regular payments. At the end of the agreed leasing period, the lessee normally becomes the owner of the leased object and pays the residual price or at least has the option of becoming the owner. This system enables finance providers to earn higher incomes. A special form of financial leasing is the sale and leaseback, whereby the owner sells the right to his property for a fixed period to a lease company in exchange for a leasehold.[12]

24. In factoring, payments are received from an organisation which takes care of the administration of debt collection on a professional basis, provides credit for the interim period and often stands guarantor for the debts.[13] Factoring may involve a waiver of recourse, in which case it amounts to a sale of accounts receivable in exchange for discount.[14]

25. What repos, financial leasing and factoring have in common in terms of property law is that they create a property right which is divided between two parties, both of whom have owner's interests in the property. An appropriate instrument of property law must take account of this 'split property right', which avoids the allocation of the whole property right to one party in the event of the financing party or the financed party going bankrupt.[15] The problems associated with these split rights can only be solved by provisions of property law,[16] and there is considerable interest in the creation of uniform European provisions to that end.

26. Security interests in property rights as a means of obtaining finance could conflict with other forms of participation which would likewise benefit from uniform regulation on a

[10] Dahlhuisen, *op. cit.*, pp. 369-371
[11] Dahlhuisen, *op. cit.*, p. 372
[12] Dahlhuisen, *op. cit.*, p. 372
[13] Dahlhuisen, *op. cit.*, p. 373
[14] Dahlhuisen, *op. cit.*, p. 373
[15] Dahlhuisen, *op. cit.*, pp. 373-374
[16] Dahlhuisen, *op. cit.*, p. 374

European scale, especially usufruct, commercial leasing and contracts of annuity.[17] Property rights used to secure civil claims must also be distinguished from privileges in enforcement proceedings, which are a common phenomenon in the French legal system in particular.[18] The same applies to the corresponding privileges of the public authorities as enshrined in the legal systems of the United Kingdom and the United States.[19]

27. One common feature of many security interests is the fact that they give rise to conditional or temporary proprietorship, which has the effect of conferring certain ownership rights in the continental systems, whereas in the common-law countries the right of an owner, being an absolute right, is divided into a possessory right and a usufructuary right, each defined in relation to the rights of others.[20] One strategy for dealing with this 'split proprietorship' is the creation of a trust, which provides the necessary flexibility. This construction is growing perceptibly in popularity in Anglo-American law in particular, whereas the civil-law countries, with their more restricted concept of property rights, find it difficult to operate with such a concept. The recognition of trusteeship duties is a more convincing concept than a restriction of rights on the basis of good faith and fair dealing.[21]

28. A uniform set of European rules is also required for the organisation of the 'floating charge'; in Dutch and German law, the equivalents of the floating charge are the assignment and transfer of security under a system whereby the collateral is automatically replaced by substitute goods or includes future values, subject to prior agreement. There is a proven need for restriction of these assignments by means of specification or identification rules.[22] Dutch attempts to restrict these forms of security have run into practical problems.[23] There appears to be a need to demarcate assignment powers and to have security in bankruptcy.[24] The status and priority of the floating charge in the United Kingdom have not been fully clarified.[25] France, Italy and Belgium have adopted a restrictive approach to recognition of the floating charge.[26]

29. ***Assignment of property rights***
A second key area in the creation of a uniform system of European property law is the harmonisation of the Member States' legal provisions on the assignment of rights in respect of movable property. Assignment acts in respect of such property rights feature in visible trade between Member States.

[17] Dahlhuisen, *op. cit.*, p. 375
[18] Dahlhuisen, *op. cit.*, p. 376
[19] Dahlhuisen, *op. cit.*, p. 376
[20] Dahlhuisen, *op. cit.*, p. 377
[21] Dahlhuisen, *op. cit.*, pp. 378-379
[22] Dahlhuisen, *op. cit.*, pp. 379-381
[23] Dahlhuisen, *op. cit.*, p. 381
[24] Dahlhuisen, *op. cit.*, pp. 381-382
[25] Dahlhuisen, *op. cit.*, p. 382
[26] Dahlhuisen, *op. cit.*, p. 383

30. In English law, in the countries with a French legal tradition (France, Belgium and Luxembourg) and in Italy, the principle is that property rights are assigned contractually, even if the object to which the property right relates has not been physically transferred. In the French tradition this principle emerges with particular clarity. In Italy it applies only to specified goods and subject to the contract having manifested itself. In English law the property passes by means of an unconditional contract; if the contract is conditional, the property is not transferred until the condition is fulfilled; payment of the agreed consideration may, for example, be the required condition.[27]

31. The situation in Germany, Greece, the Netherlands and Scotland is that a property right passes to the purchaser when possession is transferred if the parties agree at the time of transfer that ownership should pass with possession.

32. The contractual solution and the transfer of possession have been restricted or differentiated for particular types of case in their respective legal areas; for example, the principle of transferring possession is limited by the *brevi manu traditio* and is also restricted in cases where a third party is in possession of the object in question or the transferor is to retain possession. In Germany and the Netherlands, the agreement of the parties to the transfer of ownership is treated separately from the contract governed by the law of obligations and is regarded as a 'real contract'.

33. The standardisation or harmonisation of the law relating to the transfer of property rights must, we believe, be based on the principle of transferring possession, since it best serves the interests of third parties and the general good that the time at which a property right passes from one party to another should be specified. The principle will have to be modified, however, for specific types of case. The 'real contract' that exists in the German tradition should be discarded.

III. The potential legal bases in the EC Treaty

34. ***First pillar***
We shall confine our examination of the powers of the EU and potential legal bases to the first pillar of the European unification process, namely the Treaty Establishing the European Community. The reason for this is that the provisions on judicial cooperation in civil matters (Article K.1(6) of the Maastricht Treaty on European Union) has now been incorporated into the first pillar (Article 65 of the EC Treaty) by virtue of the Treaty of Amsterdam.

35. ***Principle of limited powers***
The basic applicable principle is that of limited powers which is enshrined in Article 5(1) of the EC Treaty. Article 5(1) commits the Community to act within the limits of the powers conferred upon it by the Treaty and of the objectives assigned to it therein. The question treated in this chapter of the study must therefore be formulated as follows: do

[27] On points 29 to 32, see Drobnig in Hartkamp, Hesselink, Hondius, du Perron and Vranken, *Towards a European Civil Code*, 1994, pp. 345 to 360.

the powers conferred on the Community and the objectives assigned to it by the EC Treaty offer a sound basis for the creation of a uniform European law of obligations and property? As the European Court has consistently ruled,[28] in the context of the organisation of the powers of the Community, the choice of the legal basis for a measure must be based on objective factors which are amenable to judicial review. These factors include in particular the aim and content of the measure.

36. ***Inapplicability of Article 293***
Article 293 of the EC Treaty (formerly Article 220) can be ruled out straight away as a legal base since the limited contracting powers it confers on the Member States do not extend to the creation of a uniform European law of obligations and property.

37. ***Potential legal bases***
The following articles of the EC Treaty are possible legal bases for the creation of a uniform European law of obligations and property and must therefore be examined:
- Articles 65 to 68 (new articles created by the Treaty of Amsterdam),
- Article 94 (formerly Article 100),
- Article 95 (formerly Article 100a), and
- Article 308 (formerly Article 235).

We shall not deal here with the bases for legislation in special areas such as agriculture, company rights and transport (see point 9 above).

38. ***Articles 65 and 67***
Under Article 65 of the EC Treaty, measures in the field of judicial cooperation in civil matters having cross-border implications, to be taken in accordance with Article 67 and in so far as is necessary for the proper functioning of the internal market, shall include:

(a) improving and simplifying:

- the system for cross-border service of judicial and extrajudicial documents;
- cooperation in the taking of evidence;
- the recognition and enforcement of decisions in civil and commercial cases, including decisions in extrajudicial cases;

(b) promoting the compatibility of the rules applicable in the Member States concerning the conflict of laws and of jurisdiction;

(c) eliminating obstacles to the good functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States.

[28] ECJ judgment of 13 May 1997, Case No C-233/94, ECR 1997, p. I-2405 (*Germany v. Parliament and Council*, citing point 22 of the ECJ judgment of 3 December 1996, Case No C-268/94 (*Portugal v. Council*).

Point (a) relates to cooperation between the courts of different Member States, while point (c) relates to the elimination of obstacles in the realm of civil procedure. Point (b) relates to private international law and international jurisdiction; in this context it speaks of 'promoting compatibility', which means the harmonisation of laws. The measures referred to in points (a) to (c) do not explicitly confer any power to create a uniform European law of obligations and property.

39. The wording of Article 65 of the EC Treaty, however, differs from that of Article K.1 of the Maastricht Treaty on European Union[29] in that Article 65 does not list a finite catalogue of action points. Under Article 61(c) of the EC Treaty, "in order to establish progressively an area of freedom, security and justice" (i.e. to create a unified legal area), the Council shall adopt "measures in the field of judicial cooperation in civil matters as provided for in Article 65." According to the wording of Article 65, the measures in the field of judicial cooperation in civil matters having cross-border implications shall 'include' the measures listed in Article 65(a) to (c). This does not rule out the possibility that other areas of judicial cooperation could fall under Articles 61(c) and 65. In our view, the use of the word 'include' in Article 65 leaves the door open to a certain extent, but how wide it has been left open and what should be allowed to pass through it must be more precisely defined by reference to the provision as a whole. The measures as yet undefined must belong to the field of judicial cooperation in civil matters and must have cross-border implications. It goes without saying that such unnamed measures are also subject to the proviso that the Council can only adopt them on the authority invested in it by Article 67 in so far as they are necessary, in the words of Article 65, for the proper functioning of the internal market. We believe that, even though the door may be open for the inclusion of further measures, it would still be impossible at the present stage of legal development to create a European law of obligations and property on the basis of Article 65.

40. This, however, does not exclude the possibility that Article 65 of the EC Treaty could play an important role in the interpretation of other provisions in the Treaty, notably Article 95 (the former Article 100a), since it would be wrong to take the opposite approach and use the insertion of Articles 61 and 65 by the Treaty of Amsterdam as a reason to interpret Article 95 and other articles as restrictive provisions.[30] Article 65 of the EC Treaty contains what is, to a certain extent, a legal definition to the effect that provisions of private international law (Article 65(b)) and national provisions on civil procedure which impair the proper functioning of civil proceedings may, *ipso facto*, ***have an important bearing on the proper functioning of the internal market***. Although the adoption in accordance with Article 67 of any of the measures referred to in Article 65 is subject to verification that the measure in question is actually necessary for the proper functioning of the internal market, the Treaty itself has identified such measures as

[29] See Fischer, in *Europäische Zeitung für Wirtschaftsrecht (EuZW)*, 1994, pp. 747 *et seq.*

[30] Basedow, in *EuZW*, 1997, p. 610. The Action Plan of the Council and the Commission (Official Journal C 19 of 23 January 1999, pp. 1 *et seq.*) refers (p. 10) to the "possibility of approximating certain areas of civil law, such as creating uniform private international law applicable to the acquisition in good faith of corporeal movables".

typically relevant to the functioning of the internal market. Let us put this in more concrete terms:

- The differences between the Member States' provisions on private international law are regarded as relevant to the functioning of the internal market (Article 65(b)).

- The obstacles that might confront an inhabitant of the Community in civil proceedings in another Member State are identified in Article 65(c) as relevant to the single European market.

This assessment of the Treaty is relevant to the interpretation of Article 95, which empowers the Council to adopt measures which have as their object the "functioning of the internal market".

41. ***Articles 94 and 95***
The rules of Articles 94 (formerly Article 100) and 95 (formerly 100a) of the EC Treaty conferring authority to harmonise legal provisions are mutually exclusive, with Article 95 taking precedence. As the European Court[31] ruled with regard to the relationship between the former Article 100a and Article 130s (now Article 175),[32] ***the cooperation procedure***, whereby the Council acts by a qualified majority when it intends to accept the amendments to its common position proposed by Parliament and included by the Commission in its re-examined proposal but has to secure unanimity if it intends to take a decision after its common position has been rejected by Parliament or if it intends to modify the Commission's re-examined proposal, ***must not be undermined by recourse to a legal basis that requires the Council to act unanimously***.

42. Article 94 of the EC Treaty prescribes unanimity, because it does not make provision for the cooperation procedure.[33] Under Article 95, on the other hand, the Council is to act in accordance with the codecision procedure referred to in Article 251. This procedure would be undermined if Article 94 were named as the legal basis of a measure that actually fell within the ambit of Article 95.[34]

43. Moreover, the fact that Article 95 overrides Article 94 is clear from the introductory words of Article 95: "By way of derogation from Article 94"[35]. Consequently, if Article 95 is applicable, Article 94 must be inapplicable.

[31] ECJ Case No 300/89, *Commission v Council*, concerning the Directive on waste from the titanium dioxide industry, ECR 1991, I-2867/2900, points 17 to 21.
[32] Accordingly, the legal basis for the Microorganisms Directive was switched from Article 130s of the EC Treaty to Article 100a; see Philipp, in *EuZW*, 1997, p. 390.
[33] On the Commission's plans for Amsterdam, see Wägenbaur, in *EuZW*, 1996, pp. 487-488
[34] Grabitz-Langeheine, *EGV Art. 100a*, note 93
[35] Groeben, Thiesing and Ehlermann-Pipkorn, *EGV Art. 100a*, note 1.

44. ***Articles 95 and 308***
The relationship between Article 95 (formerly 100a) and Article 308 (formerly 235) is as follows: Article 308 can only apply if the Treaty "has not provided the necessary powers" for the Community to act in pursuit of one of its objectives. This means that recourse to Article 308 as a legal base is only warranted if no other provision of the Treaty invests the Community institutions with the power to enact the requisite measure.[36] Article 308 is therefore subsidiary to Article 95; in other words, Article 308 cannot be applied to matters within the scope of Article 95.

45. ***Article 95***
This turns the spotlight on Article 95 (formerly 100a) itself as a potential answer to our question whether the European Union has the competence to create a uniform European law of obligations and property. Let us now examine Article 95 as a legal basis.[37]

46. The restrictive condition in paragraph 1 of the article, stipulating that its provisions shall apply "save where otherwise provided in this Treaty", need not be invoked in the present case, as the preceding remarks have shown. Apart from the special powers conferred in the domains of agriculture, company rights and transport, with which we are not concerned here, there is no authorising provision that would take precedence over Article 95.[38]

47. The restriction introduced by Article 95(2), whereby Article 95(1) does not apply to fiscal provisions, to those relating to the free movement of persons nor to those relating to the rights and interests of employed persons, is not directly relevant to the subject of our study.

48. ***Three prerequisites***
The applicability of Article 95 would depend on fulfilment of the following three positive conditions:
(a) the measure in question must promote the "achievement of the objectives set out in Article 14",
(b) the measure must have as its object "the establishing and functioning of the internal market", and
(c) the substantive purpose of the measure can only be the "approximation of the provisions laid down by law, regulation or administrative action in Member States".

[36] ECJ judgment of 13 July 1995, Case No C-350/92, ECR 1995, I-1985, point 26; ECJ judgment of 12 December 1996, Case No C-84/94, ECR 1996, I-5755, point 7; see Groeben, Thiesing and Ehlermann-Schwartz, *EGV Art. 235*, note 52, with further references.
[37] On the discussion regarding the powers conferred by Articles 95 and 153(3) of the EC Treaty, see Gebauer, *Grundfrage der Europäisierung des Privatrechts*, Heidelberg, 1998, pp. 130-131.
[38] On the circumscription of Article 133 of the EC Treaty (formerly Article 113), see ECR I996, I-1195 (government procurement of services). Cf. Schoo, *EuZW*, 1996, pp. 581-582, and Priess, *EuZW*, 1997, pp. 391-392. On the circumscription of Article 47 of the EC Treaty (formerly Article 57), see ECJ judgment of 13 May 1997, Case No C-233/94, ECR 1997, I-2405. On the circumscription of Article 138 of the EC Treaty (formerly Article 118a), see ECJ judgment of 12 November 1996, Case No C-84/94, ECR 1996, I-5755.

49. ***The first opinion***
In the following paragraphs (points 50 to 81), we shall present one of the opinions that is currently being expressed on the scope of Article 95 of the EC Treaty; thereafter, we shall examine an alternative view (points 82 *et seq.*)

50. ***Third condition***
We shall begin with item (c) of the three prerequisites listed in point 48 above (approximation of the provisions laid down by law, regulation or administrative action in Member States). In accordance with Council practice,[39] which was endorsed by the European Court of Justice in its opinion on the trade-related aspects of intellectual property rights (TRIPs),[40] a distinction must be made between harmonisation of the national laws and regulations on the one hand (application of Articles 94 and 95 – formerly 100 and 100a) and the creation of new titles which override the corresponding national titles on the other hand. The Court of Justice stated in point 59 of its opinion that, at the level of internal legislation, the Community has competence in the field of intellectual property rights to ***harmonise*** national laws, regulations and administrative provisions in accordance with ***Articles 100 and 100a*** and can, on the basis of ***Article 235, create new titles, which would then override the national titles***, as it did in the adoption of Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trade mark (OJ L 11 of 14 January 1994, p. 1). Different voting provisions apply to the adoption of these provisions (unanimity in the case of Articles 100 and 235, codecision procedure in the case of Article 100a) than would apply in the framework of Article 113. This statement by the Court is interpreted to mean that legal titles which override national titles cannot be created on the basis of Article 95 but only on the basis of Article 308.[41]

51. Accordingly, the Council based the Regulation of 20 December 1993 concerning the Community trade mark (OJ L 11 (1994), p. 1) and the Regulation of 27 July 1994 on Community plant variety rights (OJ L 227 (1994), p. 1) on Article 235 (i.e. the present Article 308) of the Treaty. This is relevant to the question under examination here, because both of these EC Regulations are special provisions of a uniform European system of law governing intangible property. So if, in the framework of a uniform European legal regime within the domain of property law, European titles are created, and if these titles take effect by virtue of central registration or deposit, for example, and override the corresponding national titles, Article 95, which requires the Council to act by

[39] Opinion of the Council's Legal Service, Document 4261/90 of 19 January 1990.
[40] ECR 1994, I-5267 and 5405, point 59. See also ECJ judgment of 13 July 1995 in Case No C-350/92 (*Spain v. Council*), ECR 1995, I-1985, points 23, 27 and 28, concerning the creation of a supplementary protection certificate for medicinal products. On competence in external matters, see also ECJ Opinion 2/92 of 24 March 1995, ECR 1995, I-0521, concerning Community participation in the Third Revised Directive of the OECD on national treatment.
[41] Schwartz, *Festschrift für Mestmäcker*, 1996, pp. 467 and 480. On the limits of Article 308 in relation to amendment of the Treaty, see ECJ Opinion 2/94 of 28 March 1996, ECR 1996, I-1759, concerning accession by the Community to the European Human Rights Convention; on the same subject, see Häde and Putler, in *EuZW*, 1997, pp. 13 *et seq.*

a qualified majority, is not available as a legal base for such provisions, the only possible basis being Article 308, which requires a unanimous decision of the Council.[42]

52. The view of the Court that the creation of new titles which override the corresponding national titles is only possible on the basis of Article 308 (ECJ opinion on TRIPs) not only applies to cases in which property rights are founded on central registration at the European level, as is the case for intellectual property, but also if a specific European legal institution is created to operate in place of or alongside corresponding institutions in national law. The Court focused on the creation of new titles, not on the issue of whether their validity depends on an act of registration or deposit. This is consistent with the aforementioned Council practice of creating parallel European forms of company law.[43]

53. So if, for example, a European legal regime were to be created in respect of pledges, mortgages, retention of title or equitable liens, and if that regime were to replace or operate alongside the corresponding national legal institutions, Article 95 could not apply. Such European legal institutions could only be created on the basis of Article 308.

54. Article 95, on the other hand, can be considered as a legal basis for Community powers if the measures taken to create a uniform European law of obligations and property are designed to harmonise the laws of the Member States, which ultimately means giving a ***European*** shape to the various ***national*** legal institutions without creating a separate European regime alongside or in place of the national regimes.[44]

55. This follows from the TRIPs opinion delivered by the European Court. In the paragraph of that opinion which we cited in point 50 above, the Court proceeded on the assumption that the Community is responsible by virtue of Articles 94 and 95 for harmonising national laws, regulations and administrative provisions relating to intellectual property.

56. In the TRIPs opinion[45] as well as in its judgment in the case of *Spain v. Council*,[46] the Court named both Article 94 and Article 95 of the Treaty as legal bases for the harmonisation of laws in the realm of intellectual property. Since the two articles are mutually exclusive (see points 41 to 43 above), this may be taken to mean that the Court considers the application of Article 95 to harmonisation in the sphere of intellectual property rights to be possible.

57. In fact, the First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks (OJ L 40 of 11 February 1989, p. 1)

[42] As indicated by the *Bundesrat*, the second chamber of the German Parliament, in an opinion of 29 April 1994 concerning a Community system of design registration, *EuZW*, 1994, p. 357.
[43] See point 9 above.
[44] As in the ECJ judgment of 22 June 1994 on the assignment of the *Ideal Standard* trade mark, Case No C-9/93, ECR 1994, I-2789.
[45] See footnote 40 above.
[46] See footnote 40 above.

Nr. L 40 vom 11.02.1989, S. 1) was based "on the Treaty Establishing the European Economic Community, in particular on Article 100a" [i.e. the present Article 95].[47]

58. Article 95 also permits legal harmonisation in this area by means of a Regulation, as was done, for example, in connection with the creation of a supplementary protection certificate for medicinal products by virtue of the Council Regulation of 18 June 1992 (OJ L 182, p. 1).[48]

59. ***First condition***
The first of the three prerequisites referred to in point 48 above is that the measure in question must promote the "achievement of the objectives set out in Article 14".

60. According to the first sentence of Article 14 of the EC Treaty, the Community shall adopt measures with the aim of progressively establishing the internal market. The second sentence of Article 14 defines the internal market as follows: "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 this Treaty."

61. The provision contained in the first sentence of Article 14 is to apply "without prejudice to the other provisions of this Treaty". This may be seen as a reference to Article 3(g) of the Treaty, which lays down that the activities of the Community shall include "a system ensuring that competition in the common market is not distorted". That is why the creation of fair competition is a task that can be achieved in the framework of Article 95.[49]

62. ***Second condition***
The second of the three prerequisites for the applicability of Article 95 which are listed in point 48 above is that the measure must have as its object "the establishing and functioning of the internal market".

63. The concept of the 'common market' within the meaning of Article 94 and that of the 'internal market' referred to in Article 95 differ in scope. In terms of the fundamental freedoms, the restrictions imposed on those freedoms by Article 30 (formerly Article 36) and by the unwritten exceptions to Article 28 (consumer protection, environmental protection, measures to combat unfair competition), for example, are compatible with the 'common market' of Article 94. In terms of 'conditions akin to those of an internal market', however, a harmonisation of laws can be effected on the basis of Article 95 for

[47] ECJ judgment of 16 July 1998, ECR 1998, I-4799, points 25 and 29 (*Silhouette v. Hartlauer*); the judgment related to complete harmonisation of the rules relating to the rights conferred by a trade mark and left open the question whether Article 100a of the Treaty could be applied in relations with non-EC countries (point 29).
[48] Schwartz, *op. cit.* (see footnote 41 above), p. 477.
[49] ECJ judgment in Case No 300/89, *Commission v. Council*, Directive on waste from the titanium dioxide industry, ECR 1991, I-2867 and 2901, point 23; ECJ judgment of 13 July 1995, Case No C-350/92, *Spain v. Council*, ECR 1995, I-1985, point 32; Grabitz-Langeheine, *EGV Art. 100a*, note 20; Groeben, Thiesing and Ehlermann-Pipkorn, *EGV Art. 100a*, notes 17 to 20.

the purpose of creating equivalent legal remedies throughout the Community and removing distortions of competition that might arise from national provisions in a particular sector of the economy.[50, 51]

64. So the scope of Article 95 is not restricted to eliminating the ring-fencing of national economic areas. It also covers:

(a) the legal conditions for cross-border cooperation involving companies, other establishments and individuals participating in economic life (cf. Article 163(2)),[52]

(b) the creation of equivalent legal remedies throughhout the Community, and

(c) the removal of distortions of competition arising from divergences between national rules (see point 71 below).

65. From the European Court decision concerning the Directive on waste from the titanium dioxide industry (see point 61 above) it emerges that the elimination or avoidance of distortions of competition is also an objective of the internal market; this is confirmed by the aforementioned indirect reference in Article 14 to Article 3(g). To that extent too, the concept of an 'internal market' (second sentence of Article 14) is a refinement and amplification of the 'common market' concept. The concept of the internal market is based on the assumption that businesses will be able to compete with each other on a level playing field, since the internal market is intended to make an effective contribution to the harmonious and balanced development of economic activities (Article 2 of the Treaty).[53]

66. A narrower interpretation, however, sees the scope of Article 95 confined to the removal of obstacles to the free movement of goods and to the elimination of those distortions of competition which adversely affect the free movement of goods.[54]

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[50] ECJ judgment in Case No 300/89, *Commission v. Council*, Directive on waste from the titanium dioxide industry, ECR 1991, I-2867 and 2901, point 23.

[51] Grabitz-Langeheine, *EGV Art. 100a*, note 20; Groeben, Thiesing and Ehlermann-Pipkorn, *EGV Art. 100a*, note 15; a critical view is presented by Stein, in *EuZW*, 1995, pp. 435-436, and by Dauses, in *EuZW*, 1995, pp. 649-650.

[52] Pipkorn, *op. cit.*, citing the Commission White Paper of 1985 on completing the internal market (COM (85) 310 final), Luxembourg, 1985, points 136 *et seq.*

[53] Likewise the ECJ judgment of 13 July 1995, Case No C-350/92, ECR 1996, I-1195, points 32 and 36; see also *EuZW*, 1995, pp. 666-668: Pipkorn, notes 17 and 19; Langeheine, note 20; Scheuing, 'Umweltschutz auf der Grundlage der Einheitlichen Europäischen Akte', in *Europarecht (EuR)*, 1989, pp. 153-186; Pernice, 'Kompetenzordnung und Handlungsbefugnisse der Europäischen Gemeinschaften auf dem Gebiet des Umwelt-Technikrechts', in *Umwelt und Technikrecht in den Europäischen Gemeinschaften - Antrieb oder Hemmnis?* Bibliography of German Journals (BdZ) - Environmental Technology and Recycling (UTR), Düsseldorf, 1989, as well as in *Die Verwaltung*, 1989, pp. 1-28; Müller-Graff, 'Die Rechtsangleichung bei der Verwirklichung des Binnenmarktes', in *EuR*, 1989, pp. 107-133

[54] Opinion of the German *Bundesrat* on the subsidiarity report by the European Commission; decision of 25 April 1997; cf. *EuZW*, 1997, pp. 485-486; Dauses, in *EuZW*, 1994, p. 545., can probably be included in this category too.

67. According to the first opinion presented here, the said interpretation is refuted by Article 95(2).[55] Paragraph 2 of Article 95 would not have had to exclude the rights and interests of employed persons from the ambit of paragraph 1 if the interpretation were correct. The harmonisation of provisions for the protection of employed persons relates to the removal of the distorting impact of divergent protection levels, which can lead to the relocation of production facilities. Were it not for the explicit restriction in Article 95(2), Article 95 could be used as a legal base for the harmonisation of these provisions. If, for example, there is an equivalent degree of disparity between provisions of consumer law or of environmental law, these will fall within the scope of Article 95(1), because they are not covered by paragraph 2.[56]

68. It also follows from Article 95(3) that legal regimes in the fields of health, safety, environmental protection and consumer protection come within the ambit of Article 95. Article 95(3) states that the Commission, in its proposals concerening these matters, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. The Treaty of Amsterdam added that, within their respective powers, the European Parliament and the Council will also seek to achieve this objective.

69. Accordingly, Article 153(3) states that the Community shall contribute to the attainment of the objective referred to in Article 153(1), namely helping to protect the health, safety and economic interests of consumers and to promote their right to information and education and their right to organise themselves in order to safeguard their interests, through measures "adopted pursuant to Article 95 in the context of the completion of the internal market".

70. This also makes it clear that the harmonisation of laws in the field of consumer protection also falls within the scope of Article 95 if the divergent laws in question have the effect of distorting competition.[57] Accordingly, the Euopean Commission, in its directory of Community texts in the field of consumer policy,[58] lists among its proposals projects for the harmonisation of civil law such as the proposed directives on distance contracts, comparative advertising, applications for injunctions and sales and guarantees in respect of consumer goods.

[55] On the domain of taxation, see Ohler, in *EuZW*, 1997, pp. 370-371.
[56] Pipkorn, in note 19 on Article 152(4)(c) of the EC Treaty, rules out the harmonisation of provisions in the domain of human health. Anm. 19. Art. 152 Abs. 4 Buchst. c EGV schließt die Rechtsangleichung im Bereich der menschlichen Gesundheit aus; Wägenbaur EuZW 1998, S. 387 sowie S. 709/710. Dies steht Regelungen im Bereich der öffentlichen Gesundheit auf der Grundlage von Art. 95 EGV nicht entgegen, z.B. der Novel-Food-VO v. 14.02.1997 (VO(EG) Nr. 258/97 AblEG Nr. L 43); Wägenbaur EuZW 1997, 258; Streinz, EuZW 1997, 487/490.
[57] ECJ judgment in Case No 300/89, *Commission v. Council*, Directive on waste from the titanium dioxide industry, ECR 1991, I-2867 and 2901, point 23.
[58] Directory updated to October 1996, pp. 24 *et seq.*

71. The last-named proposal for a directive on sales and guarantees in respect of consumer goods covers an important areas of private law, namely the law relating to the sale of goods. It only deals with certain parts of sales law (liability for defects and guarantees, but not other aspects of non-performance or consequential loss or damage resulting from defects). Nevertheless, it is designed to regulate an area at the heart of civil law and is warranted in terms of creating equivalent legal remedies throughout the Community and eliminating distortions of competition caused by divergences between national laws (see point 64(b) and (c) above).[59] The fact that a directive pursues goals other than consumer protection is no obstacle to the application of Article 95.[60]

72. Article 95(1) of the Treaty covers measures designed to promote both the establishment and the functioning of the internal market, thereby mirroring the wording of Article 14.

73. The term 'functioning' relates to the continuous and increasingly intensive operation of the internal market.[61] Article 95 therefore also relates to the improvement of the basic legal conditions for the coordination of the Member States' economies, the ultimate aim being their fusion into the developing internal market.[62] If the divergence or territorially limited effect of national provisions impedes cross-border activity between economic players, remedial action can be taken on the basis of Article 95, even if the activity is not classifiable as the exercise of a specific fundamental freedom,[63] as in the case of the cross-border transmission of databases containing personal data, for example.[64] Harmonisation measures designed to protect the confidence of economic players in the operation of the capital and labour markets (insider rules) lie within the scope of Article 95, as do measures to combat the use of the banking system for money laundering[65] as well as rules on flotation prospectuses and sales catalogues.[66]

74. Article 95 does not cover harmonisation measures which only serve in a general manner to promote the achievement of the economic and social aims of the EC Treaty, such as road safety or the protection of public health, unless these measures are designed to eliminate an obstacle to fair competition.

75. If, however, the divergent laws of the Member States relate to the free movement of goods or freedom to provide services, or if they burden businesses with divergent restrictions or charges which distort competition, Article 95 comes into play.[67]

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[59] Cf. Wägenbaur, *EuZW*, 1998, p. 417, and 1997, p. 546 (on the Distance Contracts Directive), Reich, *EuZW*, 1997, p. 581 (also on the Distance Contracts Directive), Schild, *EuZW*, 1996, p. 549 (on the Data Protection Directive), and Mäsch, *EuZW*, 1995, pp. 8-10.
[60] ECJ judgment of 8 October 1996, *EuZW*, 1996, pp. 654-657, point 39 per Dillenkofer.
[61] Pipkorn, note 22.
[62] Pipkorn, note 27, citing the Commission White Paper.
[63] Pipkorn, p. 30.
[64] Simitis, 'Datenschutz und Europäische Gemeinschaft', in *Recht der Datenverarbeitung (RDV)*, 1990, pp. 3-23; Pipkorn, note 30.
[65] Pipkorn, note 30.
[66] Cf. Wiesner, *EuZW*, 1998, pp. 619-622.
[67] Pipkorn, note 31, with reference to the Directives on the labelling of tobacco products (Council Directive 89/622/EEC of 13 November 1989, OJ L 359 of 8 December 1989, pp. 1-4) and on the maximum tar yield of

76. When Article 95 is interpreted, as was mentioned in point 40 above, consideration must be given to the fact that the Treaty of Amsterdam, by inserting Article 65 into the EC Treaty, has brought aspects of judicial cooperation in civil matters into the domain of the first pillar of the unification framework, i.e. the Treaty.

77. If, for example, the differences between the national regimes of private international law (in the rules concerning the conflict of laws and of jurisdiction – Article 65(b)) are referred to in Article 65 in connection with the 'proper functioning of the internal market', this relevance to the internal market of measures designed to harmonise private law must be taken into account as a prerequisite for the applicability of Article 95. The same applies to the removal of obstacles to the good functioning of civil proceeedings, which Article 65(c) establishes as one of the measures that are 'necessary for the proper functioning of the internal market'.

78. ***The subsidiarity principle***
Besides the principle of individual legal bases, Article 5 also regulates the subsidiarity principle. According to the subsidiarity principle, in areas which do not fall within its exclusive competence, the Community shall take action only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community. Article 5 also stipulates that any action by the Community shall not go beyond what is necessary to achieve the objectives of the Treaty.

79. In relation to the powers vested in the Community by Article 95 to harmonise laws, regulations and administrative provisions of the Member States, the first question that arises is whether these harmonisation powers constitute 'exclusive competence' within the meaning of Article 5. This is a hotly debated issue.[68] In our view, there is no need to try to resolve it here, because the subject of this study is not the question whether the Member States are prohibited from taking measures outside the framework of the EC Treaty to achieve a greater level of uniformity in the domain of private law. The purpose of our study is to examine whether the Community is empowered (i.e. competent) to engage in harmonisation of the civil law of obligations and property. In answer to this question, it may be suggested that such harmonisation does not fall within the exclusive competence of the Community. Even if this suggestion is correct, the aim of harmonising provisions of the law of obligations and property is the type of objective which, in the words of Article 5, "cannot be sufficiently achieved by the Member States and can

cigarettes (Council Directive 90/239/EEC of 17 May 1990, OJ L 137 of 30 May 1990, pp. 36-37), both of which were based on Article 100a of the EEC Treaty.

[68] A summary of the opinions on this subject is contained in Schwartz, *EG-Kompetenzen für den Binnenmarkt: Exklusiv oder konkurrrend/subsidiär?*, Bonn, 1995, pp. 1-13; see also Gebauer, *Grundfrage der Europäisierung des Privatrechts*, Heidelberg, 1998, pp. 226 *et seq.*

therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community".[69]

80. It follows that, if the conditions laid down in Article 95 are fulfilled, Article 5 cannot be interpreted as an obstacle to the exercise of the powers vested in the Community by Article 95.

81. However, the principle of subsidiarity must be respected in the choice of instrument (regulation or directive). So for each measure of harmonisation enacted in accordance with the precept enshrined in the last sentence of Article 5, a choice has to be made between a directive, which has the disadvantage of requiring national transposition, and a regulation, which leaves no scope for the Member States to tailor the provisions to meet their own requirements.[70]

82. ***The second opinion***
In the following paragraphs we shall present an alternative opinion, which concludes, on legal, political or tactical grounds, that it is inadvisable to create any other legal instrument for the creation of a uniform European law of obligations and property than a treaty that would be concluded by all Member States.

83. ***Flexibility***
The second view proceeds from the political assumption that it will be impossible to convince the Community institutions of the applicability of Article 95 or that, if the Commission does adopt Article 95 as a legal base, its proposal will not attract the necessary majority in the Council and/or in Parliament. In such a case, the project to standardise the economically related domains of private law in Europe, which is an important step in the development of the Community, would be blocked. By contrast, a treaty could be concluded by the Member States and ratified by those that wished to accede to it. This second opinion sees the treaty as an instrument that guarantees the necessary flexibility. Member States which are initially reluctant to sign up will be able to accede to the treaty at a later date.

84. ***Creation of the treaty***
The treaty advocated by the proponents of the second opinion could be negotiated by all the Member States. In this way it could be influenced by all the main legal traditions within the Community. The treaty itself, or an annex to it, could contain the full set of uniform rules.[71]

85. ***Jurisdiction of the Court***
The treaty could and should (in an annexed protocol, for example) provide for the European Court of Justice to be empowered to interpret the standardised legal provisions

[69] Gulmann, 'Some Remarks concerning the Principle of Subsidiarity', and Hailbronner, 'Das Subsidiaritätsprinzip als Rechtsprinzip nach dem Maastrichter Vertrag', in Hailbronner (ed.), *Europa der Zukunft - Zentrale und dezentrale Lösungsansätze*, Cologne, 1994, pp. 45-46 and 113.
[70] Gebauer, pp. 133 *et seq.*, in which the author expresses a preference for a directive.
[71] van Gerven, in *European Review of Private Law (ERPL)*, 1997, p. 468.

it contains in the same or a similar manner as the Court is vested with jurisdiction by Article 234 (formerly Article 177) of the EC Treaty.[72]

86. ***No impediment under Article 293***
Such a treaty could not be based on Article 293 (formerly Article 220) of the EC Treaty, which specifies particular areas in which the Member States may enter into negotiations but does not refer to the standardisation of civil law. Article 293, however, does not prevent the Member States from concluding international conventions on subjects other than those listed in the said article in accordance with the general rules of international law.[73]

IV. Concluding remarks

87. Which opinion – the view presented in points 49 to 81 or the view outlined in points 82 to 86, or indeed another opinion combining aspects of both – is likely to prevail in legal and political circles by the time the work on a Community code of economically related private law has been completed is impossible to predict with sufficient certainty at the present time.

88. We therefore recommend, as we argued in point 3 above, that the work on the formulation of standard legal texts for those areas where standardisation is needed be expedited by legal scholars and, when this work is nearing completion, that a decision be made in the light of the prevailing political and legal circumstances as to which instrument should be used for the implementation of the code.

[72] van Gerven, *op. cit.*
[73] van Gerven, *op. cit.*