Hidden Treasures Programme

Civil Contract Law, a Hidden EU Treasure

Introduction

Over the past decades civil contract law has lost ground to common contract law.[1] This development was part and parcel of a broad movement whereby Anglo-Saxon neoliberalism, putting shareholder interest first and introducing control-based enterprise models, made major inroads in the EU. Fast growing sectors, such as finance and trading set standards for other industries. All this was accompanied by aggressive marketing by the English Bar Association and the large American and British law firms, presenting common law as the guardian of freedom of contract whilst providing business maximum certainty.[2]

At long last this tide is receding. There is an increasing awareness of societal costs of globalization and neoliberalism and as a result common interests start gaining ground over individual interests. In addition, over time Brexit will reduce the infiltration of common law into the EU contracts. We argue that these changes create a momentum which opens up opportunities to increase the use of civil law in the EU as civil law contracts facilitate the protection of common values.

This is just in time, for three structural and interrelated reasons: (i) The level of uncertainty businesses must confront has reached an unprecedented level which calls for more flexible contracts. (ii) At the same time businesses must reposition themselves and develop new ways to innovate, to invest and to grow in a sustainable way. (iii) As a result, businesses become increasingly dependent on partners and multiparter coalitions and the way these relationships are legally structured becomes a major issue.

It will be argued that common law throws up high hurdles in all these departments whereas civil law provides useful tools. For example, innovation requires cooperation of large and small companies and knowledge institutions. And the use of common contract law in value chains implies

[1] For example, according to Cuniberti, where parties to international contracts choose a legal system other than their own, the most chosen system is the British law, followed by Swiss and US law. Gilles Cuniberti (2014), *The International Market for Contracts: The Most Attractive Contract Laws*, 34 Nw. J. Int'l L. & Bus. 455. Similarly, pursuant to data from ICC survey (ICC Dispute Resolution Bulletin 2015/1) covering 2014, most popular legal systems in ICC arbitrations in 2014 were English law (14.1%), 'American' law (10.2%), Swiss law (7.4%), German law (6.3%) and French law (6.2%).

[2] For example, there is the marketing brochure issued in 2007 by the Law Society of England and Wales, promoting England as the jurisdiction of choice for international transactions and indicating its superiority over other legal systems. Also, Sokol illustrates how US law firms expanded their activities internationally dominating the local legal markets, Daniel Sokol (2007), *Globalization of Law Firms: A Survey of the Literature and a Research Agenda for Further Study*, Indiana Journal of Global Legal Studies: Vol. 14: Iss. 1.

a low level of flexibility and hence resilience. In all EU countries, apart from Ireland, Malta and Cyprus, contract formation and implementation are based on civil law. In short, going forward the EU enjoys a considerable competitive advantage that needs to be recognized as such and be defended and be built upon.

The paper is structured as follows: first we sketch out the foundational differences in common law and civil law contract systems and then we point out how these differences translate in practical advantages in conducting business to create environmental and economic value. Finally, we present a number of options open to the Commission to support the use of civil contract law for the benefit of a sustainable economy.

1. The foundations

1.1. Systemic codification

While there is some convergence between the common law and civil systems – for example – in common law many provisions on commercial practices are also contained in codified statutes,[3] there are several fundamental differences between the two systems that persist. Civil law allows uniquely statue as a source of law and aims for coherence and completeness of the system while common law accepts multitude of sources of law (case law, custom, equity, statue) which are not bound into one complete system.[4]

Common law, as a judge-made law, develops in small, incremental steps. It is in nature retrospective and ad hoc and thus unsuitable for creating systemic changes. Like a ship at sea, it cannot be brought to the dock for complete refurbishment, rather, the system depends on perpetual tinkering. An eminent scholar such as Richard Posner, a key defender of common law, concedes that "legislative law making is apt to be more efficient than judicial law-making". The nursery of new law - the litigation of cases - often fails to raise the questions pertinent for initiation of necessary legal reform.[5]

Moreover, because of its nature, common law can only develop very tight, narrow rules tied to very specific facts of the case. These form the precedent and are binding on lower courts. While the courts explain their rulings, these explanations have no precedent-forming power.

[3] For example, the Uniform Commercial Code in the US.
[4] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, 3rd edition, p. 99.
[5] Benito Arruñada and Veneta Andonovo, (2008), *Common Law and Civil Law As Pro-Market Adaptations*, 26 Wash. U. J. L. & Pol'y 81.

Codified law can correct the emergence of inefficient legal rules. Civil law systems aim for completeness and coherence. Codification has been explained as a conscious effort to systematize and organize previous statutes and customs and integrate them in a coherent system.[6] As pointed out by Dalhuisen, "civil law remains more intellectual, conceptual, idea- and perhaps policy driven, therefore also more activist".[7] Importantly, civil law is better suited in situations where paradigm shifts are needed.

Civil law will also provide more legal certainty. Before engaging in a contractual relationship, parties are aware of the general rules and specific provisions for specific types of contracts. In the common law systems, the rules are dispersed between different cases (and precedent needs to be found in cases that are based on similar material facts), hence uncertainty reigns. The common law process is therefore more efficient. Where some would argue that given this embeddedness in statue rather than facts civil law is rigid and formalistic, in fact many codified provisions are non-mandatory – they form a default option which parties might change according to their needs. This means that the parties can rely both on customization of their contract and on the default provisions to deal with unforeseeable developments. As noted by famous comparative scholar, Hein Kötz, "some common lawyers still seem to think that the German or French code provisions on contract law lay down a rigid and unbendable set of mandatory rules and thereby severely limit the parties' freedom of action. This is misleading, to put it mildly."[8]

1.2. Normative interpretation and concept of good faith

In addition to the differences we explain above, at the conceptual level one other important difference between the civil law and the common law systems is how the nature of the contract is perceived. In the civil law systems, contract is considered as a consensus reached by the parties, while in the common law systems it is based on individual, subjective intent of each party.[9] This distinction has important repercussions.

As in civil law the contract becomes detached from the individual, subjective will of each party, a space for objectivity in its interpretation opens. It allows the judges to interpret the contractual terms according to what is, or should be, considered reasonable in given circumstances, rather than with strict adherence to the text of the contract and the original intention expressed therein. Such wider scope of interpretation is combined in civil contract law with the development of a normative

[6] *Ibidem*.
[7] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial*, Financial and Trade Law, 3rd edition, p. 101.
[8] Hein Kötz (2010), *The Jurisdiction of Choice: England and Wales or Germany?,* 18 EUR. R. PRIVATE L. p. 1246.
[9] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, 3rd edition, see in general the chapter on Formation and Interpretation, p. 255.

interpretative method based on the notion of good faith. This means that the intentions of the parties are interpreted in accordance with the premise that contractual parties are acting in good faith, which means what is objectively fair and reasonable.

In contrast to common law countries, where the concept of good faith is contested and at best limited,[10] most civil law contract systems contain a provision on good faith [Table 1], sometimes phrased in specific legal term (Treu und Glauben, correttezza, redelijkheid en billijkheid).[11] The principle of good faith is a concept that provides a general guiding standard for the behaviour of the parties to contractual relationship based on the idea of cooperation and trust, additionally giving rise to a host of ancillary duties, such as duties of information, documentation, disclosure, duty of loyalty, duty of care. These good faith duties apply to the contract seen as a continuum, in all its phases, from formation of the contract the pre-contractual to the performance and post-contractual phase.[12]

The principle of objective good faith is considered as one of the founding concepts of the civil law contract systems, meaning that even where specific reference to this principle is missing, different contractual provisions should be interpreted with reference to this concept. Hesselink notes that the standard of good faith is connected to the qualities of loyalty, honesty and taking into account the interests of the other party in a contractual relationship.[13] The principle of good faith is therefore relevant in different phasis of contractual relationship.

The concept of good faith is unique to civil law systems. While some might rush to point out that there is a common law an equivalent to good faith such as equity, it is important to note that equity performs a different function. Namely, it is not treated as a general interpretative principle that allows for an 'influx' of new ideas into contract. Rather, equity is used by judges only in very limited number of cases, as a last resort and its notions are more rigid than those of good faith.[14]

[10] The English common law does not recognize any duty to negotiate in good faith, as was decided in a unanimous, single speech, decision by the House of Lords (Walford v. Miles). J.H.M. van Erp, *The Pre-contractual Stage*, in: Hartkamp, A. & Hesselink, Martijn & Hondius, Ewoud & Mak, Chantal & E, Perron. (2011). *Towards a European civil code*. - 4th rev. and exp. ed.

[11] Martijn Hesselink, *The Concept of Good Faith*, in: Hartkamp, A. & Hesselink, Martijn & Hondius, Ewoud & Mak, Chantal & E, Perron. (2011). T*owards a European civil code*. - 4th rev. and exp. ed.

[12] Zimmermann, R. and Whittaker, S. (2000) *Good faith in European contract law*. Cambridge: Cambridge University Press (Cambridge studies in international and comparative law).

[13] Martijn Hesselink, *The Concept of Good Faith*, op. cit.

[14] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, 3rd edition, p. 294.

Table 1: Good faith provisions in selected civil law contract systems

Country /Provision	
Netherlands	Article 3:12 BW: 'In determining what reasonableness and equity require, reference must be made to generally accepted principles of law, to current juridical views in the Netherlands, and to the particular societal and private interests involved'. Reasonableness and fairness as a standard of conduct (Article 6:2(1) DCC), conferring upon reasonableness and fairness both the power to supplement a contractual agreement (Article 6:248(1) DCC) and to restrict the effect of a contractual agreement (Article (6:248(2) DCC).
Germany	§ 242 BGB
France	Art. 1104 Civil Code
Italy	Article 1366 of the civil code: contracts must be interpreted in good faith; Article 1375: contracts must be performed in good faith

2. Practical Considerations

2.1. Negotiation phase

In common law, contracts take a long time to conclude as all undesirable actions by both parties need to be explicitly excluded in the contract. A severe handicap now and increasingly in the future, as the windows of business opportunities shrink. The process of contract-drafting is adversarial and opportunistic and requires involvement of lawyers from the very beginning of the process. As a result, it is costly and time-consuming exercise which detracts resources from the exploration of potential interesting partnerships.

Further, common law contracts are very detailed and therefore brittle. The bias towards literal interpretation of the contractual terms is a lawyers' paradise. This is enforced by the parole evidence rule which precludes any extra-contractual evidence in determination of the content of

the written documents. This rule puts a lot of pressure on the negotiating parties to draft their terms in the future-proof manner.

When circumstances surrounding the contractual relationship change, as they are bound to, the contract needs to be renegotiated. The mutual assumption is that the contract partner will take advantage of a new developments or will try to avoid absorption of its fair share of the costs of a repair operation. During such discussions old issues re-emerge, parties see opportunities to correct mistakes made during the initial negotiation and to act on the basis of new insights. As there are no gap-filling or corrective mechanisms available in such cases, the business is bound to suffer. In common law trust partners do not trust each other and do not expect to be trusted. Distrust even comes at a premium as it is seen to be in the best interest of the company to reduce risk.

In common law jurisdictions contract negotiations are power plays based on the supposed virtues of adversity, pushing both parties to the limits of their creativity.[15] "Leaving money on the table" is a deadly sin. Hostages to fortune are being created that could haunt the partnership down the line. In too many cases negotiations can only be concluded if parties put in the same amount of resources and benefit equally, foregoing interesting opportunities. At any point control is at a premium enforced by penalties in case of digressions from the contract and all the time the threat of escalation of potential conflicts and the suing for damages hangs in the air.

All this makes common law unsuited for multiparty arrangements as the number of interactions between parties increases exponentially. The civil law system does not suffer from any of these flaws.

In most civil law systems, the principle of good faith extends to the crucial precontractual phase imposing specific obligations on the parties, which might be set forth in a legal provision or in case law [Table 2]. In particular, the principle of good faith imposes on the parties certain information duties. The concept of pre-contractual information duties pertains mainly to the field of the B2C contracts under the consumer law framework, but not exclusively. Pursuant to the official commentary to Art. 2.15 of Unidroit, parties are obliged to provide each other information about the facts relevant to their agreement. This obligation covers both, information about the object of the prospective contract and information about the future effect of the contract.[16] Further, duties in the pre-contractual phase might include obligations to continue to negotiate[17] or to re-negotiate

[15] On the concept of adversarial legalism, Robert A. Kagan, (1994), *Do Lawyers Cause Adversarial Legalism--A Preliminary Inquiry*, 19 Law & Soc Inquiry 1: "Cross-national case studies repeatedly indicate that compared to other economically advanced democracies, American methods of policy implementation and dispute resolution are more adversarial and legalistic, shaped by costly court action or the prospect of it."

[16] Martijn Hesselink, (2002). *Precontractual good fait*h, in: H. Beale, A. Hartkamp, H. Kötz, D. Tallon (eds), *Casebooks on the Common Law of Europe. Cases, Materials and Text on Contract Law* (pp.237-293).

[17] For example, Dutch contract law imposes very heavy pre-contractual duties on the parties stating that withdrawal from the negotiations in a very advanced stage might lead to contractual liability, including damages for

based on overriding principle of fairness. All these obligations act as conditions for a productive partnership as they assure the parties that their commitments will be honoured.

Further, such well-shaped legal framework can significantly reduce transaction costs by allowing partners to avoid detailed, complex negotiations. This is not only because civil law system offers efficient default options set forth in comprehensive codes. In addition, it allows for some flexibility where the principle of good faith has the gap-filling and correcting role depending on the circumstances and based on the objective criteria and cooperation between the parties. This is particularly relevant for the contracts of longer duration where with time the parties might have to tackle situations not expressly covered by the terms of the contract. In practice this means that in the process of negotiation the primacy is with the management, those who are accountable and not with their legal advisors, who often seem to run the show.

In civil law parties stay within the bounds of fairness and reasonableness which creates a social context in which parties can feel safe. Increased legal commitment and development of mutual trust go hand in hand during the negotiations. Mutual trust helps to cope with the inevitable future setbacks.[18] Due to the importance of the consensus-building based on objective notion of good faith, parties must take the interests of their potential partner into account.[19] This makes negotiations more efficient as value is being created when small sacrifice for one party is set against a substantial benefit for the other party. This promotes building productive and lasting relationships and a civil law contract between parties that are new to each other provides often as a steppingstone for expansion of the cooperation.

lost profit. Additionally, such obligations are set forth in Principles of European contract law (PECL), Section 3, Article 2:301:
Negotiations Contrary to Good Faith
(1) A party is free to negotiate and is not liable for failure to reach an agreement.
(2) However, a party who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party.

[18] For example, in France courts might impose liability where the defendant has undermined a relationship of trust between the parties, pursuant to the concept of *abus de droit* (abuse of right).

[19] In German law such obligation is expressly contained in the concept of *culpa in contrahendo*. The case law on the topic developed overtime has been codified in BGB. Pursuant to Article 241 II BGB when there is an obligation between two parties, they have to take into account each other's rights and interests.

Table 2: Pre-contractual good faith provisions in selected civil law contract systems

Country /case law	
Netherlands	HR 15 November 1957, NJ 1958, 67 (Baris v. Riezenkamp): parties in negotiations take part in a 'legal relation ruled by the principle of good faith'. Pre-contractual liability (NL SC 18 June 1982, NJ 1983, 723 (Plas v. Valburg): a party can obtain damages for the costs incurred in the negotiation phase (reliance damages) and also for the loss of expected profit (expectation damages).
Germany	§ 241 II; § 311 II BGB
France	Com., 20 March 1972, Bull. civ. IV, No. 93; J.C.P. 1973, 17534; Article 1112-1 civil code imposes a duty of disclosure on the parties during the pre-contractual phase: "The party who knows information which is of decisive importance for the consent of the other, must inform him of it where the latter legitimately does not know the information or relies on the contracting party (...)".
Italy	Art. 1337 Italian Civil Code contracts must be negotiated in good faith

2.2. Performance and dispute settlement

The common law system produces poor results also during the lifetime of the contract per and during dispute resolution. Following execution both parties feel compelled to closely monitor the compliance of the partner to its obligations, whilst seeking to optimize the value the contract by exploiting omissions. Vigilance is required to avoid being sued for damages. All this happens at the expense of the opportunities to build on the contract in an atmosphere of cooperation. As a result, contractual relationships tend to erode and often end in acrimony. Post contractual obligations are non existent in the common law system.

Moreover, when in Anglo-Saxon jurisdictions parties go to trial a very costly discovery phase (connected to the importance of facts in each case rather than rules) is followed by a never-ending quest for precedent and a long winding road through the court system. Common law relies on the performance of its lawyers and on advocacy to assure successful litigation, and lawyers only serve the interests of their clients.

Here, again, the civil law systems display considerable advantages.

First, the civil law contracts are more resilient in the face of changing circumstances. The flexibility brought by the underlying concept of good faith permits addressing the occasions of extreme hardship in performance due to changed circumstances. The evolving nature of the relationship between the parties and their power imbalance guides the interpretation of the rights and duties that contractual parties have in given circumstances.[20]

The contract system in civil law which is built on the concept of broader consensus between the parties and privileges the objective interpretation is also better adapted to the complexity of modern contractual environment than the common law systems. As mentioned above, the common law system attributes utmost importance to the subjective intentions of the parties that are expressed, as is assumed, in the contractual terms. This means that the provisions of contract are read pursuant to textual technique of interpretation without recourse to any external sources. Such technique is considered to best reflect the initial subjective intent of two negotiating parties. However, in globalized world of corporate or governmental deals, where contracts are negotiated in different parts of the world, concluded by different entities and often with large groups of people, such understanding of a contract as based on subjective intent of the initial negotiation parties is insufficient. Only agreements based on civil law can be building blocks for complex ecosystems, which are essential for breakthroughs in the fields of energy, sustainability, ICT, artificial intelligence, bioscience, and healthcare.

Further, civil law contracts could be also seen as a tool for promoting sustainability. The normative interpretation based on the requirement of good faith gives the judge freedom to consider what is fair in specific business relationship but also in the broader economic, societal, and environmental context. Dalhuisen argues that modern normative interpretation approach in the civil law systems focuses on the impact that large or standard contracts have on their surroundings.[21] Therefore, the protection of environment might also be taken as a factor in the validity and interpretation of a contract, as can be protection of employees and other weak parties.

[20] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, 3rd edition, p. 261.
[21] J. H. Dalhuisen, (2007), *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law*, 3rd edition, p. 263.

Finally, the obligation to meet post-contractual obligations helps to build a solid reputation as a partner, which is crucial for participating in a network economy.

3. Possible actions by the Commission to promote the use of civil law

Considering the above the Commission should demand or promote the use of EU civil law, meaning all laws of continental EU member states. The Commission, itself can build on a solid base as all its commercial contracts are ruled by Belgian law. The Commission can engage in active promotion in the following areas:

1) Within the framework of the EU Recovery Fund the EU can demand that EU Civil law need to be used in all contracts that underpin Member State projects.

2) The EU should promote civil law in global value chains. This improves flexibility and therefore resilience. EU purchasing contracts are an obvious place to start.

3) Application of EU civil law contributes to the prevention of abuse of economic power, a problem that needs to be addressed urgently as it undermines the common market

4) DG R&D could demand that all consortia that apply for Horizon funding are based on EU civil law. This is urgent because at a point in the future the UK is likely to re-enter the program

At the same time the Commission should put more resources in existing programs to remedy shortcomings in the EU legal systems that erode the competitive advantages of civil law. There is still a lack of reliable and speedy judicial remedies in many member states. Progress in weeding out corruption in some member states is too slow.

Of particular concern is that throughout the EU, SME's, key in the pursuit of the twin objectives have, for all intends and purposes, no access to the courts. Thereby cost is not the overriding reason for many small companies to refrain from seeking justice neither is the uncertainty about the outcome of the proceedings. They rightly fear the conduct of their opponents and their lawyers in the course of the proceedings (which in the opinion of the Dutch High Court should be loyal, sensible, honest and reasonable, which it isn't) and, most importantly, the duration of the procedure and rather insidiously the unpredictability of the timing of the final ruling.

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