European Parliament Committee on Legal Affairs

Draft Report on the proposal for a CESL (18.2.2013)

General Note by Professor Hugh Beale

Introduction

I am very grateful for this opportunity to give evidence to the Legal Affairs Committee, and in particular to comment on the Draft report of the Rapporteurs. I applaud and welcome the Draft Report, and in particular its support for a proposal that I believe is, in general terms, a very good one.

I believe that the CESL has the potential to benefit consumers significantly by encouraging more cross-border sales, particularly by SMEs, without significantly disadvantaging consumers, even those who are habitually resident in a Member State that on some issues has higher level of consumer protection than would be provided by the CESL. Even for those consumers, the overall level of protection offered by the CESL is very high – and it would remain so even if some of the changes discussed by the Rapporteurs, such as some restrictions on the consumer's right to terminate in cases of non-conformity – were to be adopted.

I believe that the CESL also offers significant advantages for SMEs in B2B contracts. Not only would it provide a uniform and readily-understandable set of contract rules; also it would provide a level of protection (for example, against unfair standard terms, non-disclosure where good faith and fair dealing required disclosure, and other forms of unacceptable contractual behaviour) which is not provided by the CISG nor by many national laws of contract, including my own.

Nonetheless, there are quite a number of difficulties with the Commission's current proposal. I have found the Rapporteurs' suggestions to be generally very helpful in this respect. However, in some cases I see difficulties with the draft amendments; and in others I believe the amendment would be a mistake.

I have submitted to the Rapporteurs a General Note, in which I deal with the points made by the Rapporteurs in their Explanatory Statement, and also an annotated version of the Draft Report, in which I have made comments on other amendments. I would be happy to discuss any of the points with the Rapporteurs or members of the Committee at any time.

I note that the Rapporteurs have taken into account the Statement on the CESL prepared by the ELI. In the documents that I have prepared, I have not repeated points made by the ELI. I would ask the Rapporteurs to note that I agree with all the conclusions in Part A of the ELI Statement. I only wish that it had been possible to involve the ELI at an earlier stage in the process, so that we could

have benefitted from its expertise before the Commission's proposal was finalized.

Structure

Division between Regulation and Annex: I do not know why the current division between the Regulation and the Annex was adopted. I certainly think that some provisions that are currently in the Regulations, such as definitions of terms that are employed only in the Annex, would be better placed in the Annex.

However, I am not convinced that it would help to merge the Regulation and the annex completely. Articles 1, 10 and 12-16 of the proposed Regulation do not seem appropriate for incorporation into the body of the CESL.

Some provisions seem appropriate in both places. Thus it would be normal to find the articles that define the scope of application in the "chapeau" rules of the Regulation; but I can see that it might also be useful for users of the CESL to have those in the same document as the rules, as the users will need to check that the CESL applies to the transaction they are dealing before applying its provisions.

If I may, I suggest that, the division between the Regulation and the Annex should be retained; that the definitions of terms not used in the Regulation be moved to the Annex; that definitions of terms used in the Regulation be kept there, along with the scope rules; but a series of new articles be added to the Annex giving "cross-references" to point the user to the relevant article or definition in the Regulation, e.g.

> Annex Art X: the CESL may be used for the contracts described in Article 5 of the Regulation
> Annex Art Y: "consumer" shall be defined as in Article 2(0) of the Regulation.

I am also concerned that if the draft is restructured at this stage, it will make the process of discussing the draft very complex. I wonder if it would be possible for the Legal Affairs Committee and the Commission to reach an agreement that, whatever final arrangement is agreed, for the time being the numbering is left unchanged (with any new articles being added as "A" numbers, until the end of the process.

Part IV: I have always had reservations about the arrangement of Part IV of the CESL. While I can understand that stakeholders may have been confused when they were shown the early drafts on performance and remedies, I do not think that it is necessary to separate out the seller's obligations, the buyer's remedies, etc, when this arrangement leads to so much repetition. This division is of course familiar to the users of the CISG but I am not convinced it is the easiest one to use. Like the rapporteurs, I can envisage a structure that sets out separately the obligations of the seller and the buyer but then deals with the remedies in a single chapter. Nor do I think it is necessary to "integrate" general provisions and more specific rules on sales. Lawyers and others in most countries are used to

having this kind of division. However, I agree with the Reporters that there are more important issues on which to concentrate.

Scope

I agree that the CESL should be targeted primarily at distance contracts. However, I do not see that it needs to be limited to them. If parties wish to use the CESL for contracts that are made by other means, they should be free to do so.

What is important is to explain the kinds of contracts for which the CESL is best suited, and if it is not suitable for contracts of other kinds, to indicate this clearly.

I would in any event allow MSs to extend the CESL to non-distance contracts, in the same way as they may extend it to non-cross-border contracts under Reg art 13 – in the domestic market, many more contracts will be non-distance.

Relationship to Rome I

I think the scheme proposed by the Commission is workable but the proposed clarifications would be helpful.

References to national law

I fully support clarification on these issues. However, as noted my annotations to the Draft Report, I would make the lists of what is and is not within scope of application of the CESL rather more detailed. I have found quite a number of issues on which the position is really quite uncertain.

Good faith and fair dealing

"Shield only": When the Expert Group discussed this, some of us supported giving the court the possibility of awarding damages, not in any case in which the duty had been broken and a loss had resulted, but only where the court thought that it was not necessary to prevent the party in breach from exercising or relying on its normal rights and that a small monetary award would be an adequate substitute. But I now think that this idea is too complex to be included in the legislation. Therefore I support the "shield only" approach..

Definition of good faith: However, I would caution strongly against the proposed new definition of good faith, and particularly the reference to abuse of rights. There is a very serious danger that this will be interpreted to mean that there is only a lack of good faith if the party acted with the intention of harming the other party, or at least with reckless disregard for the other's interests. That is much narrower than the meaning of good faith, as I understand it, in most legal systems. A party is not expected to put the other party's interests first – the definition of good faith and fair dealing in the CESL clearly does not require that - but a party is expected to pay reasonable regard to the other's interests.

This can be illustrated by the question on when a non-individually negotiated term should considered to be unfair – which in many countries (though not all) is

thought to be a matter of good faith. Harsh clauses, even in consumer contracts, are seldom inserted with the intention of causing a loss to the consumer, nor even in conscious disregard of the consumer's interests. They may be treated as unfair if the trader has merely drafted the term in its own interests without taking reasonable account of the consumer's interests also.

The same is true of other areas. Thus in Art 59, good faith and fair dealing is a relevant factor in interpretation and it surely refers to having a reasonable regard to the other interests, not to deliberate or reckless harm to them. Under Art 23, the duty of disclosure is not limited to avoiding deliberately or recklessly withholding information in order to deceive the other - that would be fraud within Article 49.

Even where there is no explicit reference to good faith and fair dealing, the principle may underlie the provision. An example is Article 3 on co-operation, and Recital 3 makes this very point.

Finally, one example of conduct that is contrary to good faith and fair dealing is going against what one has previously said to the other party (*contra proprium factum*, or what in my law would give rise to an estoppel). In most such cases there was no intention to harm the other, but the statement has given rise to reasonable expectations by the other party and reasonable consideration for his interests means that the party who made the statement must now stick by it.

So I would plead for Amendment number 35 to maintain the CESL definition of good faith and fair dealing.

Duty to raise awareness of terms

I have explained in the document I have submitted that it is essential that Article 70 is NOT limited to consumer contracts, as the Rapporteurs have provisionally proposed. Even in a B2B contract, transparency is essential. Each party should be given a reasonable opportunity to find out what terms are being offered.

Freedom of contract in B2B contracts

I quite agree with the Rapporteurs' concern that as between traders, there should be as little interference as possible with freedom of contract. Between traders, either party should be free "to drive a hard bargain". However, we need to draw a clear distinction between fairness in substance and "procedural fairness" (or transparency).

A trader who knows what the terms offered by the other party are and what they mean, yet who nonetheless agrees to those terms, is taking a conscious risk should be given relief only in extreme circumstances.

I would say this even when the trader who accepted the harsh terms had little bargaining power. Contract law (as opposed to competition law) can do very little about inequality of bargaining power in this sense. Even if a court were to strike down a harsh term, the inequality would remain and would simply re-

appear in another form – for example, the more powerful party would simply increase or reduce the prices to compensate. (American lawyers have sometimes called this the "bowl of jello" problem.) Basically, save in extreme circumstances, even an SME can be expected to cope with the risks that the market imposes on it. (If it does not wish to do so, it should not enter the market). So I agree that a business should be free to negotiate the terms it wants, even if to an outsider or a court those terms appear harsh.

But the CESL should insist on transparency. A party should be held to a hard bargain only if it was given a reasonable opportunity to find out what the terms on offer were. As an English judge put it, the other party should "lay its cards face-up on the table".

In other words, we should allow freedom of contract as between traders but at the same time, we should require a high degree of transparency – particularly in an instrument designed for use by SMEs.

The Expert Group discussed these issues at some length, and agreed on a two-track approach. Relief against non-negotiated "unfair" terms on the grounds of unfairness in substance would be limited to really outrageous cases. The test in what became Article 86 of the CESL ("grossly deviates from good commercial practice, contrary to good faith and fair dealing") was intended to reflect this. But in the Feasibility Study, a high degree of transparency was to be assured by a separate article on *Surprising terms included in standard terms*:

> A term contained in standard terms supplied by one party which is of such a surprising nature that the other party could not have expected it is unfair for the purposes of this Section unless it was expressly accepted. (FS Art 87.)

(The article is very similar to §305c BGB.)

For some reason that I do not know, the Commission decided to omit this article from the CESL. Instead, any unfairness because of lack of transparency would have to be dealt with under Article 86 CESL, the general provision on unfair terms. A reference was added to "the circumstances prevailing during the conclusion of the contract", presumably to encourage the court to look at issues of procedural fairness. However, the basic test of unfairness in a B2B contract - "gross deviation from good commercial practice" - was left unchanged. To my mind this test is not the correct test to apply to questions of transparency. As I have already explained, between businesses, parties must be free to drive a hard bargain – but they should have to do it in a transparent way. I very much hope that the Committee can see its way to proposing an amendment that will restore the balance that the Expert Group intended.

This could be done in one of two ways:

(1) by re-inserting a "surprising term" provision or
(2) by amending Art 86 to require that in a B2B contract, a term may be

unfair:

EITHER because it is not reasonably transparent,
OR because, in substance, it grossly deviates from good commercial practice,
in either case, contrary to good faith and fair dealing.

Remedies of the buyer

I agree that the buyer's remedies in the case of non-conformity go very far. I fully support giving the consumer an immediate right to terminate the agreement without having first to ask the trader for repair or replacement, which may take some time or cause some inconvenience to the consumer even if neither the delay or inconvenience is "unreasonable" in the circumstances. The English and Scottish Law Commissions[1] produced a very good study of consumer preferences, which shows that consumers value the immediate right of rejection (which is available in the UK) strongly. Immediate termination is often convenient – the consumer can immediately get the goods he/she wants from another supplier. In addition, having the right strengthens the consumer's position in any negotiation with the first trader.

But like the Law Commissions, my own view is that this right (which would not be subject to any claim by the trader for use or reduction in value) should be subject to a short time limit such as 30 days. After that period the consumer should be entitled to terminate (or reduce the price) only if the trader has been asked to repair or replace the goods and either repair or replacement is not feasible or the trader has failed to repair or replace within a reasonable time, etc. In that case the consumer should have a right to terminate (unless the non-conformity is insignificant) and the trader should be entitled to counter-claim for the use the consumer has had from the goods (or perhaps for the reduction in value of the goods, if that is lower).

Even with this change, the consumer would be significantly better placed than under the minimum requirements of the Consumer Sales Directive – and the overall level of consumer protection offered by the CESL would remain very high.

Restitution

I welcome the attempt to reformulate the provisions of this Chapter; the CESL articles are not easy to understand. See my comments on the proposed amendments.

However, I think we need to be very careful to delimit the scope of the CESL provisions on restitution. It should not cover, for example, every form of invalidity. Invalidity on the ground of illegality and some forms of illegality is

[1] Consumer Remedies for Faulty Goods (Law Com No 317, 2009), and see also the consultation paper (both available at http://lawcommission.justice.gov.uk/areas/consumer-remedies-for-faulty-goods.htm)

often treated differently, with restitution being denied unless the parties are not in pari delicto, etc.

I think the only other reference to a contract being invalid (as opposed to being avoided) is in Art 19(4). Art 19(4) must in any event be amended to read: "A distance contract concluded by telephone is binding on the consumer only if ..." (as in the Feasibility Study). To say that it is not valid, as art 19(4) currently provides, means that neither party is bound. That would not comply with article 8(6) of the Consumer Rights Directive.

I think there are four situations the Rapporteurs wish to cover in the Restitution chapter:

(1) avoidance of the whole or part of the contract;
(2) termination of the whole or part of the contract;
(3) where the contract, or the term of the contract according to which which the payment was made, is not binding on the consumer under various provisions of Chapter 2; and
(4) where a party has paid more than the price or other payment that appeared to be due under a term that was subsequently found to be invalid (e.g. Arts 73, 74 (price) or 79(1) (unfair term)).

Do the Rapporteurs also want to cover (5) cases where a party has paid before any contract was concluded and the contract is never concluded? (I suspect this may sometimes happen in distance sales, as some sellers provide that the consumer's offer is not accepted until the goods have been dispatched – but the consumer's card may possibly have been charged already.)

I have pointed out earlier that the reference in Art 19(2) to the contract being invalid is incorrect; it must be changed to "the consumer is not bound". If that is done, there are no other cases of invalidity that we need to cover. Assuming the Committee wants to cover the last case (payment before conclusion of the contract), I suggest the following formula:

1. Where
    a. a contract ***or part of a contract*** is avoided or terminated by either party,
    b. ***where a consumer elects not to be bound by a contract in accordance with the provisions of the CESL, and***
    c. where either or each party has conferred a benefit on the other in anticipation of a contract which has not been concluded,

    each party is obliged to return what that party ("the recipient") has received from the other party ***under the contract affected.***

2. Where a party has paid or rendered another performance in excess of what was due under the contract, the other party is obliged to return the excess.

Digital content

The CESL proposal in Art 107, where the criterion is whether the consumer has paid a price, is simple but crude. I support the proposed extension if we can find a workable criterion to distinguish between cases in which the digital content is in some sense "paid for" and where it is genuinely free.

I have a different concern over digital content which I would like to put before the Committee. It is that the consumer's rights to receive digital content that conforms to the contract are not mandatory. For contracts for the sale of goods, Article 99(3) provides that any agreement derogating from articles 100, 102 and 103 to the detriment of the consumer is valid only in very limited circumstances. I am sure that the Commission intended the consumer who buys digital content to be similarly protected, but art 99(3) applies only to "consumer sales contracts" and the definition of this and of "sales contract" sale in Art 2(k) and (l) do not include contracts for the sale of digital content which is not "goods", i.e. is not supplied on a tangible medium.

Prescription

In the very rare case where the problem does not show up fairly soon after delivery (e.g. when a drug or homeopathic remedy has a long-term side effect appears only after some years), I think that ten years is not too long. After a very careful study, the English Law Commission recommended reforming the law of prescription on just these lines. Secondly, the ten-year long period was adopted by the Products Liability Directive and has become something of a "European norm", see PECL, DCFR, etc.

I do not believe that the prescription period should be shorter for contract claims just because it is less likely that there will be problems of long latency periods than when the claim is one in tort. To have different periods for the two types of claim invites "demarcation disputes": parties trying to bring a claim in tort against the other party to the contract just in order to avoid a prescription period. Disputes of this kind have occurred in English law on a number of occasions – and they are a shameful waste of resources.

Flanking measures

I welcome these ideas.