

## EDITORIAL COMMENTS

### *Union competences in the field of contract law: Some questions – no answers*

In the previous issue of this Review, one of the articles dealt in depth with the problem of the European Union acting *ultra vires*.<sup>1</sup> In the next issue, this Review will publish a comprehensive piece<sup>2</sup> discussing the Proposal for a Directive for the revision of the consumer acquis in the field of contract law.<sup>3</sup> There is one question that might bring both articles together: whether the Proposal on the consumer acquis is firmly grounded on a legal basis provided for by the Treaties.<sup>4</sup>

The question of legal basis for consumer contract legislation has, of course, already been around for some time. Ever since the landmark ruling in the first *Tobacco Advertising* proceedings, handed down in 2000,<sup>5</sup> it has been argued that former Article 100 EEC, former Article 100a EEC and former Article 95 EC, on which most legislative acts dealing with consumer contracts rely, provide a somewhat weak basis for at least some of them.<sup>6</sup> Recently, the Commission published its Green Paper on policy options for progress towards a European Contract Law for consumers and businesses,<sup>7</sup> which plans a major piece of legislation in the field of private law. The Green Paper does not touch on the legislative basis for this endeavour, but the discussion on this very topic seems to be in full swing.<sup>8</sup>

The search for a correct legal basis for legislation in the sphere of contract law mainly turns around Article 114 TFEU and its rather obscure preconditions

1. Craig, “The ECJ and *ultra vires* action: A conceptual analysis”, 48 CML Rev. (2011), 395.

2. Eidenmüller, Faust, Grigoleit, Jansen, Wagner and Zimmermann, “Towards a revision of the consumer *acquis*” 48 CML Rev. (2011) (forthcoming in issue No. 4).

3. Proposal for a Directive of the European Parliament and of the Council on consumer rights, COM(2008)614 final; this proposal has been subject to substantial revision late in 2010, and again in March 2011.

4. See Ackermann, “Buying Legitimacy? The Commission’s Proposal on Consumer Rights”, (2010) Eur.B.L. Rev. 587.

5. Case C-376/98, *Germany v. Parliament and Council*, [2000] ECR I-8419; see Editorial Comments, Taking competences seriously, 38 CML Rev. (2001), 1421.

6. Cf. for a discussion in the English-language academic writing: Weatherill, *EU Consumer Law and Policy* (Edward Elgar, 2005) pp. 14, 70.

7. COM(2010)348 final.

8. See e.g. Max Planck Institute for Comparative and International Private Law, “Policy Options for Progress Towards a European Contract Law”, 75 *RebelsZ* (2011), 371.

for the exercise of Union powers to approximate the laws of the Member States. To be sure, the Lisbon Treaty provides other, and perhaps less controversial, bases of competence for enacting private law: the newly created Article 118(1) TFEU gives the Union the power to develop legislation that creates intellectual property rights on the Union level; Article 103(1) TFEU may be read as conveying a competence to introduce (also) private law remedies for damages ensuing from a cartel or an abuse of a dominant position (Arts. 101 and 102 TFEU). And Article 352 TFEU authorizes the Union to enact legislation in order to pursue one of the policies which the Union has the competence to develop, including the establishment and functioning of the internal market. However, Article 352 TFEU requires unanimity in the Council (and the consent of the Parliament), and may today have less appeal than in former times given a Union of no less than 27 Member States.<sup>9</sup>

Article 114(1) TFEU is one of the legal bases that empowers the Union to pursue the objectives set forth in Article 26 TFEU, mainly to improve the conditions for the establishment and the functioning of the internal market. In the first *Tobacco Advertising* case, the Court of Justice, for the first time, made it explicitly clear that the use of ex Article 100a(1) EEC is restricted by its wording (“establishment and functioning of the internal market”). To repeat the often cited paragraph 83 of the judgment: To interpret ex Article 100a(1) EEC as “a general power to regulate the internal market would not only be contrary to the express wording of the provisions ... but would also be incompatible with the principle embodied in Article 3b of the EC Treaty (now Article 5 EC)<sup>10</sup> that the powers of the Community are limited to those specifically conferred on it.” And the Court went on to explain that “a mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms or of distortions of competition ...” was not sufficient to justify the choice of ex Article 100a EEC as legal basis (para 84). The Court demanded that the measure in fact pursues the objectives stated by the legislative act, and it regarded as a precondition for the application of ex Article 100a(1) EEC that obstacles for the exercise of the fundamental freedoms exist or are likely to arise (para 86), or that the disparity between the national rules leads to an appreciable distortion of competition (para 106).

The Court in its case law has cited these principles again and again;<sup>11</sup> however, it has not invalidated any further piece of Union legislation as yet.

9. Art. 169(2)(a) TFEU, dealing with consumer protection policy, contains a mere reference to Art. 114 TFEU and its preconditions.

10. Now Art. 5(1) sentence 1 TEU.

11. E.g. Case C-58/08, *Vodafone*, judgment of 8 June 2010, nyr, para 32; Case C-301/06, *Ireland v. Parliament and Council*, [2009] ECR I-593, para 63; Case C-380/03, *Germany v. Parliament and Council*, [2006] ECR, I-11573, para 37 (with further references).

Whatever the reasons for that may be,<sup>12</sup> it is suggested that there are no strong indications that the principles set forth in the *Tobacco Advertising* case have become dead letter law: the constitutional principle of attributed competence as set forth in Article 5(1) TEU (and, perhaps, the principle of subsidiarity) as well as the potential vigilance of the constitutional courts in the Member States against *ultra vires* actions by the Union legislature should work against such an assumption. One important candidate that has not been tested for its legal basis and where the Court may have to consider whether the limits of Article 114(1) TFEU have any bite is Union legislation in the field of contract law. It is to be conceded that the Court, in a number of judgments, has dealt with various consumer contract law directives, building up quite a case law. However, in these preliminary ruling proceedings, the Court has always only been asked to give its interpretation of a certain provision in a directive, and it has never been confronted with the question of whether the relevant directive was firmly based on Article 114(1) TFEU (or its predecessors). The answer might have been in some cases a “no” – as the following example may demonstrate.

In the year 2000, the Community enacted Directive 2000/35/EC on combating late payment in commercial transactions,<sup>13</sup> setting forth, *inter alia*, provisions under which interest for late payment can be claimed, the relevant date from which the interest becomes due, the level of interest, and the question whether the parties can deviate from these provisions by contract. This Directive has recently been replaced and recast by Directive 2011/7/EU.<sup>14</sup> Both Directives are based “in particular” (what else?) on former Article 95 EC, and on Article 114 TFEU respectively. But do both Directives have the aim to eliminate obstacles to the free movement of goods or the freedom to provide services, or to remove appreciable distortions of competition? A look at the Preamble of Directive 2000/35/EC is revealing. The recitals start not with the legal basis, but with a reference to the “integrated programme in favour of SMEs and the craft sector” (recital 1), and add later on that late payments are considered to be responsible for insolvencies and heavy administrative and financial burdens placed on businesses, “particularly small and medium-sized

12. See for an analysis Wyatt, “Community Competence to Regulate the Internal Market”, in Dougan and Currie (Eds.) *50 Years of the European Treaties: Looking Back and Thinking Forward* (Hart, 2009), pp. 93; Weatherill, “The limits of legislative harmonization ten years after *Tobacco Advertising*: How the Court’s case law has become a ‘Drafting Guide’”, 12 German L.J. (2011), 827.

13. Directive 2000/35/EC of the European Parliament and of the Council of June 29 2000 on combating late payment in commercial transactions, O.J. 2000, L 200/35.

14. Directive 2011/7/EU of the European Parliament and of the Council of 16 Feb. 2011 on combating late payment in commercial transactions, O.J. 2011, L 48/1.

ones” (recital 7). These recitals stand for the predominant aim of the Directive: it is the aim to foster small and middle-size businesses and support them *vis-à-vis* their more powerful contract partners – it is industrial policy set forth by the Union which, according to ex Article 157(3) EC, had to be pursued under other provisions of the Treaty, such as Article 95 EC. Following the Lisbon Treaty, Article 173(3) TFEU is still more explicit in excluding any approximation of the laws of the Member States for the sake of furthering industrial policies set out in Article 173(1) TFEU. Nevertheless, Directive 2011/7/EU, in its Preamble, again refers to the economic consequences of late payment: “Such late payment negatively affects liquidity and complicates the financial management of undertakings. It also affects their competitiveness and profitability ...” (recital 3).

As the Union has no competence to approximate the laws of the Member States with the (sole) objective to pursue a certain industrial policy, it all comes down to the question of whether the preconditions of Article 114(1) TFEU (ex 95 EC) are met. The Preamble of Directive 2000/35/EC mentions that in some Member States contractual payment periods differ significantly from the Community average, and that these differences between payment rules and “practices” (!) in the Member States “constitute an obstacle to the proper functioning of the internal market” (recitals 8–9). The Preamble goes on to explain that these differences have the effect of considerably limiting commercial transactions between Member States, and distortions of competition “would” ensue if substantially different rules were applied in transborder operations compared with domestic contracts (recital 10). The Preamble to Directive 2011/7/EU only refers to the distortion argument.

It is submitted that these considerations set forth in the preambles to both directives may be called into question. Before the enactment of Directive 2000/35/EC, legal provisions in the laws of the Member States on late payments and the duty to pay interest used to be of a non-mandatory character, as far as commercial transactions are concerned. Whether and to what extent non-mandatory contract law is likely to work as an obstacle to the fundamental freedoms is, however, not explained in the Preamble, and is indeed rather speculative. The varying “practices” in the Member States (referred to in recital 9 of Directive 2000/35/EC) are nothing other than the contractual practices prevalent in the Member States, and as such an immediate consequence of freedom of contract in the law of the Member States. Moreover, contract partners in a transborder transaction have always enjoyed freedom to choose the applicable law (including the law of a third State; see now Art. 3(1) of Regulation 593/2008 – the “Rome I” Regulation). The contract partners have had the privilege to select a law most appropriate for their transaction. In a world of freedom of contract and party autonomy, it is hard to conceive how – without any further explanation – provisions (and practices) concerning late payment

may work as “obstacles” for the fundamental freedoms in any realistic fashion.<sup>15</sup> Remember that the Court of Justice has held that the mere finding of disparities between national laws is simply not enough to serve as a foundation for a power to approximate national laws.

As far as the topos “distortion of competition” is concerned, recital 5 of Directive 2011/7/EU argues that undertakings “should be able to trade throughout the internal market under conditions which ensure that transborder operations do not entail greater risks than domestic sales,” the mere difference in rules thus creating a distortion of competition. Aside from the fact that in the *Tobacco Advertising* judgment the Court of Justice asked for a demonstration that competition is distorted to an *appreciable* extent, the consideration presented in recital 5 is somewhat unsatisfactory. It does not really attempt to give an explanation for the contention why transborder transactions entail a greater risk than domestic transactions – except for the fact that the applicable law (chosen by the parties or determined by the objective connecting factors of Art. 4 of the Rome I Regulation) may just be different from whatever the applicable “domestic” law might be, and perhaps less known to one of the parties. Both considerations, however, do not conclusively indicate an appreciable distortion of competition. It is submitted that the recast Directive 2011/7/EU will get into troubled waters if the principles developed in the *Tobacco Advertising* case are taken seriously.<sup>16</sup>

Directive 85/577/EEC on doorstep-selling,<sup>17</sup> based on former Article 100 EEC, and now incorporated into the Proposal of a Directive on consumer rights,<sup>18</sup> has, in the past, been viewed as a prime example for the unconstitutional “competence creep” of the Union.<sup>19</sup> The Preamble of Directive 85/577/EEC states that (at the time, in 1985) the practice of concluding contracts with consumers in a doorstep situation was subject to legislation which differed from one Member State to another, and concludes therefrom that “any disparity between such legislation may directly affect the functioning of the common market”, and make it “therefore necessary to approximate laws in this field.” No more than that: the finding of disparities between national laws as reason enough to approximate them. It is suggested that this is the kind of approach which the Court of Justice explicitly rejected in its *Tobacco Advertising* ruling

15. See also Case C-339/89, *Alsthom Atlantique SA*, [1991] ECR I-119, para 15.

16. Roth, “Rechtsetzungskompetenzen für das Privatrecht in der Europäischen Union”, (2008) *Europäisches Wirtschafts- und Steuerrecht* (EWS), 401, 406.

17. As for the discussion in the English-language literature, see e.g. Weatherill, loc. cit. *supra* note 6.

18. See *supra* note 3. The relevant provisions are carried on in the Council Proposal of 30 Nov. 2010.

19. Weatherill, op. cit. *supra* note 6, p. 70; Roth, “Europäischer Verbraucherschutz und BGB”, (2001) JZ, 475, 477–478.

as vesting in the Community a general power to regulate the internal market, contrary to the express wording of the legal basis, and also as incompatible with the principle of attributed competence.

It is somewhat surprising that more than twenty years later and in full knowledge of the discussion around Directive 85/577/EEC, the Preamble of the Proposal for a Directive on consumer rights has not a lot more to say relating to the legal basis of Article 114(1) TFEU. As far as doorstep selling is concerned, recitals 5–7 of the Preamble refer to appreciable distortions of competition and obstacles for the functioning of the internal market created by the divergent consumer protection laws in the Member States that go beyond the minimum standard set by the Directive 85/577/EEC. In recital 7 of the Preamble it is argued that as a consequence of legal diversity, undertakings which engage in transborder business have to incur higher compliance costs for this business, which amount to an appreciable distortion of competition (recital 6). It is submitted that this argument may be put into question: expenditures for information on and compliance with varying national laws are a natural consequence of any business transacted on an international basis. If the reduction of these costs could justify legislation on the approximation of national laws, Article 114(1) TFEU would amount to the “general power” that it is just not meant to be. Moreover, undertakings, in their transborder business with consumers, will never be able to escape the information and compliance costs deriving from other provisions of the applicable private law, and most prominently, the costs of using the language of the State in which the business is transacted.<sup>20</sup>

Recital 7 refers also to the confidence-building rationale for harmonization of consumer law, set forth for the first time in the Preamble of Directive 93/13/EEC on unfair terms in consumer contracts.<sup>21</sup> The claim is that legal diversification in consumer law tends to undermine consumer confidence in the internal market, thereby reducing the volume of transborder business. Apart from the question whether the confident consumer rationale is nothing more than camouflage for another version of “competence creep” under the heading of Article 114(1) TFEU,<sup>22</sup> it is suggested that this consideration related to the practice of doorstep selling (or selling at the worker’s place) may be put into doubt as well. In the doorstep selling setting, Article 6 of the Rome I Regulation

20. A distortion of competition as a consequence of mandatory consumer law is forestalled by Art. 6 of the Rome I Regulation, which provides for the application of the mandatory consumer law of the Member State where the business is transacted and the consumer resides (in the case of doorstep selling obviously one and the same).

21. Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, O.J. 1993, L 95/29.

22. See Ackermann, *op. cit. supra* note 4, 593–594.



leads to the application of the mandatory consumer provisions of the law of the Member State where the doorstep selling (at the home of the consumer) has taken place. No other law is applicable (except if validly chosen by the consumer). The diversity of legal provisions is no issue, and therefore not even theoretically a threat to the consumer confidence to be protected.

The foregoing argument is not meant to say that the Proposal for a Directive on consumer rights as a whole is without a valid legal basis and therefore *ultra vires*. However, the Proposal should (before the legislative process reaches its final stage) be scrutinized as to the question whether and how far all (other) parts of the Proposal may be carried by the legal basis of Article 114(1) TFEU: just a further question – and no answer given here.

One final observation regarding legal basis seems to be in place. As already mentioned, the Court of Justice has, in the last years, built up quite an extensive case law with regard to the consumer contract directives, especially the Doorstep Selling Directive. In all these cases the Court was asked by a national court for an interpretation of a particular provision, and never whether the relevant directive was grounded on a firm legal basis. This appears to be an unfortunate state of affairs. It is submitted that the Court may have some (understandable) hesitations to hold a directive (or a provision in a directive) that it has already interpreted a number of times invalid for lack of Union competence. However, for the future, there should be a way out of this dilemma: when the Court, in the preliminary reference procedure, is asked for an interpretation of a Union measure based on Article 114 TFEU, one important feature in determining the valid objective of the measure (or of the provision to be interpreted) will be, as it has been in the past,<sup>23</sup> the interpretation of the measure in the light of its legal basis. It is suggested that such an interpretation necessarily implies addressing the incidental question of whether the measure can be justified by the legal basis on which it is founded.<sup>24</sup> To that extent, the discussion and (strict) control of the legal basis should become a regular exercise in the interpretation of secondary Union law in the field of contract law.

23. See e.g. Case C-467/08, *Padawan*, judgment of 21 Oct. 2010, nyr, para 35; Joined Cases C-42, 45 & 57/10, *Vlaamse Dierenartsenvereniging VZW et al.*, judgment of 14 April 2011, nyr, paras. 67–69.

24. As a step into that direction (though not directly at issue) e.g. Case C-518/08, *Fundación Gala-Salvador Dali*, judgment of 15 April 2011, nyr, para 31; Case C-127/08, *Metock*, [2008] ECR I-6241, para 62.