Contract law and commercial practice

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Modern perspective on contractual obligation

Empirical studies of contracting behaviour consistently demonstrate that commercial contracting parties care little for written contracts or the rules of contract law. Should the law of contract manifest any concern over this? If not, why not, and if so, how should the rules of contract law be amended to better reflect commercial practice?

Question: A

Introduction

The overwhelming majority of contracts are transacted in an informal setting. Such contracts are either made by word of mouth, or even by a party's conduct. Whilst that may be the case, written contracts are the types of agreements which are favoured by parties in the commercial world, not least because of what is potentially at stake in the event of a breach of the agreement .

The extent of the terms of some commercial agreements and the seriousness of the implications of a breach of a party's obligations, written contracts are resorted to to ensure both that the parties to the contract are aware of their rights and obligations and also as a reference tool in the event of a dispute.

The advent of the European Community witnessed a renewed impetus to harmonize the laws pertaining to, inter alia, commercial contracts. Various efforts have already been made to facilitate international transactions. For instance, the Uniform Law on International Sales and the Vienna Sales Convention, the Rome Convention on the Law Applicable to Contractual Obligations. These efforts have been producing w new codified *lex*

mercatoria .

This work is seeks to highlight the rules applicable to parties to commercial contracts within the European Community and whether or not these rules are adequate to cope with parties who do not honour their contractual obligations. More specifically, are contracts which are made orally or by conduct enforceable in European Law?

The essay shall also highlight whether there is any concern if parties care little for written contracts, and if not why not? In the Conclusion, the work shall explain whether or not the rules ought to be modified to reflect current commercial practice.

Harmonising European Contract Law

Efforts already made to harmonize the EU contract law rules have manifested in various forms. The national laws applicable to contracts vary from Member State to Member State. This difference or divergence in the laws inevitably adversely influences the decision of businesses whether or not to carry out cross-border transactions. A difference in the laws can result in uncertainty and negatively affect whether or nota business decides to enter an agreement with a party based in a different Member State. The European institutions have therefore taken action to alleviate this problem by introducing laws which are applicable throughout Member States. These laws come in a variety of forms; Regulations; Directives and European Court of Justice judgments. Most notably, however, The Principles of European Contract Law 1998 has done a good job in encapsulating, codifying and harmonizing the rules of contract law from Member States.

The Principles of European Contract law

Parts I and II – (Parts I and II completed and revised) states (at Article 1) that the Principles are intended to be applied throughout Member States as the general rules of contract law in the EC. Furthermore, the Principles shall apply when the parties agree to their application, or in the event that it has not been expressly stated that a specific system or rules of law shall govern the contract (see Section 1, Article 1. 101(3)(b)). In addition, the Principles can also be used where other national laws or rules fail to provide a solution (see Section 1, Article 1. 101(4)). Under the Principles however, the parties still maintain the right to freedom of contract. That is to say that parties are permitted to agree upon the terms they wish to agree upon. However, set out in the document are ‘ General Obligations’ of ‘ Good Faith’ and ‘ Fair Dealing’ (Section 2, Article 1. 201) and a ‘ Duty to Cooperate’ (see Section 2, Article 1. 202). These obligations cannot be derogated from and therefore provide a safeguard for parties to a contract. Albeit a contract, under the Principles, may still be made orally or by conduct, and does not have to be in writing. All that is required is that the parties intended to be ‘ legally bound’ (see Section 1, Article 2. 101), and that they reached a ‘ sufficient agreement’ (see Section 2, Article 2. 101). Furthermore, those terms which have not been individually negotiated can be invoked (under Article 2. 104) against a party who claims to have been unaware of them, providing that the party wishing to invoke them takes reasonable steps to highlight their existence prior to, or at the time of, concluding the contract.

The European Contract Law Project

The Principles of European Contract Law document is over a decade old now. Since the introduction of the Principles of European Contract Law, there have been further efforts within the European Community to streamline and harmonise European Contract law. Most notably, the Common Frame of Reference has made great strides in this area.

Background to the Formation of the Common Frame Reference

In 1999, the European Council (Tampere) requested a study on the feasibility of approximation of civil law in order to facilitate the efficient functioning of the European market. The European Commission responded by announcing that a consultation shall take place in order to collate information on how to form a European Contract Law. Subsequent to this, an Action Plan followed in 2003 proposing measures, for instance, the Common Frame of Reference was one such measure.

Common Frame of Reference

In essence, the Common Frame of Reference (‘ CFR’) outlines the model rules, principles and definitions to be applied to contract law within the EC. It is a long-term project with the objective of facilitating the preparation or revision of existing legislation in the field of contract law. It shall be of assistance to EC Legislators by providing solutions to contractual problems within the EC. These solutions have been extracted from existing contract law within the Member States. It is hoped that this will, *inter alia* , modify the existing body of rules applicable to contract law within the EC.

Work already done in this area has produced various pieces of legislation aimed at improving existing laws. For instance, EU consumer protection law is a good example of all the work that has resulted in EC laws.

R. Madelin, in his article, *European Contract Law: Moving Forward Together, Director General for Health and Consumer Protection European Commission* stated (at pg. 5) that it is hoped that the European Contract Law Project, and particularly the CFR, shall aide the pursuit of the following goals: achieving better regulation, boosting competitiveness and improving the functioning of the international market (see pg. 5, R. Madelin, *European Contract Law: Moving Forward Together, Director General for Health and Consumer Protection European Commission* , Conference of the network of stakeholder experts on the Common Frame of Reference in the area of European Contract Law (CFR-net), Charlemagne Building, Meeting Room S2, 15 December 2004)

Reshaping the legal landscape to enhance competitiveness within the EC ought to provide an environment in which businesses are able to operate within the EC in a more efficient and profitable manner. This should address some of the complaints which have been forthcoming from small and medium size enterprises, who were concerned, *inter alia* , about inconsistent and diverse contract laws throughout the Member States (see pg. 5 article). It was felt that a more consistent and transparent system would facilitate competitiveness by allowing businesses to conduct cross-border transactions in a more efficient manner by supplying goods and services in a more competitive environment.

It follows that greater confidence in European Contractual Law would inject greater confidence in the EC business community and in turn increase cross-border transactions. Ultimately therefore, European institutions are responsible for introducing laws which will simplify, and be more coherent to facilitate transactions within the EC, which ought to eliminate, or at least reduce, legal obstacles to trade.

The European Commission has committed itself to utilizing the CFR in order to improve the quality and coherence of contract law. The success and development of the CFR is due to the fact that it has received support from all European Community institutions, Member States and stakeholders alike.

Following public consultation, the CPR was adopted. The objective of the CFR shall become a toolkit for the Commission’s lawmakers, including the European Council and EC Parliament. The CFR shall also be of benefit as a source of reference for law-makers, judges and lawyers.

The work carried out for consumer contract law has been particularly fruitful. For instance, in October 2008, the proposal for a Directive on Consumer Rights was adopted by the Commission. The ultimate objective of which was to make it easier and cheaper for Member States to conduct cross-border transactions.

The *Unfair Contract Terms Directive* (1993/13/EEC) is only of eight pieces of legislation which is being analysed in relation to the Review of the Consumer Acquis. Such initiatives are aimed at improving legislation by identifying and alleviating problems.

For instance, the *Unfair Contract Terms Directive* has introduced the concept of ‘ good faith’ into consumer contracts, in an attempt to redress any imbalance that may be present in a contract between a seller and consumer. In addition, the Directive sets out a list of terms that are to be deemed unfair in such contracts, and are thereby rendered obsolete if they are included in such agreements. It is a further requirement that terms are to be ‘ plain and intelligible’ and any ambiguity shall be interpreted in the consumer’s favour. Therefore is accordingly a duty on Member States to ensure that the provisions of the Directive are implemented.

Conclusion

As noted above, the European institutions have been busy harmonising the laws applicable to contracts throughout the Member States. The work already completed with the CRF has ensured that parties to contracts have participated in the process of harmonising the laws applicable to contracts. This therefore ensures that the rights and obligations of the parties to a commercial contract are reflected in the laws introduced by the EC institutions. It accordingly follows that there is no need for any concern if parties prefer to enter contractual agreements by conduct or statement. Providing such agreements are clear (see Section 2, Article 2. 101 of the Principles), and that both parties are aware of the terms, and express their wish to be legally bound by the agreement (see Section 1, Article 2. 101 of the Principles), the right to freedom of contract has been preserved. Given the differences in the Common law system adopted in Ireland and the United Kingdom, and the variations of the civil law systems adopted by the remaining Member States, these efforts by the EC institution *et al* to

harmonise the contract laws applicable to Member States ought to improve the position of parties to commercial contracts by keeping them informed of their rights and obligations, which in turn, one would think, ought to ultimately reduce breaches of contract within the EC.

Question B

EU business law

Critically assess the corporate structures within EU Member States.

Introduction

The corporate structures in Member States of the European Community (' EC') differ immensely in their form and the practices that they adopt. The EC institutions have accordingly endeavoured to facilitate the smooth functioning of the internal market by harmoninsing the systems and laws applying to corporate structures throughout Member States.

This assignment provides a critical assessment of the corporate structures applicable to Member States. More specifically, the work shall explore whether or not corporate structures within the EC are operating in an efficient manner. Given the limited word count of this work, however, and the complexity of the subject, the essay concentrates on one aspect of corporate structures within the EC; Golden Shares.

The work shall highlight the efforts made by the EC institutions, particularly the European Court of Justice (' ECJ'), in attempting to bring about parity within Member States by eliminating obstacles to the free movement of capital, as required under Article 56 EC Treaty. Golden shares inhibit the free

movement of capital by discouraging foreign investment, *inter alia* , due to the special rights that are often retained by the holders of golden shares.

EC law makers, particularly the ECJ, have endeavoured to bring a degree of semblance to the EC rules governing corporate structures in relation to ‘ golden shares’. This has been done through a process of sifting out the ‘ golden shares’ and ruling them to be inconsistent with EC law. The assignment shall commence by outlining information about ‘ Golden Shares’ before setting out numerous prominent ECJ case law pertaining to ‘ Golden Shares’. Finally, in the Conclusion, the work shall sum up the findings.

Golden Shares

A ‘ golden share’ is a shareholding which derives from a former state-owned company, in which a government of a Member State may reserve, subsequent to its privatization. Such shares carry with them special rights which the government shareholder can enjoy. Albeit the government, despite being a minority shareholder, often wields rights which permit it to exercise undue influence over the company. This usually exceeds the percentage of the stake the government owns in the company. The special rights in question can come in the form of: power to veto certain actions by the company in question; limiting the size of other shareholdings; blocking foreign shareholdings; and a right to control the appointment of directors. Whilst being a relatively common practice in Member States, the EC feels that the practice is undesirable and has therefore sought to tackle such shareholdings. For instance, in 2003, the ECJ found that the UK government

failed in its duty to fulfill its obligations in accordance with Article 56 of the EC Treaty, namely in respect of the principle of the free movement of capital.

In addition, Spain was also held to have upset the ECJ by holding golden shares in numerous companies, such as: Repsol, an energy company; Telfoncia, telecommunications company; Tabacalera, tobacco company; Argentaria, banking group; and Endesa, electricity company. Again the ECJ held that the shareholdings held by the Spanish government in this regard were inconsistent with EC principles as they restricted the free movement of capital throughout the EC. The result of the ECJ's judgment was that the Spanish government was compelled to change its relationships with the companies in question.

The ECJ has illustrated, however, that its decision are thoroughly thought through before outlawing such shareholdings. For instance, the ECJ found that a Member State can derogate from the obligations under Article 56 EC Treaty of ensuring the free movement of capital, on the basis of retaining special rights as the holder of ' golden shares', on grounds of national security, and in applying the principle of proportionality, when it decided that Distrigaz, a Belgian energy firm, was permitted to retain its ' golden share' because it was a ' legitimate measure designed to promote the general national interest in terms of the security of the national gas supplying times of emergency'.

However, the general consensus within the ECJ appears to be one of ruling such shareholdings to be inconsistent with EC principles. For instance, in 2006, the ECJ proved once again that it would not shy away from ruling that

a Member State had infringed the principle of free movement of capital when the Netherland's government was found to have breached the principle by retaining special rights (golden shares) following the privatization of the national postal, Koninklijke KPN NV (' KPN'), and telecommunications companies TNT Post Groep NV (' TNG').

The shares themselves permitted the government to, *inter alia* , give prior approval of specific management decisions. The ECJ accordingly held such rights to be disproportionate to the rights enjoyed by ordinary shareholders. It was accordingly felt that such shares could potentially discourage investors from other Member States from investing in the company.

Conclusion

The ongoing campaign by EC institutions, particularly the ECJ in this regard, in seeking to eradicate any impediments to greater liberalisation of the EC Member States' markets, is clearly not complete. It is therefore highly likely that the eradication of government owned ' golden shares' is likely to continue unabated. That is that there appears to be no room for ' golden shares' in the EC's agenda. Whilst this may impact hard on the corporate structures of many Member States, the harmonization of the rules shall undoubtedly result in an increase in cross-border mergers, which includes former state owned companies in which the government hitherto held ' golden shares'. This may call for a shake-up of the current corporate structures in this regard, but the closer cooperation of Member States can only enhance and improve the corporate structures.

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Under Article 2. 102, a party's intention to be bound by the contract shall be discerned from the statements or conduct of the parties.

The Directives in question are: the Doorstep Selling Directive 85/577; the Package Travel Directive 90/314; the Unfair Contract Terms Directive 93/13; the Timeshare Directive 94/47; the Distance Selling Directive 97/7; the Price Indication Directive 98/6; the Injunctions Directive 98/27 and the Consumer Sales Directive 99/44.

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