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## **INTRODUCTION: A LAW AND ECONOMICS APPROACH TO EUROPEAN CONTRACT LAW**

OMRI BEN-SHAHAR\*

### **1. Introduction**

How do you engineer a hostile disagreement?

Bring together a group of prominent European private law scholars and members of the University of Chicago's Law and Economics faculty, and ask them to talk about the bureaucratic regulation of markets.

This was the recipe for the conference we are presenting to you in this volume. The anticipated collision between the two orthodoxies was also the secret, almost perverse, plan of its organizers. Under the title "A Law and Economics Approach to European Contract Law," I expected a heavyweight slugfest.

There was good reason to expect this conference to emerge as such. Here you have, on the one hand, a group of American law and economics scholars – all members of Chicago's faculty – who know relatively little about European contract law, probably never have read the underlying European treaties, and certainly don't think that such prior meticulous research of the black letter law is necessary to join the debate. Instead, they pride themselves in the expertise of identifying the effects of laws on behaviour, in warning against unintended consequences of laws, and they think they know something about unification because they have previously used their skills in analysing uniform laws in the United States.

On the other hand, arriving from Europe at the University of Chicago campus was a group of influential scholars who have long been studying European law and contributing to the debates over the harmonization enterprise, over the correct scope and strategy of legal unification, and over the proper role and limits of the EU framework. While habitual consumers of the law and economics methodology, they are nevertheless primarily engaged in European law scholarship.

I thought this was going to be a dogfight between pragmatists and reformers, between sceptics and optimists, between insiders and outsiders. Even more dramatically, it was billed to be an encounter between two legal intellectual traditions: law-and-economics, where law is evaluated by the

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incentives it creates using external social scientific perspectives, versus doctrinal (“dogmatic”) analysis, where law is evaluated according to the internal coherence within its various texts.

I have participated in the past in several private law meetings between American law and economics scholars and European experts. With some noted exceptions, they left something to be desired.<sup>1</sup> First, there was almost no dialogue between the two “camps,” and at times the Q&A deteriorated into snide, condescending remarks against the methods that the speaker – who was exasperatingly regarded as “representing” an entire misinformed continent – uses. Second, any attempt to reach out across the Oceanic intellectual divide meant diluting the discussion. It meant talking about basic rather than sophisticated arguments. With Americans in the room, Europeans could not comfortably debate the text of a treaty (“Does Article 6 of CISG allow parties to exclude CISG only explicitly, or also implicitly?”); and with Europeans in the room, American law and economics scholars could not go beyond “Incentives 101” (“Would the default rule lead to opt out?”). These past meetings delivered a sombre lesson. We had no common dialogue.

Remarkably, the Chicago conference did not live up to this dour billing. Rather than engendering dissonance in content and in method, it turned out to be a sophisticated joint effort to think about the economic underpinnings of the campaign to unify European Sales Law. It was successful, because each side reached out to the other persuasion. The European contributors have been actively interested in law and economics even before this conference, and indeed they are responsible for some of the strongest economic arguments – in this volume and in prior debates over European law. Conversely, the Chicago contributors have paid close attention to the actual text of the proposed law, and offered original observations uniquely tailored to the current context. Rather than a face-off between two hardened, resistant paradigms, each preaching to the other, this meeting brought together scholars eager to discuss the insights of another school of thought, appreciating the value of different intellectual temperaments.

One striking conclusion arising from this meeting is that most authors have a negative view of the proposed Common European Sales Law (CESL). Some thought that the premise of common private law is misguided (“Let States Compete!”). Others thought that the substance of this statute is flawed (overprotective; inefficient; unfit to serve its purposes). Others still thought it

1. Although, to be fair, some of the published articles from these symposia that were later submitted to journals made legitimate contributions. See, e.g., *Conference on Commercial Law Theory and the Convention on the International Sale Of Goods (CISG)*, 25 Int’l Rev. L. & Econ. (2005), 311–512. My characterization here is of the symposia’s oral proceedings, not of the individual paper contributions.

is based on faulty premises about how parties negotiate. And the fact that the instrument is merely optional did not seem to assuage the critics.

Perhaps the most important lesson, which at least for American commentators is surprising, is that the law and economics methodology has taken a stronghold in European legal academia. This, of course, is not the first conference to demonstrate such transition.<sup>2</sup> But the joint intellectual effort that this volume brings should be a powerful testament to the maturity of economic analysis of European law.

In this short Introduction, I do not plan to march down the programme of the conference article-by-article, but rather lump together ideas that are scattered across the seventeen articles. Since most of the original arguments presented here are critical of the CESL, I will begin by reviewing these critical themes.

## **2. The CESL will not lead to more cross-border trade.**

The basic premise justifying an optional common law is that it will overcome obstacles to cross-border trade, and draw more transactors in. William Hubbard shows that this premise is empirically questionable – that contract law is *not* a significant barrier to cross-border trade. The pool of traders who want to engage in cross-border trade but are currently excluded due to contract-law-related barriers to trade is microscopically small. Strikingly, Hubbard’s empirical findings are based on Eurobarometer surveys – the very same source of data the Commission invokes in justifying the need for the proposed regulation!

## **3. Will firms ever opt into the CESL?**

Even if there existed an inventory of firms who are eager to enter cross-border business but are holding back due to contract-law related issues, the CESL would fail to usher these firms in if the transaction costs of opting in are too high. There are several reasons why firms might ignore the CESL, and prior literature has already explored some of the economic incentives of firms to either shun the CESL or opt in selectively (sometimes referred to as “social dumping”). Some contributions in this volume look specifically at the transaction costs of choice-of-law. Eric Posner argues that adding an optional

2. See, e.g., *Conference on Regulatory Competition in Contract Law and Dispute Resolution*, at [www.cas.uni-muenchen.de/veranstaltungen/archiv\\_veranstaltung/tagungen/regulatory\\_comp/index.html](http://www.cas.uni-muenchen.de/veranstaltungen/archiv_veranstaltung/tagungen/regulatory_comp/index.html).

instrument to the negotiations would increase, rather than decrease, transaction costs. It is simply more costly to evaluate more options.

Two papers debate another transaction cost aspect: the value to firms of having a uniform, one-size-fits-all, law. On the optimistic side, Juan Jose Ganuza and Fernando Gomez show that firms doing cross-border business may prefer to opt into the CESL, despite its strong consumer protections, because they would no longer have to learn about, and comply with, diverse national laws. Richard Epstein disagrees: the price for such convenience, he argues, is too high, given the heavy restrictions that CESL places on voluntary transactions. Epstein advocates the American choice-of-law model, allowing firms to choose any law, overriding the consumer protections in their national laws.

#### **4. An optional instrument is not useful, and may be harmful**

“What can be wrong with an option?” Horst Eidenmüller asks, and answers: vertical regulatory competition (mother Europe versus Member States) is not needed when horizontal competition is already sizzling. Both Eidenmüller and Stefan Grundmann argue that the present scheme in fact hurts competition by tilting the playing field in favour of the CESL, being the only regulatory product in this competitive law-as-product market that provides a conflicts-of-laws safe harbor. Grundmann additionally shows that competition may be undermined by network effects that uniquely bolster the CESL.

Thomas Ackermann argues that, in theory, an optional instrument with high levels of consumer protections can be desirable if there is competition between laws, in which case it would be “branded” the high quality product. But as long as there is no such competition in the EU (due to restrictive conflicts rules), we have to be candid and ignore the optional façade. Let’s call it by its real name: “a creeping codification of contract law that is ultimately meant to preempt Member States’ laws.”

Further, Eric Posner argues that an optional instrument would lead to few benefits if its application is shrouded in uncertainty (which would take years to resolve), and could instead lead to inefficient competition (“race to the bottom”). Simon Whittaker demonstrates some of the costs that the CESL would create, including uncertainty over the interpretation of the open-ended provisions of the law. Such provisions do not have a shared European meaning, and by leaving so much discretion to national courts, the costs that the CESL sought to save through a uniform statute would, ironically, find parallel in non-uniform interpretation and adjudication.

## **5. The evils of harmonization**

I have mentioned already a prominent theme in some of the critiques – namely, that harmonization reduces regulatory competition. Saul Levmore adds another concern: harmonization is a result of interest group contest, whereby a majority can write more law than is efficient by imposing some of the law's costs on others. Is it possible, he ponders, that those who favour strong harmonization of EU commercial law also expect to be net winners – at the expense of minorities – in the battles over European markets and over European identity?

## **6. The CESL's specific rules are poorly designed**

Several authors take issue with specific proposed rules. Douglas Baird examines precontractual disclosure duties under the CESL, arguing that the standards of disclosure they set are often redundant, and might paradoxically leave parties with *less* information than even a regime of caveat emptor. Lisa Bernstein argues that the CESL's incorporation of trade usage and commercial practice as interpretive rules is misguided, because such practices either do not exist or are hard to verify in continent-wide scale. While a custom-oriented methodology may be suitable for small, close-knit groups, who know of and rely on such practices in daily business, it is particularly unsuitable for a large, diverse community. Ariel Porat critiques the mistake and fraud rules under the CESL, showing that they reduce the value of private information and, by allowing rescission of contracts too often, they also undermine efficient transactions. And Fabrizio Cafaggi argues that the CESL (and most of European consumer contract law) is methodologically misguided. Instead of focusing on the *status* of the contracting party – consumer, SME, large business – the law should focus on the pathologies of the transaction, such as asymmetric information, cognitive biases, or unequal bargaining power.

## **7. The CESL's consumer protection is naïve and potentially harmful**

Consumer protection is an area where the American and European traditions dramatically diverge, and it is therefore an excellent platform for cross-Atlantic debate. Interestingly, however, the most biting critique of the CESL's ambitious protective agenda comes from Gerhard Wagner, in his

article examining the broad termination rights that consumers have under the CESL, and the correspondingly narrow seller's right to cure. Wagner shows that these provisions impose substantial costs on sellers, that these costs are patently inefficient, and that they would likely be passed on to consumers. Oren Bar-Gill and I criticize the four general techniques of consumer protection that we identify in the CESL (mandatory restrictions on terms, mandated disclosure, withdrawal rights, and pro-buyer default rules). Like Wagner, we argue that some of the mandatory protections and withdrawal rights are overly broad and would thus backfire, particularly against the weakest of consumers. We also argue that the CESL puts much naïve and unjustified faith in the mandated disclosure technique.

## **8. In defence of the CESL**

Against this tide of disfavour, some brave voices view the CESL in a more forgiving light. Ganuza and Gomez, as mentioned above, reject the claim that the CESL, due to its ambitious consumer protection rules, is doomed to be ignored by transactors. Firms would be drawn to the benefit of a one-size-fits-all law, which saves them the cost of learning how to comply with diverse national standards. This benefit, they show, might more than offset the burden of aggressive pro-consumer mandatory rules.

Jan Smits likes an optional law that offers high consumer protections, but would ultimately like to see this trend go further. Smits argues that the CESL needs to be more significantly distinct from existing national law, that its benefits have to be more transparent to people (perhaps through consumer ratings of the law "feature" of their product experience), and that it has to be easier to opt into. Chantal Mak argues that even if short-term costs would be added by the CESL, the long-term benefits could outweigh them. "Defying" the law-and-economics hegemony of this conference, Mak suggests that social justice concerns and the ideal of access to markets may trump economic aspects. She views this as a step towards a unique "European legal order" conception of fair markets.

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There you have it: seventeen articles on the economic approach to European contract law. I hope that readers will find much to disagree with, and plenty to add to. There is much more empirical work to be done, testing the various

conjectures developed in these articles. And there are numerous legal issues in the European harmonization project that could benefit from an economic perspective. Yet this conference marks an important milestone in the academic dialogue between two mature legal traditions, who for too long have managed to ignore each other.