

The 2011 Proposal for a Regulation on a Common European Sales Law: A House of Cards?

– The *Chapeau* Rules as Foundations and the Necessary Extensions of the Personal and Territorial Scopes of Application.

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1 Introduction

‘I want both consumers and businesses to benefit fully from our Single Market, without having to navigate a legal maze when buying and selling in another EU country.’¹

It has been a long-standing ambition of the European Union (EU) to create an Internal Market without barriers to free movement and trade.² However, despite many efforts, there are still various obstacles remaining that need to be tackled in order to achieve the completion of it. Especially in the area of sales contracts many hurdles to the achievement of a market without frontiers are to be found which include *inter alia* linguistic differences, cultural diversity and the wide variety of national approaches to contract law among the 28 Member States of the EU.³ It is true that in particular the former two obstacles cannot necessarily be overcome by legislation, however, differences in national contract laws can and even should be legislated upon by the EU.

Within the area of the sale of goods diverging approaches to contract affect both, businesses as well as consumers, and lead to the current situation of limited cross-border trade and purchases. This in turn causes the potential of the Internal Market not to be

1 Reding 2011.

2 See also: Doralt 2011, p. 2.

3 As of July 1st, 2013 the Republic of Croatia is a Member State of the European Union. See also: Eurobarometer 2011, p. 5.

fully taken advantage of. The most prominent reasons for businesses not to engage in transnational trade are high costs, legal uncertainty and complexity.⁴ Consumers on the other hand, are mostly concerned with their rights while buying goods abroad.

The Commission has long recognized this issue and has already taken up actions in 2001 with its Communication⁵ on a far reaching public consultation on the effects the diverging and fragmented environment regarding contract law in the EU. The Commission has ever since underlined the necessity to decrease the costs which are related to cross-border trade, achieve legal certainty and reduce complexity, especially also to encourage small and medium-sized enterprises (SMEs) to engage in transnational sale of goods, for they make up over 90% of all businesses in the EU.⁶ All these aims are to lead to the overall objective of enhancing the functioning of the Internal Market.

The EU has come a long way of various European Contract Law initiatives, consultation rounds with stakeholders and academic and political debates⁷ to arrive at the 2011 Proposal of the European Parliament and the Council for a Regulation on a Common European Sales Law (the Proposal).⁸ It is a Proposal for a second regime on the sale of goods which would be optional to opt-into by parties and would exist next to national contract laws of Member States for cross-border sale of goods transactions.⁹

However, in spite of all of these efforts to achieve a possible future Common European Sales Law, it is striking that most of the work and discussions were solely focused on the substantive rules which are to make up the future European tool.¹⁰ Thereby, the equally important *chapeau* rules, which set out the scopes of application of an instrument, remained largely neglected. The *ratione personae* (personal scope application) and *ratione loci* (territorial scope application) of the envisaged instrument constitute an intrinsic part of trying to create an instrument which tackles the barrier to trade consisting of different national contract law regimes. Setting the scopes too narrow (as it is the case in the current Proposal), making limitations on *who* can make use of the future instrument and in *what* specific situations, leads to undesirable practical results and ultimately makes

4 See inter alia: Piers & Vanleenhofen 2012, p. 3.

5 COM(2001) 398 final.

6 See inter alia: European Law Institute 2012, p. 19; Eurobarometer 2011, p. 5 and 7.

7 See inter alia: Basedow 2012a, p. 42; Schulte-Nölke, 2012.

8 COM(2011) 635 final.

9 Explanatory Memorandum 2011, p. 8; See also: Low 2012, p. 145; Rühl 2012, p. 149; IP/11/1175, p. 2.

10 See also: Basedow 2012a, p. 42 - 43.

the efforts of over two decades being in vain, for the attractiveness of such a Common European Sales Law (CESL) is greatly depreciated.

The personal and territorial scopes of application of the Proposal are to be analysed carefully and thoroughly to facilitate the success of the envisaged instrument and achieve the Commission's aim of enhancing the functioning the Internal Market of the EU.

This paper shows that the current Proposal for a CESL is build on such weak 'foundations', consisting out of the scopes of application, that there is a very high probability of it collapsing like a house of cards. It will argue that there is a pressing need for an elaborative consideration and revision of the personal and territorial scopes of application by the European legislator in order to guarantee success.

The first section of this paper outlines the historical background of the 2011 Proposal for a Common European Sales law. Following that, section two delineate what the current Proposal entails and which objectives are pursued by the Commission. Section three focuses on the personal scope of application. It sets out the limitation of requiring one of two traders, in a business-to-business transaction, to be an SME and the extension possibility for Member States to include all transactions between two traders to fall within the *ratione personae*. An analysis of the current personal scope of application is made by way of scenarios, upon which the consequences of the limitation are outlined. Furthermore, the justifications of the Commission of including such restrictions are provided and assessed upon their feasibility and strength. Following this analysis, the necessity of an extension of the personal scope to achieve the objectives pursued is addressed. Section four will elaborate on the territorial scope of application of the current Proposal. The cross-border requirement and minimum EU link of sale of goods transactions is explained. Again, the consequences of the choices made for the territorial application of the Proposal are scrutinized and in the evidence of which, essential changes are proposed to be in line with the initial aims of the Commission.

It is concluded, that an extension of the personal scope, to include *all* business-to-business and business-to-consumer transactions, is necessary as the current limitations are not justified and lead to further fragmentation of the legal environment. Furthermore, prove is given that having the restriction of the territorial applicability to cross-border sale of goods *only*, necessarily lead to not achieving the initial aim of the Commission, to eliminate obstacles to cross-border trade and facilitate the functioning of the Internal Market This results in unattractiveness of the envisaged instrument. It is argued, that although the creation of such a Common European Sales Law is a commendable effort by

the EU legislative organs, it is 'doomed' to fail if fundamental changes to the *chapeau* rules of the Proposed Regulation are not undertaken.

2 Historical Background

The roots of the Proposal for a Common European Sales Law lie back in the 1980s with the work of European scholarship. One of the major initiatives include the 'Commission on European Contract Law', chaired by Ole Lando,¹¹ leading to the adoption of the Principles of European Contract Law (PECL) in 1995.¹² This commission was a private initiative on comparative law of Europe which sought to provide a set of rules of European Contract Law. This set was intended to be a 'toolbox' for future European legislation in that area. Other initiatives in that field include the so-called 'Pavia-Group', lead by Giuseppe Gandolfi, which worked on a civil code and the 'Study Group on a European Civil Code' which is regarded as the successor of the Commission on European Contract Law, resulting in a number of contributions on specific contracts ('Principles of European Law').¹³ The most recent one was the 'Research Group on the Existing EC Private Law' also known as the 'Aquis-Group' which took up the task of delineating common characteristics and principles to be found in the EU's *Aquis Communautaire*.¹⁴

2.1 Political Efforts Since 1997

Besides academic efforts, the European Private Law Conference in Scheveningen in 1997,¹⁵ which was held under the heading 'Towards a European Civil Code', marked the first political move in this area. Following that lead, the European Council's Tampere Conclusions of 1999 also list the aim of greater convergence in the field of private law and name the decision to embark upon a study which would measure the necessity of this.¹⁶ The culminating point was the Commission's Communication¹⁷ on a far-reaching public consultation on the effects of the fragmented legal environment in the area of European

¹¹ Schulte-Nölke 2012, p. 4-5.

¹² Basedow 2012a, p. 28 and 48; Hondius 2011, p. 709.

¹³ See: Hondius 2011, p. 710.

¹⁴ Schulte-Nölke 2012, p. 4-5.

¹⁵ Under the Dutch Presidency.

¹⁶ Schulte-Nölke 2012, p. 4.

¹⁷ COM(2001) 398, 11.07.2001.

Contract Law which already mentioned an optional instrument in the field of contract law.¹⁸ In the light of this consultation and the Action Plan of 2003, concrete steps on the lack of coherence on contract law related issues within the *Aquis* were taken by creating the 2009 ‘Draft Common Frame of Reference’ (DCFR).¹⁹ The DCFR was developed with the help of legal researchers and stakeholders to provide the EU with a tool for a revision and also to serve as a basis for such a future optional instrument.²⁰

A fresh wave of interest came in 2010 with the appointment of Vice President and Justice Commissioner Viviane Reding who took up the work and largely contributed the rapid developments that followed.²¹ Yet another public consultation already took place in 2010, where the Commission’s Green Paper on policy options for progress towards a European Contract Law for consumers and businesses has been introduced.²² Seven policy options were set out ranging from measures resulting in no harmonization to a complete European Civil Code which could be taken up to strengthen the functioning of the Internal Market. The public consultation round²³ on the 2010 Green Paper amounted to a response rate of 320 stakeholders, most of which showed support for option 4 on an Optional Instrument on European Contract Law, solely or in conjunction with a ‘toolbox’ applicable to the sale of goods only.²⁴

Some conditions were named by the interest groups such as a high level of consumer protection. A critical point of concern was visible in the clarity and user-friendliness of future substantive provisions of a European Contract Law. In order to address these concerns, the Commission invited the interest groups to comment on the Feasibility Study which was conducted by a group of Experts,²⁵ to develop a (possible) future instrument on European Contract Law.²⁶ The user-friendliness of the instrument was to be guaranteed

18 By then, all three European institutions (the European Parliament, the Commission and the Council) have made the goal of a European Private Law a point on their agendas. (Schulte-Nölke 2012, p. 4 and 6).

19 von Bar & Eric Clive 2009; COM(2011) 636 final, p. 5.

20 MEMO/11/55, p. 2; Schulte-Nölke 2012, p. 6.

21 See also: Schulte-Nölke 2012, p. 13; Doralt 2011, p. 4.

22 COM(2010) 348 final.

23 Closed on 31.01.2011.

24 COM(2011) 636 final, p. 6.

25 Commission Decision setting up the Expert Group on a Common Frame of Reference in the Area of European contract Law. [Commission Decision], OJ L 105, Brussels: 27.4.2010.

26 IP/11532, p. 1.

by involving a ‘Key Stakeholders Sounding Board’.²⁷ The final Feasibility Study has been published on 3 May 2011.²⁸ Noteworthy, the comments of the stakeholders were only taken into account for the substantive rules before the Proposal was introduced by the Drafting Group, whereby leaving out the *chapeau* rules.²⁹

2.2 Instrumental Preferences

The Commission’s preference among the seven options amounted to the Optional Instrument (option 4) as it would result in only ‘one-off’ costs for traders, in contrast to the larger expenses related to other options such as a Directive or Regulation.³⁰ Also approval and support for a measure which would achieve the establishment and functioning of the Internal Market came from the European Parliament in its Resolution of 08. June 2011.³¹ Another explicit reference to the need to ease transnational contracting and the lowering of costs for both, traders and consumers, is made in the Commission’s Communication ‘Europe 2020’.³² This need could be satisfied by an Optional Instrument such as the Proposed CESL.³³

The results of the consultation round on the Green Paper of 2010 ultimately lead to the Commission’s Proposal for a Regulation on a Common European Sales Law which was introduced already in October 2011.³⁴

2.3 Existing Harmonization Measures

With regard to existing harmonization measures on national contract laws, the area of consumer protection and the various Directives which have been introduced must be

27 The ‘Key Stakeholders Sounding Board’ was made up of practitioners, stakeholders, business representatives, consumers’ associations, courts, notaries, lawyers and professionals which held monthly meetings with the Expert Group. (See: Schulte-Nölke 2012, p. 15). See: COM(2011) 636 final, p. 7.

28 Until July 2011, an informal consultation round was open on the Feasibility Study. See: Hondius 2011, p. 710.

29 Schulte-Nölke 2012, p. 18.

30 Explanatory Memorandum 2011, p.7 et sequ.; See also: Basedow *et al.* 2011, p. 33; Eidenmüller 2012, p. 306.

31 European Parliament Resolution on Policy Options for Progress towards a European Contract Law for Consumers and Businesses. [Resolution], (2011/2013(INI)), Strasbourg: 08.06.2011. See also: MEMO/11/236; IP/11/683, p. 1.

32 Europe 2020: Commission Proposes New Economic Strategy in Europe. [Press Release], IP/10/225, Brussels: 03.03.2010; MEMO/11/55, p. 2.

33 ‘Explanatory Memorandum’ in: Proposal for Regulation of the European Parliament and the Council on a Common European Sales Law. [Proposal], 2011/0284 (COD), Brussels: 11.10.2011, p. 5 et sequ.

34 See *inter alia.*: Schulte-Nölke 2012, p. 16; Clive 2012, p. 121.

named.³⁵ However, these have only covered limited and specified areas and were in the form of minimum harmonization,³⁶ which lead to various degrees of interpretation and the possibility to introduce more stringent requirements by Member States. In addition to that, the recently adopted Consumer Rights Directive³⁷ fully harmonizes particular areas. Also, the E-commerce Directive³⁸ covers certain fields of both consumer contracts (B2C) and business-to-business (B2B) transactions in regard to contracts concluded by electronic means.³⁹ For B2B transactions only, the EU has merely regulated the field of late payments, however, the international arena also provides for uniform contract law rules under the Vienna Sales Convention (CISG)⁴⁰ which applies by default to B2B contracts unless parties choose to opt-out. Nevertheless, several difficulties arise in the context of the CISG.⁴¹ There is a lack of a mechanism for uniform interpretation, several areas relating to contract law are omitted, as well as the fact that not all EU Member States have ratified it.⁴²

Having only specific and limited areas within the field of contract law harmonized by Directives necessarily leads to the legal environment in that field to be highly fragmented and constitute a 'maze' of applicable laws, making the engagement into transnational trade particularly complex for small and medium sized enterprises (SMEs).⁴³

35 Whereas the Directives focused on consumer protection measures, the European Parliament (EP) has pursued the objective of harmonizing not only contract law but also other areas of private law (i.e. property law). This is evident from a number of resolutions passed since 1989. (See: Schulte-Nölke 2012, p. 3; Clive 2012, p. 121).

36 These measures included matters such as door-step selling, consumer credit, package travel, unfair terms in consumer contracts, timeshare and investor compensation as well as certain aspects on the sale of consumer goods and associated guarantees. (Schulte-Nölke 2012, p. 2).

37 Directive 2011/83/EU. It is to be transposed into national laws by 13. June 2014.

38 Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, OJ L 178, 17.07.2000.

39 Explanatory Memorandum 2011, p. 5.

40 United Nations Convention on Contracts for the International Sale of Goods. [CISG], 1489 U.N.T.S. 3, 19. I.L.M. 671, Vienna: 11.04.1980.

41 1980 Vienna Sales Convention (CISG).

42 The United Kingdom, Ireland, Malta and Portugal have not ratified the CISG. (See: <http://www.cisg.law.pace.edu/cisg/countries/cntries.html> (last visited: 22.06.2013)).

43 See inter alia: Doralt 2011, p. 2.

3 Current Proposal for a CESL – Cross-Border Trade Issues and Prime Objectives

3.1 Basic Structure

The 2011 Proposal for a Common European Sales Law has a unique structure in the sense that it contains a rather short Regulation (counting only 16 Articles) which serves a basis for Annex I which provides for the substantive rules of contract (the 'CESL'). The Regulation provides for the so called *chapeau* rules which define the scopes of application. Art. 1 of the Proposed Regulation sets out the main purpose of the instrument and clarifies the structure of it. Furthermore, it states a short introduction to the subject matter and scope of application⁴⁴ and underlines the overall aim of the instrument to improve the functioning of the Internal Market of the European Union and explains how this instrument would contribute to it.⁴⁵

Article 3 of the Proposed Regulation provides for the optionality of the instrument (opt-in) subject to the limitations of the scopes to be found in Art. 4 (territorial), Art. 5 and 6 (material) and Art. 7 (personal). The CESL is intended to be a choice for cross-border transactions⁴⁶ in B2C and B2B contracts on the sale of goods and provision of digital content and related services⁴⁷, provided that in B2B transactions one of the parties is an SME.⁴⁸ Furthermore, account shall be taken of the possibility of an extended personal and territorial scope under Art. 13.⁴⁹ Having the Proposal based on an opt-in model provides for a less intrusive measure in order to calm the nerves of some Member States who fear the 'creep' of a European Civil Code.⁵⁰

Before the Proposal was published, three models were discussed. The first option was a '28th regime'⁵¹ which would amount to a separate legal system next to the current 28

44 Wendehorst 2012, p. 9.

45 Wendehorst 2012, p. 10.

46 Art. 4(1) of the Proposed Regulation.

47 Art. 5 of the Proposed Regulation.

48 Art. 7 of the Proposed Regulation.

49 Art. 13(a) of the Proposal gives the Member States the possibility to extend the territorial application of the CESL to include also domestic transactions and Art. 13(b) provides for an option to the Member States to make it applicable also to two large traders.

50 Wendehorst 2012, p. 30-31.

51 At the time the term of a '28th regime' emerged, the EU counted 27 Member States. As of July 1st, 2013 the Republic of Croatia has joined the EU. In that sense now reference under that model would appropriately be called the '29th regime'.

legal orders of the Member States which could have been opted for by virtue of Art. 3 of Rome I Regulation.⁵² Nevertheless, it would have been limited by virtue of that Regulation's Art. 3(3) on the freedom of choice for domestic transactions and Art. 9(3) on mandatory provisions. A '28th regime' would not have achieved the benefits sought for, as Art. 6(2) of the Rome I Regulation would also have subjected the choice of law to the mandatory provisions of the habitual residence state of the consumer.⁵³

The second model of a self-standing legal order where a choice of it would have led to a derogation from the Rome I Regulation. This option was not favoured due to uncertainty on the appropriate legal basis, the possibility of traders of the so-called 'cherry-picking' of provisions under Art. 6(2) of that Regulation and the risk of parties not being aware of the necessity to make a second choice of law for the areas not covered by the instrument, if the default regime, applicable under Art. 4 of the Rome I Regulation would wanted to be avoided.⁵⁴

For all these reasons, the '2nd regime' model was chosen for the optional instrument which provides for the Proposal being envisaged to operate next to national contract laws (similar to the CISG Art. 1(1)(b)).⁵⁵

The material scope of the Proposal is set out in Art. 5 of the Regulation, save the exceptions mentioned in Art. 6. The envisaged CESL is to be available for sales contracts (pursuant to the definitions provided in Art. 2), contracts for the supply of digital content (irrespective of whether or not supplied on a tangible medium or contracted for in exchange for a non-monetary compensation) and related service contracts (regardless of agreeing on a separate compensation for it or not).⁵⁶

In terms of the scopes of application, a now common provision on the evaluation and review of the instrument is included in Art. 15 of the Proposed Regulation. It provides for the obligation of Member States to supply the Commission with information on the application and the acceptance of the CESL, four years after the application of the Regulation.⁵⁷ Furthermore, subsection 2 obliges the Commission to draft a report on the operation of the Proposed Regulation and in particular on the necessity to extend the

52 Regulation (EC) No 593/2008 on the law applicable to contractual obligations, OJ L 177, 04.07.2008.

53 Wendehorst 2012, p. 31.

54 Wendehorst 2012, p. 32.

55 *Ibid.*

56 Art. 5 of the Proposed Regulation.

57 Art. 15(1) of the Proposed Regulation.

scope of application to all B2B transactions. *Inter alia* technological developments and changes in the *Aquis* shall also form the basis of the report.⁵⁸

3.2 Aims and Objectives Pursued by the European Commission

The harmonization of contract law matters by Directives has been long justified upon the need for consumer protection. This is due to the evident link of it with the Internal Market, such as enhancing consumer confidence and incentivising the entering into cross-border transactions. In turn, consumer confidence is linked to conflict-of-law rules and the necessity of consumers to be able to rely on a uniform, minimum consumer protection, leading to the justification of using Directives to that manner.⁵⁹

However, as familiarity with the available rights under Rome I Regulation (especially Art. 6) is not sufficient and consumer confidence was not enhanced to such a degree as envisaged, the way forward was to set aside minimum harmonization measures by Directives and move towards a (high level) uniform protection which could be achieved by means of a Regulation.⁶⁰

The lack of confidence in EU law is just as well an issue for traders as it is for consumers,⁶¹ as Brussels I Regulation⁶² sets the forum to be the one in the state of habitual residence of the consumer and Rome I (Art. 6, Reg (EC) No 593/2008) subjects the applicable law to mandatory rules of the consumer's state of habitual residence.⁶³

3.2.1 Cross-border trade issues in B2B contracts

The Explanatory Memorandum, which is to be found in the very first part of the Proposal of the Commission, explicitly sets out contract law difference between Member States to be one of the major obstacles to the engagement in cross-border trade by consumers and traders.⁶⁴ The Commission stresses that the lack of expansion of businesses to cross-border regions, especially in the case of SMEs, stems from the complexity and costs which have to be

58 Wendehorst 2012, p. 82.

59 Wendehorst 2012, p. 10.

60 Twigg-Flesner 2011, p. 240; Wendehorst 2012, p. 11.

61 Similar barriers to trade can be observed for both consumers and traders, i.e. language, cultural differences and insufficient confidence in the enforcement of foreign law.

62 Art. 16 of Regulation (EC) No 44/2001.

63 Wendehorst 2012, p. 11.

64 Other barriers to trade include *inter alia* linguistic differences, culture, tax regulations and administrative requirements.

incurred when engaging in transnational dealings. In particular, the adaptations necessary due to various national requirements make such transactions less attractive by being more intricate and costly, leading many traders to engage only in domestic sales of goods.⁶⁵

The aspect of higher costs largely relates to the necessity of getting legal advice on the mandatory national provisions on contractual obligations and negotiation costs related to this.⁶⁶ The Commission specifically emphasises the disadvantageous position that SMEs find themselves in, due to the costs of taking up cross-border dealings making up a larger part of the overall turnover, compared to large enterprises.⁶⁷ They are often disproportionately high and may subvert the value of the transaction itself. Thus, the larger the number of countries trade is directed to by businesses, the more significant are differences in contract laws to such traders. Therefore, a specific focus is laid upon the fostering and strengthening of the position of SMEs on the Internal Market, which has been a long standing objective of the EU.⁶⁸

Legal complexity is another component of the issue with varying national contract laws between Member States. The necessity to familiarize and use a foreign national law to expand a business towards that country discourages many parties from engaging in cross-border trade. The complexity and difficulty is even higher in cases where the national law of the targeted foreign market belongs to another legal family, i.e. there are particularly large differences in approaches between common law and civil law systems.⁶⁹

An overall result of the lack of active engagement in cross-border trade by many enterprises (as over 90% of all enterprises in the EU are SMEs)⁷⁰ has a significantly negative impact on the entire Internal Market. Limited competition within the EU's Single Market results in tens of billions of Euros being foregone each year and the missing out on opportunities of transnational trade has a considerable negative effect also on the

65 Explanatory Memorandum 2011, p. 2.

66 Other cost raising issues include the setting up of complaint schemes, the establishment of a brand reputation abroad and the development of a distribution chain for transnational sales. (See: Basedow 2012a, p. 35).

67 See inter alia: Piers & Vanleenhofen 2012, p. 3.

68 See for e.g.: Report for the Commission to the European Parliament and the Council on the Projects of the Public Health Programme Committee in 2003-2004. [Commission Communication], COM(2005) 511final, Brussels: 24.10.2005; Piers & Vanleenhofen 2012, p. 5; Doralt 2011, p. 3.

69 Explanatory Memorandum 2011, p. 3.

70 MEMO/11/55, p. 1.

500 million consumers in the EU.⁷¹ The reduced competition among European traders and fewer imports necessarily results in a limited choice of goods within a national market and thus, less consumer choice, culminating in higher prices.

3.2.2 Cross-border trade issues in B2C contracts

However, not only traders are discouraged to engage in cross-border trade, the same is true for consumers, although for different reasons. The awareness of private parties of the advantages of shopping in another Member State is not actually absent, however, the uncertainty as to consumer protection and rights in another country disincentivizes such engagement in cross-border shopping.

A major concern of consumers is the availability of remedies in cases a good is not in conformity with the contract or the trader does not perform his obligations properly. Another example of why consumers often tend to limit their purchases to their domestic market lies in the fact that while making use of e-commerce (i.e. online purchasing portals) so as to find the best prices or offers, consumers are often barred from placing an order through the trader's refusal. The basis of such a rejection to sell or deliver a good is *inter alia* based on contract law considerations of traders.⁷²

3.2.3 Prime objectives of the Commission

For all the reasons outlined above, the Commission's overall aim of enhancing the functioning of the Internal Market and fostering cross-border trade boils down to taking away the complexity of diversity and lowering transaction costs through a uniform set of rules and eliminating the need for legal advice on each foreign national system.⁷³ This in turn shall particularly benefit SMEs which have been found to be especially disadvantaged by the current diversity of contract law regimes.⁷⁴ For consumers, certainty as to consumer rights would be facilitated through the use of uniform consumer protection rules, if opted

71 See also: COM(2011) 636 final, p. 2-3.

72 Again, such considerations involve especially mandatory provisions of the foreign country (i.e. consumer protection rules) and the necessity to familiarize oneself with the foreign national law and adapt one's terms and conditions accordingly which result in high costs for traders. See also: Explanatory Memorandum 2011, p. 3-4.

73 See *inter alia*: Piers & Vanleenhove 2012, p. 7; European Law Institute 2012, p. 11; Eidenmüller 2012, p. 304.

74 It is claimed by the Commission in the Explanatory Memorandum that the Proposal is in line with the EU's policy of aiding SMEs in making use and benefitting from the Internal Market.

for the CESL,⁷⁵ and in addition to that, a less costly and complex legal environment would in effect lead to greater competition between traders which would result in a greater variety of goods and lower prices.⁷⁶

4 *Ratione Personae* – Limitations and Consequences

The personal scope of the Proposal is to be found in Art. 7 of the Proposed Regulation setting out the necessary criteria for the availability of the CESL for a choice of application to a contractual relationship.⁷⁷

The Proposed CESL, as it stands now, is only available for contractual relationships where at least one of the parties is a ‘trader’ in according to Art. 7(1) and furthermore, the ‘seller’ of the goods or digital content must be a trader⁷⁸ if the other party is a consumer (B2C). The CESL Proposal itself makes constant differentiation between situations where the customer is a consumer and transactions where the customer is a trader in the sense of Art. 2 of the Proposed Regulation. As there is nothing in between, it is apparent that a loophole in the provisions exists as parties who are neither consumers nor traders in the strict sense, fall outside the scope of personal application, i.e. non-profit organizations or higher education institutions.⁷⁹

However, one significant limitation is imposed for cases where both parties are traders, for the proposed CESL is only available for such B2B transactions, where one of the traders is to be qualified as a SME.⁸⁰ Subsection two furthermore, sets out the criteria for determining a SME for the purposes of the Proposal. The consequences flowing from this limitation are now analysed to justify the necessity of abandoning it.

4.1 Definition of an SME – Characterization Requirements

The opting-into the CESL, in B2B transactions, is largely dependent on the determination

75 It must be noted however, that de facto choice of the applicable law in consumer contracts will usually be limited to the trader, for the consumer may encounter a ‘take it or leave it’ approach from the side of the trader.

76 See also: MEMO/11/55, p. 1; IP/11/1175, p. 1-2.

77 Lando 2011, p. 720; Wendehorst 2012, p. 53.

78 In the sense of Art. 2 of the Proposed Regulation.

79 Wendehorst 2012, p. 19.

80 Art. 7(1) of the Proposed Regulation.

of the parties characteristics and the necessity of one of them to be regarded as an SME. The complex and detailed requirements which need to be fulfilled are set out below.

In order to be classified as an SME, the party in question must satisfy the criteria below cumulatively which are based upon the Commission Recommendation No 2003/361/EC on the definition of micro, small and medium-sized enterprises.⁸¹

A business has to have less than 250 employees and the annual turnover may not exceed 50 million Euros or, the total amount on the annual balance sheet may not exceed 43 million Euros in order to be characterized as an SME. The calculation of the annual turnover excludes all indirect taxes (including Value Added Tax (VAT)).⁸² For SMEs habitually resident in one of the Member States not carrying the Euro or third states, the equivalent amounts will be determinative.⁸³

Taking Art. 5 of the Recommendation as a parameter, the headcount is to be regarded as the number of annual work units (AWU). This can be the amount of persons working within the enterprise, or on its behalf, in the financial year in question (part-time workers are calculated as a fraction of the AWU). Persons who for that purpose constitute staff include: (a) employees, (b) subordinated workers (deemed employees under national law) and (c) owner-managers, (d) partners who are engaging in the activity of the enterprise on a regular basis for financial compensation.⁸⁴

The inclusion of the annual balance sheet as another criterion of determination has been regarded as necessary by the Commission already in the Recommendation, for businesses in the trade and distribution sector have usually higher turnovers than the manufacturing traders, simply by the character of the business. Thus, such an objective criterion reflecting the overall wealth of the enterprise, the annual balance sheet ceiling of 43 million Euros was added to the total turnover measure.⁸⁵

The relevant time period of assessment relates to the annually calculated accounting period latest approved.⁸⁶ In regard to changes within an accounting period to the previous

81 See: Recital 21 of the Proposed Regulation (COM(2011) 635 final).

82 Wendehorst 2012, p. 56.

83 Art. 7(2) Proposed Regulation on CESL. Wendehorst raises a concern regarding exchange currency fluctuations within Europe (See: *Ibid.*).

84 Persons involved in vocational training are not included and any maternity or parental leaves do not have any effect on the AWU. (See: SME User Guide 2005 p.15; Wendehorst 2012, p. 57).

85 Wendehorst 2012, p. 54.

86 *Ibid.*

one, the status of an SME will not be lost by exceeding the ceilings, unless this is the case for two consecutive accounting periods. Newly established businesses will be assessed upon an estimation of the headcount and financial ceilings for the relevant financial year, subject to good faith.⁸⁷

The fact, that there is no explicit reference to the Recommendation No 2003/361/EC besides in the recitals, makes it ambiguous as how it is to be interpreted, either as binding or merely as a guideline.⁸⁸

4.1.1 SME requirements - Issues Related to Sub-Entities

An obvious difficulty arises with the definition of businesses which consist of a number of sub-entities.⁸⁹ Taking the Commission Recommendation as a guideline, the key notion for determination is the 'autonomous enterprise'⁹⁰, which shall be neither a 'linked' not a 'partner' enterprise.

To be regarded as the former ('linked enterprise'), a business must show one of these relationships: (a) a majority shareholding of voting rights in another enterprise, (b) the right to remove or appoint the majority of the bodies (administrative, supervisory or management) of another enterprise, (c) a dominant influence by way of contract, articles of association or memorandum of another enterprise or, (d) being a shareholder in another enterprise and controlling alone the majority of the shareholder's or member's voting rights of that enterprise, pursuant to an agreement with the shareholders or members of that enterprise. It must be noted, that any such relationship by virtue of natural persons acting jointly also falls under the definition of a 'linked enterprise' if their activity relates to substantially the same market or any neighbouring one.

The later kind ('partner enterprises') are defined as those which do not show any of the above mentioned relationships but rather, the enterprise in question holds (exclusively or jointly with other linked enterprises) a minimum of 25% of the capital or voting rights of another business. An exception to being considered a partner enterprise is available for a number of privileged investors for whom the minimum percentage does not count as long as the criteria for linked enterprises are not fulfilled by them. Such privileged investors may be i.e. universities, regional development funds or autonomous local authorities with fewer than 5,000 inhabitants and an annual budget ceiling of 10 million Euros.

87 Wendehorst 2012, p. 55.

88 Wendehorst 2012, p. 54.

89 See: European Law Institute 2012, p. 18.

90 See: Art. 3(1) Commission Recommendation 2003/361/EC.

Another limitation relates to the public sector involvement, where a definition as an SME will be denied in cases where a minimum of 25% of the voting rights or capital is held (whether solely or jointly, directly or indirectly) by one or more public bodies, not being privileged investors.⁹¹

4.2 Extension Possibility to All B2B Transactions (Art. 13(b))

The Proposed CESL Regulation provides for the possibility for Member States to expand the scope of personal application to include all transactions between traders (B2B) (Art. 13(b) of the Proposed Regulation). This option tries to strike a balance in regard to the decision of limiting the personal scope for contracts between traders to situations, where at least one of the parties is an SME⁹², for the sake of political acceptance, subsidiarity and proportionality.⁹³ As will be argued later on, the justification of the limitation on the grounds of subsidiarity and proportionality is unfounded.

The incentive for Member States to actually make use of the possibility under Art. 13(b) is most probably not the desire to make it available also to two large enterprises. Rather, the motivation lies in trying to eliminate the embarrassment of domestic traders connected to the need to disclose the headcount and financials (annual turnovers or balance sheets pursuant to Art. 7) which makes the choice of the CESL very unattractive.⁹⁴

In contrast to the result stemming from extending the territorial scope under Art. 13(a), choosing to make it applicable to all B2B transactions enables all traders from other Member State to make use of the CESL even if the requirement of Art. 7, one being an SME, is not present. The applicability of the CESL for two large businesses is available by choosing the law of the Member State which has granted the extended personal scope under Art. 13(b), provided that the Member State in question does not make an artificial distinction between domestic and foreign traders.⁹⁵

In example where two large traders, one habitually resident in Germany and the other in France, want to opt for the CESL to be applicable to their contract (assuming that both Germany and France have not opted for the extension of the personal scope under Art. 13(b)), they simply are able to make a choice of law, under the Rome I Regulation, for i.e. Maltese law (assuming Malta made use of the option for the extended personal scope of application).⁹⁶

⁹¹ Wendehorst 2012, p. 55.

⁹² In the sense of Art. 7(2) of the Proposed Regulation.

⁹³ See: Basedow 2011 *et al.*, p. 36.

⁹⁴ Wendehorst 2012, p. 80.

⁹⁵ See: Basedow 2012a, p. 41.

⁹⁶ Wendehorst 2012, p. 80.

4.3 Consequence of the Limited Personal Scope

Following the above analysis of the necessary requirements, which need to be fulfilled in B2B transactions to be able to opt-for the application of the CESL to the sale of goods contract, it is evident that the limited personal scope makes the instrument far too complex. This also stems from the fact, that businesses and also legal advisors do not necessarily know whether a particular party satisfies all criteria to be regarded as a SME.⁹⁷

Although there is no explicit restriction with regards to parties who are neither traders nor consumers in the strict sense, the Proposal is nevertheless drafted in such a way as to make non-profit organizations fall outside the personal scope of application.⁹⁸ This leads to an unnecessary degree of difficulty.⁹⁹

The determination of the other party's status to have certainty as to the availability of the CESL in effect makes the Proposal highly unattractive.¹⁰⁰ This especially applies to 'borderline' cases where it is not clear whether a particular enterprise falls within the definition of an SME as provided for in the Proposal¹⁰¹ or in cases where businesses consists of a number of sub-entities and the necessity of establishing whether they are to be regarded as 'linked' or 'partner' enterprises. Mass cross-border contracts create another almost insurmountable hurdle to a definition in each case.¹⁰² Besides the practical difficulties that businesses encounter, it also leads to embarrassment of enterprises by having to provide the other party not only with a headcount but also with the annual turnover or balance sheet.¹⁰³

Another issue arises with regard to mistakes in classification of SMEs. Recommendation 2003/361/EC provides for the possibility to make a 'solemn declaration' certifying specific characteristics under Art. 3(5), even where the capital is not determinable at the very moment. A *bona fide* declaration of not being owned by a minimum of 25% by another

97 Basedow 2012a, p. 40.

98 See also: European Law Institute 2012, p. 19.

99 See also: Zoll 2012, p. 23.

100 See also: Zoll 2012, p. 10.

101 Wagner 2011, p. 10.

102 See also: European Law Institute 2012, p. 18.

103 See also: Wendehorst 2012, p. 57.

enterprise or being a linked enterprise is sufficient.¹⁰⁴ As the proposed Regulation does not make an explicit reference as to the applicability or binding power of the Recommendation 2003/361/EC it is somewhat unclear if such a declaration would also be valid for the purposes of the Proposed CESL and if reliance would in fact be granted, which formal criteria would have to be satisfied.¹⁰⁵

Although there is a possibility for Member States, under Art. 13(b) of the Proposed Regulation, to extend the scope to all B2B transactions, this solution is not ideal. Not only does it make the choice of the CESL more complex, but also this possibility is unnecessary. If one Member State opts-for making use of Art. 13(b), all large traders can make use of the CESL by choosing the law of that Member State as the applicable law to the contract under the conflict-of-law rules.

However, the desirability of this is not clear as there are certain areas not being covered by the CESL. Those areas are then necessarily governed by the national law of that particular Member State which fills in, as a kind of 'background' law, those rules on parts of contract law not regulated in the Proposal. This might again lead to uncertainty and unattractiveness as businesses have to find out what the law of that Member State provides for in these specific areas and what implications it has on their contractual relationships.¹⁰⁶

4.4 Justification Attempts

One of the justifications for limiting the personal scope that has been put forward is the 'necessity' to limit it to SMEs to defend the applicability of the Proposal also to B2B contracts,¹⁰⁷ for it is widely accepted that the fortification of SMEs is one of the policy areas of the EU within the Internal Market.¹⁰⁸ Furthermore, it has been claimed by the Commission that no demonstrable need for action for B2B transaction regulation has been found.¹⁰⁹ Also, the limited scope was reasoned to be necessary to ensure the legal basis of the instrument being Art. 114 of the Treaty on the Functioning of the European Union (TFEU).¹¹⁰

¹⁰⁴ Wendehorst 2012, p. 56.

¹⁰⁵ Wendehorst 2012, p. 57.

¹⁰⁶ See: Doralt 2011, p. 25; Basedow 2012a, p. 40-41.

¹⁰⁷ See also: COM(2011) 63 final, p. 2 and 8.

¹⁰⁸ Wendehorst 2012, p. 53; *supra* at 53.

¹⁰⁹ Explanatory Memorandum 2011, p. 10; COM(2011) 636 final, p. 8.

¹¹⁰ However, the debate on the appropriateness of the legal basis raises much more fundamental issues which will be elaborated upon in Section 5. (See also: Wendehorst 2012, p. 57).

The justification based on the legal basis argument is rather weak as over 90% of all traders in the EU in fact fall within the definition of an SME in any case.¹¹¹ It would be sufficient to declare the objective of protecting SMEs in Art.1 of the proposed Regulation.¹¹² It must further be emphasized that according to well established EU case law, the principles of subsidiarity and proportionality, do not require, nor even *allow* the restriction of legislative measures which pursue a valid aim (such as the furthering of the Internal Market) in a way which would seriously call into question its suitability to achieve the objectives.¹¹³ Having to characterize the parties before the choice for the CESL could be made does *de facto* amount to the reduction of the suitability to attain the goals of the Commission.

4.5 Proposal for Necessary Changes in the Personal Scope

For all of the negative consequences mentioned above it is clear that having restrictions onto the personal scope of application of the Proposed Common European Sales Law is far from ideal. Going back to the very aims of the Commission of taking away the complexity of transnational contracting and enhancing legal certainty to foster the cross-border sale of goods, an evident lack of achievement of them is to be noted. It has already been outlined how complex the characterization of falling within the definition of an SME for the purposes of the Proposed CESL is.

The same is true for the apparent loophole of not including juridical persons which are not involved in commercial activities such as universities. This is especially problematic in e-commerce scenarios and for large traders who would like to opt for the CESL as they would have the burden of proof concerning the availability of the CESL as a choice.¹¹⁴ It can therefore, not be claimed that by limiting the personal scope the instrument achieves simplification or legal certainty.¹¹⁵

111 The issue of the appropriate legal base for the optional instrument is another sensitive and highly debated area. Many scholars and also governments claim that Art. 114 TFEU is not the appropriate legal basis and that Art. 352 TFEU should rather be opted for. Especially the issue in how far 'approximation' of national laws is achieved by the Proposal and the consequences of that analysis are argued in different ways, splitting academia. For a more in depth discussion on the appropriateness of the legal base see inter alia: Micklitz & Reich 2012, p. 4 et sequ.; Twigg-Flesner 2012 p. 11 et sequ.; Low 2012, p. 134 et sequ.

112 European Law Institute 2012, p. 19.

113 *Ibid.*; Wendehorst 2012, p. 57.

114 See: Twigg-Flesner 2011, p. 30.

115 See also: Twigg-Flesner 2011, p. 254.

Striving towards the enhancement of the functioning of the Internal Market depends on the attractiveness of the Proposal to businesses. Therefore, it is crucial to abandon the limitation of one party having to be an SME in business-to-business transactions to be able to choose the CESL. As has been shown, there is in fact a practical need for the extension to all B2B transactions and, as this restriction calls into question the suitability of the achievement of the aims of the Commission, the justifications based on the proportionality and subsidiarity¹¹⁶ principles are invalid.

The extension of the personal scope to include all B2B and B2C transactions should not be too difficult as most of the provisions of the Proposed CESL are formulated in a rather general manner and would require only small corrections.¹¹⁷

Leaving the Proposal as it stands now, with the personal scope being narrowed down, risks the success of the Proposal and therefore could lead to all the work on a CESL to get lost in the shuffle.

5 *Ratione Loci* – Limitations and Consequences

The limited applicability of the Proposed CESL to cross-border transactions only, is claimed to be appropriate as this is the area where regulation of the Internal Market is needed most and it is the 'least' intrusive means.¹¹⁸ However, the following sections by way of analysis, of the consequences of making the CESL only applicable to cross-border transactions, will prove the undesirability of such a limitation.

5.1 Current Territorial Scope

The Proposal for a Common European Sales law, as it stands now, is only applicable to sale of goods transactions which have a cross-border element and satisfy the minimum EU or European Economic Area (EEA) link.¹¹⁹ For that, Art. 4 of the Proposed Regulation sets out the territorial scope of the instrument as well as it provides for a definition of what

¹¹⁶ See: COM(2011) 636 final, p. 9.

¹¹⁷ The only area where a larger amount of changes would have to be made to incorporate all B2B and B2C transactions relates to the area of non-performance and defective performance in Part IV of the CESL. However, as it has been already argued by the author elsewhere, a fundamental revision of that part is in any case necessary. (See also: Zoll 2012, p. 23).

¹¹⁸ See: COM(2011) 636 final, p. 9; COM(2011) 635 final, p. 4.

¹¹⁹ See also: Lando 2011, p. 721.

constitutes a cross-border scenario and defining the minimum EU/ EEA links.¹²⁰

Thus, the availability of the CESL mainly depends on having a 'cross-border element'. For B2B transactions this requirement is fulfilled when both traders are 'habitually resident' in different countries and one of those countries is a Member State of the EU. The habitual residence of the traders is to be regarded as being the 'central place of administration'.¹²¹ In consumer contracts, the determination of a cross-border element is made upon the habitual residence or address provided by the consumer being in another Member State than the trader's habitual residence. The address may refer to the billing address, the delivery address or the residence address of the consumer.

5.2 Determination of Cross-Border Scenarios

In accordance with Art. 4(1), the optional instrument is only applicable to cross-border transactions. A distinction is made between contracts between traders and consumer contracts. The former is set out in subsection 2 of this Article where a cross-border relationship exist where the 'habitual residences' of the traders are located in two different countries of which one must be a Member State of the EU.¹²² The determination of the cross-border element is solely to be based upon the time of agreement on the usage of the proposed CESL and any future changes to places of residence do not have an impact on the validity of the cross-border requirement.¹²³

The Green Paper on the Review of the Consumer *Aquis*¹²⁴ provided for three options for the measure to be adopted: cross-border and domestic, only cross-border and limited to distance selling for both domestic and cross-border. The Commission favoured the first option due to the difficulty of defining what would constitute a 'cross-border' scenario, as well as it would lead to legal fragmentation which is contrary to the objective pursued.¹²⁵

The *Aquis* Group has also voiced its support for the abandonment of the cross-border limitation as they perceive the establishment and verification of the place of residence of a consumer on a web-based platform as being technically to difficult. This follows the

120 This article is similar to Art. 1 of the CISG. However, contrasting to the CISG, the Proposal also extends to consumer contracts which adds another dimension to it. (See: Wendehorst 2012, p. 53).

121 See: Micklitz & Reich 2012, p. 15.

122 Wendehorst 2012, p. 35.

123 Wendehorst 2012, p. 38.

124 Green Paper on the Review of the Consumer *Aquis*. [Green Paper], COM(2006) 744 final, Brussels: 08.02.2007.

125 Twigg-Flesner 2012, p. 30.

reasoning that the billing address may vary from the delivery address (especially often to be found in border regions) and in order to discern the cross-border element, the disclosure of the place of residence of the consumer must be required, before the applicable terms of contract could be determined.¹²⁶

Despite this, the Proposal limits the territorial application to cross-border transactions only and the Drafters did not take into account the concerns which have been voiced as to the difficulty of determination.

5.2.1 The Concept of ‘Habitual Residence’

The term ‘habitual residence’ is used for the determination of the cross-border element for both, transactions between traders as well as consumer contracts. This is a well known concept in B2B relations and can also be found in Art. 19 of the Rome I Regulation which makes a reference to Art. 22 of the Brussels I Regulation defining the central place of administration as being the trader’s ‘habitual residence’.¹²⁷ Nevertheless, it is used in a highly inconsistent way in Annex I where reference is often made to the ‘place of business’ rather than habitual residence of the trader.¹²⁸

5.2.1.1 B2B transactions

The crucial point for transactions between traders can be found in subsection 5 of Art. 4 of the Proposed Regulation: ‘Where the contract is concluded in the course of the operations of a branch, agency or any other establishment of a trader, the place where the branch, agency or other establishment is located shall be treated as the place of the trader’s habitual residence.’¹²⁹ It must be noted that the Proposed Regulation lacks a definition of what constitutes a ‘course of operation’ in the meaning of Art. 4(5). In general, common aspects of determination include the address provided on the preparatory documents and contract, the place of offer and acceptance as well as the place of negotiations of the contractual terms, the place of employment of the negotiation parties, the place of performance of the contractual obligation and the currency used within the contract.¹³⁰

126 Dannemann ed. 2011 [Oxford University Comparative Law Forum]; Twigg-Flesner 2012, p. 54.

127 See: Micklitz & Reich 2012, p. 15.

128 See for e.g.: Arts. 10(4)(b), 93, 102, 125 and 144 of Annex I of the CESL Proposal. Also: Wendehorst 2012, p. 35.

129 Similar provisions can be found in the Rome I Regulation (Art. 19(1)) and Rome II Regulation (Art. 23(1)). See also: Wendehorst 2012, p. 36.

130 *Ibid.*

If there is only one establishment, the location of it determines the ‘habitual residence’ of the trader. Subsection 4 of Art. 4 provides for the situation where an allocation of the transaction to a branch, agency or other establishment is not possible. In such transactions, the ‘habitual residence’ of the trader, who is a natural person, is to be regarded as corresponding to the ‘principle place of business’. In situations where the trader is a company or other corporate or unincorporated body, the ‘habitual residence’ will be defined as the ‘central place of administration’.¹³¹ This distinction seems rather unnecessary, as the principle place of business will usually correspond to the place of central administration.¹³²

As Art. 4(1) requires the habitual residence of the traders to be two different countries, of which one must be a Member State, it is crucial to determine the relationship between subsections 4 and 5 for situations where the principle place of business or central administration coincide in one Member State, but the contract may have been concluded ‘in the course of operations’ through a one party’s foreign branch, agency or other establishment.¹³³

5.2.1.2 Consumer Contracts

The definition of ‘cross-border’ contracts is a different one for consumer contracts, as the Proposal will be available in cases where the address indicated by the consumer, the delivery address or the billing address are located in a country than the habitual residence country of the trader and one of those countries is a Member State (Art. 4(3)).¹³⁴

In contrast to transactions between traders, consumer contracts do not require the habitual residence of both contracting parties to be located in two different countries. Pursuant to subsection 3 of Art. 4, the cross-border requirement is already satisfied if one of the possible addresses to be provided is located in another country than the trader’s habitual residence. It must be noted, that there is no requirement imposed as to the truthfulness of the indication of address. It may well be, that the consumer indicates another delivery address simply to be able to use the proposed CESL.¹³⁵

131 Art. 4(4) of the Proposed Regulation. Article 19(1) Rome I and Art. 23(2) Rome II Regulation provide for the same provisions. (See: *Ibid.*).

132 See: Basedow 2012a, p. 30. For a detailed commentary on the distinction and reference to the Bundesgerichtshof defining ‘place of business’ under Art. 1 ULIS as the ‘center of the business activity directed to the participation in commerce’ (BGH 2 June 1982, NJW 1982, 2730 at 2731) see: Magnus 2005, Art. 1 CISG, paras. 62 – 69.

133 Wendehorst 2012, p. 36.

134 Wendehorst 2012, p. 37.

135 *Ibid.*

For instance if a Dutch trader desires to enter into a contractual relationship with a Dutch consumer under the proposed CESL, he will be able to do so if the Dutch consumer indicates his Belgian holiday house as the billing address, while delivery of the good in question will be made to the residence in the Netherlands.

5.2.2 The Minimum EU Link Requirement

The Proposed Regulation for a CESL should be read as being applicable to all EU Member States as well as to the European Economic Area (EEA).¹³⁶ Whether it is the seller or the buyer having the habitual residence in the Member State is not of relevance and therefore, sales from a seller of a third country into the EU or EEA is just as possible as sales exports to third countries.¹³⁷

The Commission claims in the Explanatory Memorandum that the Proposal is in line with the EU's international trade policy by allowing parties from third countries to opt-for the CESL under the condition that the other contracting party is established in one of the Member States.¹³⁸

However, cases where both traders are not habitually resident within the EU, the opting-into the CESL are denied. Therefore, i.e. a Swiss trader is under the current Proposal not able to choose the CESL for a transaction with a Japanese trader.

5.3 Extension Possibility to Purely Domestic Situations (Art. 13(a))

Article 4 of the Proposed Regulation is to be read in conjunction with Art. 13(a) as it provides for the possibility of extending the territorial scope of application to encompass also domestic transactions if a Member States would choose to do so.¹³⁹ In B2B transactions¹⁴⁰ this relates to scenarios where both traders have their habitual residence in the same jurisdiction and in B2C contracts to situations where the indicated address of the consumer and the habitual residence of the trader coincide in one country.¹⁴¹

Contrary to the effect of the optional extension of the personal scope under Art. 13(b),

¹³⁶ See: COM(2011) 635 final, p. 10.

¹³⁷ European Law Institute 2012, p. 20; Wendehorst 2012, p. 37.

¹³⁸ Explanatory Memorandum 2011, p. 7; COM(2011) 636 final, p. 8.

¹³⁹ The Proposed Regulation seems to be partly ambiguous whether it regards the necessity of a cross-border requirement as to being inextricably linked, as is suggested in Art. 4, or whether the territorial scope can be separated from the cross-border aspect, as is hinted at in Art. 3. (See: Wendehorst 2012, p. 35).

¹⁴⁰ Subject to the limitation imposed by Art. 7 of the Proposed Regulation.

¹⁴¹ Wendehorst 2012, p. 79.

the possibility of gaining the right to use the CESL by two parties based in one jurisdiction by simply choosing the law¹⁴² of a Member State who made use of the extension of the territorial scope is *not* available. For instance two German traders (assuming that Germany has not made use of Art.13(a)) are *not* allowed to make use of the CESL by choosing Maltese law to govern the contract, even though Malta (assumingly) has made use of the option and extended the territorial scope of application to include purely domestic transactions. Only (in this case) two habitually resident Maltese traders may opt for the CESL for purely domestic contracts.¹⁴³ This is due to the fact that the habitual residence of the parties is determinative of the right to use the extension.¹⁴⁴

5.4 Consequences of the Limited Territorial Scope

The limitation of the territorial scope of application of the Proposal for a Common European Sales Law has several consequences which do not necessarily foster the achievement of the goals which are aimed at by the Commission.

5.4.1 Cross-Border Requirement consequences

In B2C scenarios the requirement of having a cross-border element is determined on a much more subjective basis and is also more lenient compared to B2B transactions.¹⁴⁵ For example a Danish trader will be able to contract under the CESL with a Danish consumer if the consumer will indicate his Swedish holiday house as the billing address. The rationale behind providing a rule on cross-border determination in consumer contracts pursuant to the indicated address might be the objective of making it available in the majority of cases and to provide certainty to the trader of the possibility to use the proposed CESL even if the indication does not coincide with the truth.¹⁴⁶

In transactions between two traders one can immediately see the difficulty which arises with regards to having such a limitation of being applicable solely to cross-border transactions. SMEs are put in a substantially disadvantageous position *vis-à-vis* large

142 Being the applicable law to the contract under Art. 3 Rome I.

143 Wendehorst 2012, p. 80.

144 If however the Member State which chose for the extension will not have a restriction to make the extension available only to domestic parties, also two foreign based parties will be able to make a contract under the CESL by choosing that Member States law as being the applicable law under applicable conflict-of-law rules.

145 Micklitz & Reich 2012, p. 15.

146 Wendehorst 2012, p. 37.

enterprises, as the latter usually have the possibility to channel their transactions through branches established in another Member States, thereby easily satisfying the cross-border requirement.¹⁴⁷ In contrast to them however, SMEs do not have such an option as they do not have a foreign branch nor are they usually are under the disposition of sufficient funds to establish one. In example a large Danish trader could contract under the CESL with a small Danish trader if he channels the contract through his branch in Sweden, thereby creating a cross-border element.

The restriction on the territorial application also triggers legal uncertainty, especially in e-commerce cases where the establishment of the other parties' habitual residence is difficult. In example, the domain name is not determinative of the habitual residence of a business.¹⁴⁸ It may well be that a trader has the domain name which would refer to one Member State but his principal place of administration would be located in another. In the same sense, the location of technical equipment used for contracting or e-mail address used do not determine the territorial applicability requirement.¹⁴⁹

The intricacy of satisfying the cross-border requirement, especially by SMEs, results in having to apply (at least) *two* legal regimes, one for domestic transactions and of e.g. the CESL for cross-border scenarios if the Member State does not extend the scope of application to include domestic transactions.¹⁵⁰ Thus, the possibility to lower transaction costs through using a single set of rules for the sale of goods and therefore also added simplicity and lower transaction costs is only possible for large traders.¹⁵¹

147 This possibility of 'channelling' transactions to achieve a cross-border element has also been one of the reasons to propose the 'Principles of European Insurance Contract Law' to be applicable also in domestic situations. (See: Fleischer 2012, p. 246); See also: European Law Institute 2012, p. 19 – 20.

148 Twigg-Flesner 2011, p. 252.

149 Already the UN Convention on Use of Electronic Communication in International Contracts of 2005 has recognized this complication and has tried to address it. Art. 6 of it provides that the place of business will be determined by the indication made by the trader and in case of natural persons, the habitual residence of the trader will be decisive. (United Nations Convention on the Use of Electronic Communications in International Contracts. [UN CUECIC], No. E.07.V.2, New York: 2007); (See: Twigg-Flesner 2011, p. 252).

150 By virtue of Art.13 of the Proposed Regulation. See also: Twigg-Flesner 2011, p. 246; Smits 2012, p. 13; Doralt 2011, p. 17; Wendehorst 2012, p. 38.

151 See also: European Law Institute 2012, p. 19 – 20; Low 2012, p. 143; Eidenmüller 2012, p. 318 and 319.

5.4.2 Minimum EU Link Consequences

Besides the cross-border requirement, the minimum EU link also entails several consequences which are not necessarily desirable.

With regard to consumer contracts, the wording of Art. 4(3)(b) does not make it apparent whether the minimum link to the EU as described ('one of the countries') relates to the habitual residence of the trader or not. The only clarification is provided in recital 30 of the Proposal that it relates to the consumer's address which has been indicated.

However more importantly, the fact that third country traders may operate under a *single* legal regime (the CESL), traders in the EU do not have such a possibility when trading with non-EU consumers.¹⁵² The missing logic behind this limitation is presented by Wendehorst as follows: 'the idea of 'neutralising' arts 6(2) and 9(2) REG (EC) 593/2008[...] does not work outside the EU/EEA'.¹⁵³ Third-country consumers may in any case be able to benefit from any overriding (even sometimes more favourable) mandatory provisions applicable under the foreign applicable law, pursuant to the conflict laws.¹⁵⁴ This limitation to European consumers may, be justified upon the possibility of traders being otherwise misled as to which are the applicable rules to the contract and upholding the false impression of applicability of the CESL.¹⁵⁵

However, this justification is rather weak as traders are, nevertheless, not 'safe' from the applicability of foreign law as the consumer in question may be habitually resident outside the EU/EEA but indicate an address for purposes of delivery or billing which is located in one of the Member States or EEA countries.¹⁵⁶ Therefore, the minimum EU link must either be stricter as the one proposed to achieve such a 'safeguard' or abandoned completely.¹⁵⁷ The latter is to be preferred as it takes away some of the complexity of the applicability of the CESL and keeping it would not provide for any substantial benefit as to justify the added intricacy.

The ability to trade freely is not restricted to the EU's Internal Market, but rather, it is an international principle flowing from the 'most favoured nation' clause which can be found

¹⁵² See: Wendehorst 2012, p. 37.

¹⁵³ Wendehorst 2012, p. 39.

¹⁵⁴ See also: Recital 14 of the Proposed Regulation.; Basedow 2012a, p. 38-40.

¹⁵⁵ See: European Law Institute 2012, p. 20; Wendehorst 2012, p. 39.

¹⁵⁶ See: Basedow 2012a, p. 37-39; European Law Institute 2012, p. 20.

¹⁵⁷ See also: Wendehorst 2012, p. 40.

in the GATT 1947,¹⁵⁸ which is attached to the WTO Marrakesh Agreement 1994.¹⁵⁹ Although the legal frameworks differ between the EU and the WTO, the political commitment and universal objective remains the same of encouraging transnational trade. Therefore, a trade between EU and third country parties should be fostered in the same sense as transnational trade between parties from the EU Member States. In the same sense, the private law approach dictates the equal treatment of individual's interests regardless of whether they are EU or third state citizens.¹⁶⁰ The necessity to also regulate third state relations within the Proposal is not eliminated by the mere fact that the CISG already sets out rules for international trade. This flows from the fact that it does not apply to most B2C transactions as Art. 2(a) of the CISG excludes goods sold for personal use. Furthermore, also in B2B transactions a regulation of this area within the Proposal is not redundant as there are several states which have not ratified the CISG (i.e. Portugal, the United Kingdom, Brazil and South Africa), although traders from that country may well want to contract under a more 'neutral' contract law regime.¹⁶¹ The CESL could provide such a possibility.¹⁶²

In addition to that it is hard to see why the EU would want to put its traders at a competitive disadvantage compared to third state traders when contracting with consumers.¹⁶³ Again, it should be at the heart of the EU legislator to avoid creating legislation with such effects and rather make EU traders more competitive on the global market.

158 Art. 1(1) General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. All, T.I.A.S. 1700, 55 U.N.T.S. 194.

159 Marrakesh Agreement Establishing the World Trade Organization. [WTO Marrakesh Agreement 1994], 1867 UNTS 154; 33 ILM 1144, Marrakesh: 15.04.1994.

160 Basedow 2012a, p. 37.

161 It should nevertheless be borne in mind that the applicability of EU law may only be guaranteed in courts of Member States, not necessarily in third countries which limits legal certainty with regards to transactions with foreign parties. Incoming B2C transactions from a foreign trader to an EU consumer will be guaranteed by virtue of Art. 6(1) Rome I Regulation. In outgoing transactions from an EU trader to a foreign consumer, where there is an absence of a choice of law of a Member State, Art. 6(1) of the Rome I Regulation will necessarily lead to the third country jurisdiction which in turn will decide on the applicability of the CESL. In addition to that, Art. 6(2) will also prohibit the derogation from mandatory national consumer protection law, thereby superseding the CESL if necessary. Having established that, recital 12 of the Proposal is incorrect in stating that 'Art. 6(2) of Rome I Regulation has no practical importance for the CESL' and legal uncertainty will not be overcome in transactions with third states. (See also: Basedow 2012a, p. 38-39; Basedow *et al.* 2011, p. 30 and 33).

162 The choice for the CESL would under Art. 6 of the CISG exclude the Vienna Sales Convention applicability. See: Basedow 2012a, p. 37-38.

163 See: European Law Institute 2012, p. 20.

5.4.2.1 Third and Fourth State Party Exclusion

Another example of undesirable consequences inherent in the minimum EU link requirement is the seemingly lacking justification for the limitation on the availability of the CESL to two non-EU/EEA traders. As in the example provided above, the Swiss trader is barred¹⁶⁴ to choose the CESL for his contractual relationship with the Japanese trader even when having opted for one of the MS law to be the governing law under the Rome I Regulation or other conflict-of-law regime.¹⁶⁵

This choice of the EU legislator is rather surprising as it should be in the EU's interest to promote its legislation and it could in fact be used as a 'quality trademark' if the CESL should be a success and businesses would largely make use of it (due to its added value).¹⁶⁶ Such a restriction of availability to third and fourth state parties can only be traced back to a 'Eurocentric' approach of the drafters who failed to see a common sales of goods law as being valuable also outside of the Internal Market of the EU.¹⁶⁷

Therefore, the CESL should also be available for third and fourth state traders to opt-into by virtue of a choice of law. This is apparent from the frequent use of European arbitration tribunals (i.e. in Stockholm, Paris, Vienna or London) by two third state parties submitting their agreement to litigation in those tribunals. This implies that the law of the forum where the arbitration takes place is the applicable law to the dispute. For example if a Canadian and a Japanese trader agree to submit their dispute to a sales contract to the Parisian arbitration tribunal, French law is applicable to the dispute resolution. No apparent justification can be seen as to why such agreements should not be able to be submitted under the CESL by an additional choice of law.¹⁶⁸

Allowing for such a choice would not only trigger regulatory competition,¹⁶⁹ which furthers the development of the law, but it may also globally advertise and foster legal services (such as arbitration tribunals) in the EU.¹⁷⁰

5.4.2.2 Mixed-Purpose Contracts

Having analysed both B2B and B2C contracts and the outcomes the limited territorial

164 Under Art. 4 of the Proposed Regulation.

165 Wendehorst 2012, p. 39.

166 See also: Eidenmüller 2012, p. 351; Loos 2011, p. 11; Basedow *et al.* 2011, p. 30.

167 See also: Basedow 2012a, p. 42.

168 *Ibid.*

169 See: Eidenmüller 2012, p. 347; Basedow *et al.* 2011, p. 36.

170 See Basedow 2012a, p. 42.

scope of application generates, a loophole is noticeable within the Proposal. Situations which involve mixed purpose contracts in the sense of territoriality are not addressed at all.¹⁷¹ It may well be that a trader supplies goods under a contract to several locations. In example two Danish traders may contract to have a certain good delivered at a German branch, a French branch and the Danish location. For such situations where both a cross-border as well as domestic element is present under a single contract, the Proposed Regulation does not provide an answer as how to categorize them.

5.4.2.3 Definition Issues

Besides the practical consequences the limitation entails and the apparent loophole, also linguistic and interpretative difficulties arise which may be traced back to the rather short period of drafting.¹⁷²

As regards Art. 2 on definitions, it does not only lack a coherent order, it also does not include all necessary definitions of which some are crucial for a proper and uniform interpretation of the envisaged instrument. The most prominent example is the lack of definition of 'residence' which plays a vital role in the determination of the scope.¹⁷³

Another one has been pointed out by Twigg-Flesner. He criticises the wording of the translated Art. 4(3) of the Proposed Regulation, relating to the address of the consumer, as the German version refers to the "*Anschrift*" of the consumer instead of the address indicated by him. This leads to a discrepancy in possible interpretation as "*Anschrift*" relates in general to the 'address', not necessarily to the provided one.¹⁷⁴

5.4.1 New Business Models

If the restricted scope of territorial application should remain, it might well trigger the development of new business models. As has been pointed out before, a way around the restriction, at least for large enterprises, is the channelling of contracts through foreign branches.¹⁷⁵ Such a business model could be used as a cost-saving device eliminating the related transaction costs of cross-border trade by contracting under a single set of terms and conditions via the CESL. However, this would largely remain an option only for large businesses which have foreign branches or which have the capacity to take on the one-time costs of establishing one.

171 See: European Law Institute 2012, p. 21; Basedow 2012a, p. 31.

172 See: Zoll 2012, p. 10.

173 Wendehorst 2012, p. 30.

174 Twigg-Flesner 2012, p. 75.

175 See: Basedow 2012a, p. 35.

Such a practice would not amount to abusive behaviour. The European Court of Justice has explicitly laid out in *inter alia* the ‘Centros’ case that the right of businesses to set up branches in other Member States is ‘inherent’ in the exercise of the freedom of establishment within the Internal Market.¹⁷⁶ The mere fact of establishing a branch in another Member State for the sole purpose of establishing a cross-border element in order to be able to use instruments such as the CESL can therefore, also not be regarded as abusive.¹⁷⁷

Using such techniques would be made possible also through the fact, that the crucial point of determination is the ‘conclusion’ of the contract in the course of operations, whereby ‘performance’ is irrelevant. The operation done by the branch does not need to go beyond merely ‘processing’ the contract in its initial stage.¹⁷⁸ Retaining the territorial application restriction would in fact be advantageous to small EU Member States such as Cyprus, Malta, Latvia or Luxemburg as they could in effect become the main locations of e-commerce via branches of large enterprises. The parent business would however remain close to the customers’ place of residence in densely populated areas. Such a business model could in example entail show rooms close to local customers to display the goods, but any sales contract could be made by virtue of a computer which would channel the contract through a foreign branch. The logistics, delivery and storing of the goods could again remain in the same area near the customers. Marketing, billing, warehouse storage and logistics would not have to be changed which would make such business models easy to set up.¹⁷⁹

Even though a circumvention of the territorial scope application would be possible by large traders, it would still amount to an artificial distinction between cross-border and domestic transactions and could in the end also lead to economically inefficient investments.

5.5 Justification Attempts

The Commission has put forward the subsidiarity and proportionality principles as grounds of justification for the restriction of the territorial scope of the Proposal to be confined to only cross-border scenarios where one of the parties to the contract is habitually resident in a Member State of the EU.¹⁸⁰

176 C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-01459, at para. 27; See also: Basedow 2012a, p. 37.

177 C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-01459, at para. 18.

178 See: Basedow *et al.* 2011, p. 420 – 424; Basedow 2012a, p. 35.

179 See: Basedow 2012a, p. 36.

180 See: COM(2011) 636 final, p. 9; Explanatory Memorandum 2011; Piers & Vanleenhove 2012, p. 9.

5.5.1 Subsidiarity

Art. 5(3) of the Treaty of the European Union (TEU) provides that where competences are shared between the EU and the Member States, such as within the area of the Internal Market,¹⁸¹ the EU 'shall act only and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States [...], but can rather [...] be better achieved at Union level.' It must however be noted, that these provisions regulate the *exercise* of the competence to legislate and not the *existence* of it.¹⁸² Thus, the legislative instrument chosen for a given measure is not relevant. Rather, the allocation of responsibilities, between Member State and the EU, for the substance of the instrument is decisive.¹⁸³

Arguing that the aim of simplifying the fragmented legal environment in the area of the sale of goods in particular, largely also due to national contract law differences could be better achieved by national measures would be rather cumbersome. It is also apparent from the European Union Court of Justice judgement in '*Vodafone*'¹⁸⁴ that the EU legislator is given a wide margin of discretion with regard to the subsidiarity principle.¹⁸⁵ Even if the EU does not have exclusive competences to eliminate distortions to competition, it nevertheless may be allowed to if the situation calls for the action by virtue of the Member States not being able to avoid it.¹⁸⁶

In addition to that, under a legal analysis of the Commission's argument of subsidiarity and the necessity to restrict the application to cross-border transactions only is rather questionable too. The Internal Market of the EU is to [...] comprise an area *without internal frontiers* [emphasis added] in which the free movement of goods, persons, services and capital is ensured [...].¹⁸⁷ Such a wording should also exclude 'legal frontiers' from existing in the Internal Market. Thus, it is the explicit task of the EU to enact measures which establish and ensure the functioning of the Internal Market,¹⁸⁸ however, the restriction on

181 Pursuant to Art. 4(2)(a) of the Treaty on the Functioning of the European Union (TFEU).

182 Micklitz & Reich 2012, p. 8; Basedow 2012b, p. 3.

183 Twigg-Flesner 2012, p. 40.

184 C-58/08 R ex parte Vodafone and others v Secretary of State for Business, Enterprise and Regulatory Reform [2010] ECR I-4999, at para. 77.

185 See also: Micklitz & Reich 2012, p. 8.

186 Case C-491/01 The Queen v Secretary of State for Health ex part: British American Tobacco (Investments) Ltd. et. al. ('Tobacco Manufacture') [2002] ECR I-11453, at para. 182.

187 Art. 26(2) TFEU.

188 Art. 26(1) TFEU.

the territorial applicability of an instrument entails the adding of another 'layer' of legal frontiers.¹⁸⁹ This is done so by excluding the possibility to opt-for a single set of terms and conditions which is applicable to all transactions and the necessity, especially for SMEs, to have to use a separate set for domestic transactions. Such an artificial distinction of sale of goods contracts upon habitual residences would *de facto* make the legal environment of the Internal Market even more complex.¹⁹⁰

This very objective of also eliminating legal frontiers was also the reason to include all domestic contracts into the territorial scope of all consumer protection Directives since 1985.¹⁹¹ Although it is true that the Directives are minimum harmonization measures and do not harmonize national and cross-border contracts completely, the recent change in directions of the 2011 Consumer Rights Directive¹⁹² has to be recalled.¹⁹³ Recital 2 of that Directive unambiguously states that it moves away from the traditional approach of minimum harmonization to create a 'level playing field'. In recital 4 furthermore, explicit reference is made to Art. 26(2) TFEU for justifying the applicability of the Directive also to domestic contracts to achieve the goal of promoting a 'real consumer [I]nternal [M]arket'.¹⁹⁴

It is evident that the attempted justification of the territorial scope restriction is inappropriate and unfounded if the aim of achieving and functioning of the Internal Market is dependent on the elimination of differences between domestic and cross-border transactions. It would be unreasonable to invoke the principle of subsidiarity to 'restrain' the very aim pursued under the Treaty by the measure in question.¹⁹⁵

5.5.2 Proportionality

In addition to the subsidiarity, subsection 4 sets out the proportionality principle which has to be observed whereby 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties'.¹⁹⁶ The limitation to cross-border transactions only has been claimed to be appropriate and proportional by the Commission,

189 Doralt 2011, p. 13.

190 See also: Eidenmüller 2012, p. 305.

191 Basedow 2012a, p. 33.

192 Directive 2011/83/EU.

193 See: Twigg-Flesner 2011, p. 242.

194 Directive 2011/83/EU, recital 4.

195 See: Basedow 2012a, p. 34.

196 Art. 5(4) TFEU.

for they are best addressed by EU law.¹⁹⁷

The ECJ has set out in its '*Air Transport Association*' case, that in order for a measure to be contrary to the proportionality principle, it needs to be '*manifestly inappropriate* [emphasis added] having regard to the objective which the competent institution is seeking to pursue.'¹⁹⁸ The requirement of being 'manifestly inappropriate' is a very high hurdle to cross for a challenge under disproportionality.¹⁹⁹ The ECJ has also emphasized this in its '*International Air Transport Association*'²⁰⁰ judgment, where it confirmed that the EU legislature should have 'a broad discretion in areas which involve political, economic and social choices'²⁰¹ on its part.²⁰²

In the light of that, it is rather improbable to have the instrument challenged in front of the European Court of Justice on the grounds of proportionality and thus, presents a very weak argument to try to justify the limited scopes of the Proposal.²⁰³ Furthermore, it is clear from the '*Vodafone*'²⁰⁴ judgment of the ECJ, that harmonization measures of consumer law cannot be regarded as being contrary to the subsidiarity and proportionality principle *per se*.

5.5.3 Protection from Foreign Mandatory Law

The limitation of the application with regards to the minimum EU link which is required, of one party having to be habitually resident in one of the Member States, is also based on a rather insufficient justification.²⁰⁵ The probable intention of setting such a requirement was the protection of EU traders from foreign mandatory protection rules. However, such a limitation does not achieve this aim as in cases where the indicated delivery or billing

197 Explanatory Memorandum 2011, p. 10; See: Piers & Vanleenhove 2012, p. 9.

198 C-344/04 *The Queen on the application of International Air Transport Association, European Low Fares Airline Association v Department of Transport* [2006] ECR I-403, at para. 80; C-376/98 *Germany v Parliament and Council* ('Tobacco Advertising') [2000] ECR I-8419, at para. 123. (See also: Reich & Micklitz 2012, p. 9).

199 See: Twigg-Flesner 2012, p. 40; Micklitz & Reich 2012, p. 8.

200 C-344/04 *The Queen on the application of International Air Transport Association, European Low Fares Airline Association v Department of Transport* [2006] ECR I-403, para. 80.

201 Case 380/03 *Federal Republic of Germany v European Parliament and Council of the European Union* [2006] ECR I-11573, at para. 145.

202 See: Micklitz & Reich 2012, p. 9; Twigg-Flesner 2012, p. 41.

203 See also: Clive 2012, p. 126.

204 C-58/08 *R ex parte Vodafone and others v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] ECR I-4999; See also: Twigg-Flesner 2012, p. 41.

205 See: Wendehorst 2012, p. 39.

address lies within the territory of the EU, Art. 6(2) and Art. 9(2) of Rome I Regulation may still direct to a third country law by virtue of the habitual residence of the consumer being in that foreign country.²⁰⁶

This is even more true where national laws of third states prohibit the choice of applicable law in B2C transactions (i.e. Switzerland).²⁰⁷ It is clear that inserting such a restriction does not 'save' the traders from foreign mandatory provisions and only contributes to making the envisaged instrument for a Common European Sales Law more complex than necessary.²⁰⁸

5.6 Proposal for Necessary Changes to the Territorial Scope

Having the territorial scope of the Proposal limited to cross-border contractual relationships is not desirable.²⁰⁹ Although political support for the Proposal is more probable if the instrument is only applicable to cross-border scenarios, it is important to rather take account of the practical implications such a limitation would entail.²¹⁰

National governments of Member States might be politically opposed to accept an instrument which would also include purely domestic transactions within its territorial scope.²¹¹ This is due to a fear of the national contract law regimes 'losing' their importance within the area of the sale of goods in the Internal Market if such an optional instrument would become the primary regime contracts would be entered into.²¹² However, this fear should not affect the considerations which are necessary for the success of the Proposal. Only if the envisaged instrument will be based on proper foundations, including a wide scope of territorial applicability, it would be in line with the aims of the Commission.²¹³ Furthermore, having an attractive optional instrument triggers regulatory competition also between the national contract law regimes²¹⁴ which is not to be regarded as a negative trend, but rather, it should be encouraged.²¹⁵

206 See also: section 4.4.2, p. 26 et sequ.

207 European Law Institute 2012, p. 20.

208 See: Rühl 2012, p. 160.

209 See inter alia: Doralt 2011, p. 13; Loos 2011, p. 3.

210 See also: Zoll 2012, p. 10.

211 See: Basedow 2011 et. al., p. 36.

212 See: Doralt 2011, p. 14.

213 See inter alia: Low 2012, p. 143; Clive 2012, p. 124.

214 See also: Fleischer 2012, p. 250.

215 See also: Smits 2012, p. 5.

Although there is the possibility for Member States to extend the scope of application to include all domestic transactions under Art. 13(a) of the Proposed Regulation, such an option does not necessarily make the CESL more attractive. This is due to the fact that only traders habitually resident in that particular state opting for extension are then able to use the CESL. Thus, it is not possible to do so for two foreign parties choosing the law of that country. The extension of the territorial scope of application to include all domestic and cross-border transactions is therefore crucial.²¹⁶

Furthermore, the minimum EU link requirement should be abandoned,²¹⁷ for, as has been explained before, the justification of ‘neutralizing’ Art. 6(2) and Art. 9 of Rome I Regulation is not achieved in a sufficient manner. The CESL should be an instrument which is available as an optional regime for *all* contracts whether entered into by two parties habitually resident in one Member State or two, as well as it should offer the possibility of two third and fourth county parties to make use of it. Only by providing a wide scope of territorial application the Proposal brings it in line with the EU’s guiding principle of ‘simplicity’.²¹⁸

Additionally, it will have the sought-after added value by simplifying the legal environment and lowering costs by making it possible for traders to operate under a single set of rules for all their transactions.²¹⁹ It will also enhance legal certainty as a characterization of being a cross-border scenario or not will no longer be necessary.

Finally it should be stressed again, that any distinction between domestic and cross-border transactions in the area of the sale of goods will go against the *raison d’être* of the Proposal, namely enhancing and functioning of the Internal Market of the European Union.²²⁰

216 See also: Piers & Vanleenhove 2012, p. 8 – 9; Lando 2011, p. 721.

217 European Law Institute 2012, p. 20.

218 See also: Doralt 2011, p. 13.

219 See also: Piers & Vanleenhove 2012, p. 8; Smits 2012, p. 7; Wagner 2011, p. 11.

220 See also: Basedow *et al.* 2011, p. 36.

6 Conclusion

This paper is intended to be a call for reconsideration of what is at stake and how the choices made by the EU legislature for the scopes of application influence the accomplishment of the envisaged aims.

The success of the Proposal is jeopardized by having very restricted personal and territorial scope applications. If a simplification of the legal environment, the lowering of related transaction costs for cross-border trade and legal certainty are not achieved, the added value is in effect missing and therefore, the attractiveness of the envisaged instrument to businesses is largely taken away. Consequently, the efforts of over two decades of debates and work by a number of actors involved in the process, ranging from the EU legislature and politicians, stakeholders to legal academics, is in vain as the Proposed CESL will not be opted-for by businesses and is 'doomed' to become largely irrelevant to transnational trade in the Internal Market.

The contemplation of the necessary scopes should be based upon actual and potential needs of the market and commercial practices *in lieu* of holding on to the competence rivalry between Member States and the European Union. The 'Eurocentric' view on EU legislation especially in the area of having to apply and regulate cross-border situations *only* is outdated and should be abandoned for the sake of actually encouraging cross-border trade, especially also for SMEs, and eliminating another obstacle to the Internal Market of the European Union.

The release of restrictions for the envisaged instrument and including *all* B2B transactions, without the need to characterize the other contracting party as being a large enterprise or SME is necessary. It would not only make the CESL more appealing but also safe SMEs from embarrassment. In addition to that, the wording of the Proposal should be changed as not to exclude parties which are neither traders nor consumers in the strict sense, such as non-profit organizations or universities. Such an extension should not be too difficult as most provisions of the CESL are drafted in a rather general manner.

Furthermore, it is crucial to make the Proposed CESL applicable to *all* transactions, including domestic ones, will be the first step towards making the desired Common European Sales Law work in practice. Only the elimination of the restriction of one party in B2B contracts having to be an SME will achieve the cost saving aims, will make the legal environment simpler and will enhance legal certainty by making a complex characterization of places of habitual residence redundant.

The problem of mixed contracts in the territorial sense would also become irrelevant by extending the scope to include all sale of goods contracts. The aim of fostering cross-border transactions of SMEs in particular, can only be granted if they will be able to make use of a *single* set of terms and conditions to contract with all their customers and not being disadvantaged *vis-à-vis* large traders who are usually able to channel transactions through their foreign branches.

The minimum EU link requirement of one party having to be habitually resident in the EU should be abandoned as it neither brings about an added value nor contributes to simplicity of the instrument. Making the CESL available for all parties to choose for, regardless of their origin, will advertise EU law and will generate a 'level playing field' in the competitive global market. An additional side benefit could also be achieved through the promotion of European legal services such as arbitration tribunals and creating a model for the modernization and reformation of national contract law regimes, also fostering regulatory competition.

The justification attempts of the Commission with regard to the limitations which have been imposed upon the personal and territorial scopes of application largely relate to the subsidiarity and proportionality principles. However, it is clear that those principles shall not restrict and undermine the very aim of the objective sought by the measure, which is the enhancement of the functioning of the Internal Market, including the elimination of legal frontiers.

Leaving the Proposal as it stands out ultimately leads to shooting far off target and missing the chance of eliminating another barrier to the Internal Market of the EU, at least for the next years (if not decades) before a new and improved attempt to tackle the issues on differentiated national contract laws could emerge.

The consistent neglect of an appropriate consideration of those 'foundations' led to the current Proposal for a Common European Sales Law to become a 'house of cards', which will not be able to stand its ground in the Internal Market and will collapse by failing to provide for an added value and achieving the initial goals of the Commission. Therefore, it is imperative to build the envisaged CESL on solid foundations of *chapeau* rules setting out much wider scopes of personal and territorial application.

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