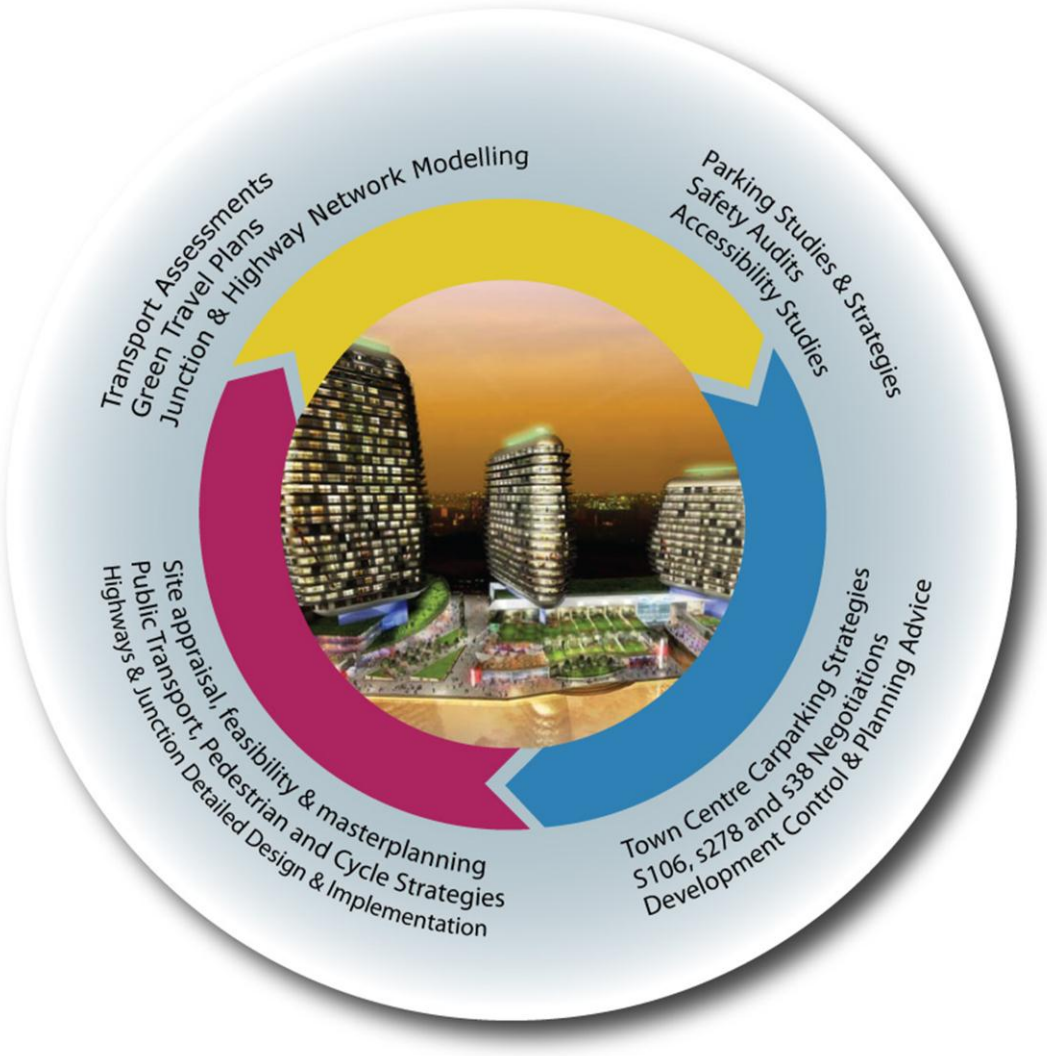

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A European Contract Law Option - Would it make a difference in the construction industry?

In July 2010, the European Commission published a Green Paper setting out its policy options for progress towards a European Contract Law for consumers and businesses. The Commission is of the view that differences between national contract laws may entail additional transaction costs and legal uncertainty for businesses in the internal market which in turn could lead to reluctance by businesses to engage in cross-border transactions. The Commission put forward seven options for making progress in this area, ranging from the publication of the Commission's expert group's findings which could be used by legislators as a source of inspiration when drafting legislation (but which would have no formal authority or status) to a Regulation establishing a European Civil Code which would replace national laws and cover not only contract law but the law of general obligations. What could be considered the middle ground, Option 4, is a Regulation setting up an optional European contract law instrument which would provide parties with two regimes of domestic contract law to chose between. It would work by inserting a set of self-standing contract law rules into the national law of Member States which could be chosen by parties as the law governing their contract instead of the national law of one of the contracting parties.

In April 2011, the European Parliament Committee on Legal Affairs voted in favour of Option 4, commenting that an optional instrument would have the effect of providing a single body of law which could do much to improve the functioning of the internal market. The Committee also noted a need to seek provision of standard terms and conditions of trade for businesses based upon such an optional instrument.

The idea of an optional European contract law instrument has not been well received in the UK. The UK government raises the concern that such an optional instrument would have an impact on the current commercial position of English law which it states is the preferred choice of global and inter-EU commercial contract law. The government comments that if this commercial position is unsettled, any business the UK loses would most likely not be displaced elsewhere in the EU. The government also raises concerns regarding the interface such a optional instrument would have with other areas of law (for example, tort) stating that it would seem impossible for any new instrument to cover all possible areas of dispute (and that as a result, any instrument would need to refer back to national law in any event).

The Law Society actively opposes the introduction of such an instrument and disagrees that diverging national laws in fact impede cross-border trade. It believes that many barriers to cross-border trade are practical and procedural, adding that the concerns businesses have in entering the markets of other Member States relate to differing court processes, means of seeking redress and difficulties relating to enforcement procedures.

The Law Society further comments that an optional instrument would lack any established jurisprudence and that it would not be possible to ensure consistent interpretation of the new instrument across Member States meaning that divergences would continue.

On 3 May 2011, the European Commission's Expert Group published the results of its feasibility study in which it delivers a text striving to constitute a complete set of contract law rules covering those issues that are relevant in a contractual relationship. The text includes rules relating to (i) the meaning of certain concepts (e.g. "damages") and general principles of contract law which parties should observe (e.g. good faith and fair dealing); (ii) how agreements are concluded and the rights to withdraw from an agreement; (iii) how contract terms should be interpreted and what constitutes an unfair (and therefore invalid) term; (iv) the obligations and remedies of parties to sales and services contracts; and (v) damages, interest, restitution and prescription.

In considering what impact these rules could have on construction contracts, one example is the proposed rule relating to a stipulated basis of payment for non-performance. This states that, where a contract provides that a debtor who fails to perform an obligation is to pay a specified sum to the creditor for such non-performance, the creditor is entitled to that sum irrespective of the actual loss, but the sum may be reduced to a reasonable amount where it is grossly excessive in relation to the loss resulting from the non-performance and the other circumstances. This is in stark contrast to the English law applicable to clauses dealing with liquidated damages for delay by contractors which are frequently used in construction contracts. They provide an employer with an easily-quantified remedy under the contract to cover the losses it would sustain in the event of the contractor's delay. Under English law, such amounts must reflect a genuine pre-estimate of the loss that would be incurred by the employer in the event of the contractor's delay, such assessment taking place at the time the contract was entered into. If it is not found to be a genuine pre-estimate by a court, the provision is unenforceable and loss would have to be proved in the usual way. No principle of court adjustment exists in English law, enabling a court to reduce an agreed basis or amount to a level deemed

appropriate in the circumstances. This would be a significant change.

More generally, would an optional European contract law have any impact on the UK construction industry, in terms of employers and contractors from different Member States looking to enter into a construction contract having a "third" common regime that they could choose to govern their contract in place of one or other's national laws? We would be surprised if employers and contractors would readily choose such a "third" option to govern their contract. In our experience, parties confronted by a choice of law are generally prepared to contract under English law and many of the industry standard contract forms used in major construction projects are drafted on the basis of an English law approach. Parties from other Member States seeking to contract with a UK party are therefore familiar with the principles of English contract law and are comfortable entering into contracts on that basis. If implemented, we would therefore question whether an optional European contract law would be often chosen as the law to govern contracts in the construction industry in the UK.

Finally, in a multi-contract project, involving both contracts between UK parties and contracts between a UK party and parties from other Member States, it is essential that the governing law provisions are consistent across all of the contracts. In view of this, our view is that English law will continue to apply as the law of choice for these projects.

For more information or advice, please contact:

Claudia Touma
Solicitor
Tel: 0845 498 8403
claudiatouma@eversheds.com

Amer Waheed
Managing Director
Tel 0845 47 48 851
amer@iprtgroup.com