# Competition between legal systems in European private law: towards a European competition law for legal systems?

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## *A. Introduction*

1. At a conference on the future of European private law, a reflection on competition between legal systems (more specifically those of the EU Member States) cannot be missed in my view; I thus endeavour to deliver some ideas about this topic. The question is whether, and under which conditions, competition between legal systems, is a better alternative than uniformization of the law. My contribution is necessarily limited, and a first limit is that I am only reflecting on competition between systems of rules (substantive law) and not court systems (jurisdiction of courts). I am thus not dealing with choice of forum and forum shopping. Secondly, the focus is on situations where there are mandatory rules of private law, not merely default rules.

2. In this regard, it can be noted already that the type of competition that may take place, also depends on the degree of imperativeness of the rules, or seen from the other side, the degree of private autonomy. We must distinguish basically two degrees as to the extent to which the law allows competition with other legal systems:

1° "simple" private autonomy within the limits of mandatory provisions of the applicable law;

and

2° international private autonomy making choice of law possible – usually only in cross-border cases – within the limits of overriding mandatory law only.

In the second degree, a choice between mandatory sets of rules – and thus a competition between the legal systems having these sets of rules – is to some degree made possible as soon as the case is international

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or made international. This is largely the case in e.g., the field of non-consumer-contracts (choice of the *lex contractus*, art. 3 and *a contrario* art. 6 para 2 Rome-I-Regulation), torts in relation between parties pursuing a commercial activity (art. 14 Rome-II-Regulation), company law (choice of incorporation), or civil procedure (choice of a court and its procedure). Choice is limited only by overriding mandatory rules, and competition between systems and the pressure to adapt is therefore wider than in the first degree. Even such overriding mandatory rules can be set aside to some extent, if they are contrary to the rules on free movement in EU primary law (country of origin principle); this does in most cases not relate to private law rules (with as a main exception some cases of rules on services).

In the first degree, where mere choice of law does not have the same effect, as it can only set aside non-mandatory rules, avoiding mandatory rules requires moving cross-border. Parties can make another system applicable only by moving into the territorial scope of application of the preferred the burden of moving is for the parties concerned, the lesser the pressure for the systems. Without moving cross-border, parties not only remain bound by the mandatory rules, but also have to take into account the default rules: although they can in principle deviate from them (opt-out), they nevertheless remain relevant especially because a) they cannot be set aside as unfair terms whereas deviation from them can, and b) they are the yardstick in relation to which deviations can be unfair terms.

As long as a large part of transactions and relations to be governed by the relevant rules is domestic rather than international, the conditions under which legal systems compete differ considerably from the one situation to the other: in the first degree, the competition is basically external, in the second degree it is to a large extent internal.

**3.** Competition between legal rules or systems is excluded completely to the extent that the rules are made uniform. In the EU, a federal, i.e. "Union" competence, insofar as exercised, abolishes competition between rules. As said, the question is whether, and under which conditions, competition between legal systems is a better alternative than uniformization of the law. Do we get better rules by centralising rulemaking and excluding competition ('ius commune') or by maintaining or enhancing competition and decentralizing rulemaking ('ius particulare')?

Strictly speaking, these are two separate questions:

1° which is the best level to legislate – centralised or decentralised – and what are the advantages and disadvantages of these levels?; and

2° how to organise coordination and/or competition at the decentralised level?

But they cannot be separated completely. The latter has an impact on the former: a good system of coordination and/or competition may indeed tilt the balance in the first question towards more decentralization and vice versa. It is thus very well possible that we tend too much towards federal solutions because the competition between legal systems is not working, and that we can reach better solutions with a different type of federal law and a different relation between *ius commune* and *ius particulare*.

Let us however, first summarize the arguments in favour of decentralization and competition and those in favour of centralisation and uniformity, resulting mainly from economic analysis of law, behavioural law & economics and political history.

## *B. Arguments in favour of decentralized rulemaking and competition*

4. In favour of decentralised law making, implying more choice by the lower level and thus the possibility of a variety of solutions, mainly the following arguments can be found.

### I. Heterogeneity (in preferences, situations) and homogeneity bonus

5. Preferences of the persons involved may differ and tend to be more homogeneous at a lower level: there can thus be a *homogeneity bonus*[2] in decentralised competences. Inter-jurisdictional competition serves first of all as a mechanism to match better the preferences of citizens[3]. This is even more so if barriers to move are small[4], as more people then tend to move to jurisdictions where the rules match their preferences.

2 Boudewijn Bouckaert, "Defederalisering van de Belgische Justitie? Een rechtseconomische overvlucht", in J. Laenens e.a., in *Defederalisering van justitie, Staatsrechtconferentie 2002* (Larcier 2003), 37–42.

3 Klaus Heine, "A Quick Guide to Behavioural Federalism", in *Don't take it seriously, Essays in law and Economics in honour of Roger Van den Bergh* (Intersentia 2018), Ch. 13, p. (219) 225.

4 Those barriers can be of different kinds, rational and non-rational, see the different behavioural explanations by Klaus Heine, in *Don't take it seriously, Essays in law and Economics in honour of Roger Van den Bergh*, Ch. 13, p. (219) 227 ff.

This bonus varies depending on the type of rules and problems. A serious judgment needs more empirical evidence, but it may be possible to indicate some degrees. A classical distinction differentiates between "nomocratic" or "facilitative" rules and "teleocratic" or "regulatory" law[5]. The first type consists of rules helping the parties to enforce contracts and supplying default rules, thus facilitating transactions and the purposes of individual market participants. The second type concerns rules aimed at realising common purposes. Some authors believe preferences as to the first are relatively homogeneous on a broader scale[6], others stress that even for those rules' preferences tend to differ, but also to change (the latter comes close to the learning argument *infra* n° 8 and ff.)[7]. Most authors believe preferences as to the second type of rules are clearly more homogeneous at a lower level.

6. Sometimes, it is argued that where "fundamental" issues are at stake, there are common values and thus matters must be centralised. It is, however, perfectly possible to be strongly divided over these common values. I would even say that most if not all of the sharp ideological conflicts in our societies – sometimes called essentially contested concepts[8] – are conflicts about the interpretation and balancing of common values. To some extent even these conflicts are similar in the different Member States. But precisely in these situations to impose uniformity of rules only makes things worse. Given the diversity of opinion on how to balance such values, there is already on the national level a serious problem of democratic legitimacy, but the problem only increases when moving up to the European level. It is precisely where people feel very strong about issues that imposed uniformity is a very bad idea, creating polarisation at a much higher level[9]. There

5 See for this distinction / terminology i.a. B. Bouckaert, in *Defederalisering van justitie, Staatsrechtconferentie 2002,* 34–35, following F.A. von Hayek, *Law, Legislation and Liberty* (Routledge London 1973); S. Grundmann & W. Kerber, "European System of Contract Laws – a Map for Combining the Advantages of Centralised and Decentralised Rule-making", in S. Grundmann & J. Stuyck, *An Academic Green Paper on European Contract Law* (Kluwer Law International 2002), (295) 297.

6 B. Bouckaert, in *Defederalisering van justitie, Staatsrechtconferentie 2002,* 34–35.

7 S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 297–299 and 300–301.

8 In the words of Walter B. Gallie, 'Essentially Contested Concepts', 56. *Proceedings of the Aristotelian Society* (1956), 167–198.

9 Compare the dissenting opinion of Justice A. Scalia in *Planned parenthood of Southeastern Pa. v. Casey*, http://laws.findlaw.com/us/505/833.html: "The Court's description of the place of Roe in the social history of the United States is unrecognizable. Not

may be an argument where differences in rules create negative spill-over effects into other jurisdictions (one of the arguments pro centralization discussed *infra* n° 15 ff.), sometimes called external effects. But there is also another kind of external effect: an identical solution where preferences differ means that those having other preferences than the dominant one bear the cost of the dominant preferences – whereas more people are happy when the differing solutions in different countries correspond to the preferences of the local majority.

## II. More possibilities to restrict rent seeking

7. Mandatory rules can be used to protect special interest groups, including also politicians or bureaucrats; this is called rent seeking behaviour. The possibility of exit restricts rent seeking. Inter-jurisdictional competition serves as a means to prevent the rent-seeking[10]. And although lobby groups may be interfering even more on a lower level, the overall impact is smaller in case of decentralised rule making. Centralisation prevents local alternatives where a local majority can be found against such interest groups.

## III. Better use of and creation of knowledge

8. Decentralized law-making may be a better answer to two kinds of knowledge problems.

only did Roe not, as the Court suggests, resolve the deeply divisive issue of abortion; it did more than anything else to nourish it, by elevating it to the national level, where it is infinitely more difficult to resolve. National politics were not plagued by abortion protests, national abortion lobbying, or abortion marches on Congress before Roe v. Wade was decided. Profound disagreement existed among our citizens over the issue – as it does over other issues, such as the death penalty – but that disagreement was being worked out at the state level. As with many other issues, the division of sentiment within each State was not as closely balanced as it was among the population of the Nation as a whole, meaning not only that more people would be satisfied with the results of state-by-state resolution, but also that those results would be more stable. Pre-Roe, moreover, political compromise was possible. Roe's mandate for abortion on demand destroyed the compromises of the past, rendered compromise impossible for the future, and required the entire issue to be resolved uniformly, at the national level'. For Europeans, read evidently 'federal' or 'Union' for 'national'.

10 Klaus Heine, in *Don't take it seriously, Essays in law and Economics in honour of Roger Van den Bergh*, Ch. 13, p. (219) 225; S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 304.

The first deals with the possibility to learn and innovate[11]. Knowledge about the best legal rules has to be developed permanently and is never fully acquired. It is important to have the capability to learn built in in the legal system (institutional learning). In general, the system is easier to adapt, and it is easier to correct errors if there is a plurality of systems that can experiment with new solutions. Only then is learning by comparison possible. In some cases, however, there is more flexibility to adapt the law at a more centralised level, but in most cases the probability that new solutions will be adopted if there is more than one legislator is much higher.

9. The second knowledge has to with the dispersion of knowledge. It could be said that in case of centralisation, more knowledge can be used to learn and improve the law. But on the other hand, in case of decentralisation, the influence of “local” knowledge will be greater, and the local knowledge may be more relevant than foreign knowledge[12].

## IV. Pressure to learn, innovate and adapt

10. Competition also provides incentives and even pressure to adapt. The degree of this pressure again depends on the degree of private autonomy. It is higher in case of internationally extended private autonomy (choice of law setting aside otherwise applicable mandatory rules). But it does exist to some extent with simple private autonomy: either because people vote with their feet ("exit")[13] and/or because they pressure their legislator to change the rules.

In general competition leads in relation to the "products" at stake, namely collective solutions for (mainly socio-economic) problems, to

a) better products and performances, in the sense of more pressure to obtain products better suited to needs and preferences;

11 S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 302–303.

12 S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 302: "If local knowledge about the specific problems and preferences in certain regions or Member States exists, then a decentralised system of rule-making is much more suitable for using this local knowledge about the suitability of legal rules for solving transaction and cooperation problems".

13 The classical development of this argument is by Charles Tiebout, "A Pure Theory of Local Expenditures", in 64. *Journal of Political Economy* 1956, 416 ff.

b) lower cost for the same product as the method will be sought to realise them at lower cost[14];
c) more innovation (unless innovation requires economies of scale)[15].

Competition as a learning process will lead to similar solutions where preferences do not differ. This is especially the case with facilitating / nomocratic rules (where there is usually less heterogeneity of preferences) and less with redistributive (teleocratic) law. Paradoxically, for the first type of situations & rules, competition thus becomes an element of integration[16].

### *C. Arguments against decentralized rulemaking and competition*

11. On the other hand, there are classical arguments in favour of centralisation.

#### I. Economies of scale

12. First, there can be economies of scale in a strict sense: it is less costly to make good laws at a central level[17] (static economies of scale); it is also less costly to maintain the law up to date and there is more experience with the application of the rules which is helpful for that purpose (dynamic economies of scale). On the other hand, in case of decentralised law making between jurisdictions where uniform law could work or make sense, copying is precisely rather cheap.

13. Secondly, there can be economies of scale in the sense of less transaction costs for the users[18]. It is less costly for users in cross-borders situations

14 Comp. for competition on products for goods and services Richard Whish & David Bailey, *Competition law* (Oxford: Oxford University Press, 9th ed. 2018), p. 6 ('productive efficiency').

15 Comp. for competition on products for goods and services Richard Whish & David Bailey, *Competition law,* p. 7–8 ('dynamic efficiency').

16 Horatia Muir-Watt, *Choice of law in integrated and interconnected markets: a matter of political economy*, Ius commune lectures on European private law (2003), 11, referring also to W. Kerber and R. Van den Bergh.

17 S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 297–299 and 300–301.

18 One could also look into the political transaction costs for making the law: S. Grundmann & W. Kerber, in *An Academic Green Paper on European Contract Law*, (295) 300 conclude that the answer here is mixed again.

to know the law when it is the same on both sides; a broader territorial application of rules also means more cases, which in principle make the law also better understood for the users. However, the latter is not necessarily true: it is in most cases more difficult to keep track of application of uniform law in other countries as to keep track of case law of a single jurisdiction. This is especially the case when the case law is spread over different languages. Further, when the same rule applies across different jurisdictions with preferences that are less homogeneous, there is a greater risk of differing interpretations of the same rule, and uniform application of the uniform rule may become an illusion.

## II. Barriers of trade

14. Different super mandatory rules may constitute barriers to trade and distort competition within the internal market of the EU. Simple mandatory rules, which can be displaced in cross-border cases by choice of law, do not constitute such barriers[19].

## III. Negative interjurisdictional spillovers

15. Another classical argument for centralised law-making is that the negative effects of choices remain to a much larger extent internal instead of spilling-over to the neighbours (interjurisdictional spillovers)[20]. The scale of law-making should thus be big enough to make sure most (negative) effects of the choices made are internal. Centralising law-making in the EU also internalises inter-state external effects.

The possibility to externalise effects would also pressure other jurisdictions to follow the path and lead to a "race to the bottom". But here too, one should not generalise too much. The risk of external effects varies according to the problems and rules. A race to the bottom is precisely avoided if the entity is relatively homogeneous[21], and if effects are mainly internal and those affected have "voice" (impact on decision making processes).

19 ECJ 24 January 1991, C-339/89, *Alsthom Atlantique / Sulzer.*

20 Robert Inman & Daniel Rubinfeld, "Federalism", *Encyclopaedia of Law and Economics* n° 9700 (2011), (661) 668 f.

However, in the opposite situation, decentralised autonomy may indeed cause problems which may lead to "regulatory dumping" i.e., the situation in which a jurisdiction adopts a legislation which is more lax than that of other states, in the knowledge that the interests which a more stringent regulation would protect are outside its own territory[22]. The opposite can be true, too, where a more stringent legislation is tailored in a way that there are more benefits for the domestic population and more expenses for citizens or companies abroad[23].

16. This risk can be limited precisely by conflict of law rules carefully allocating legislative jurisdiction[24], and thus internalising costs to a higher degree.

First of all, the degree of private autonomy is clearly relevant. In the case of simple private autonomy (not displacing the mandatory rules of the applicable law), the risk of externalising costs by private parties is much smaller (but the benefits of decentralisation are also smaller), even if there is still a risk of externalising costs by governments. In case of international private autonomy (choice of law displacing mandatory rules) or application of country-of-origin rules, where cherry-picking is possible at a larger scale, the risk of negative spill-over effects is bigger. This is even more so if the conflict of law rules allow *depeçage*, i.e., where the parties do not even have to take a legal system as a whole, as "package", but can disassemble it.

21 Wallace Oates & Robert Schwab, "Economic competition among jurisdictions: efficiency enhancing or distortion inducing", 35. *Journal of Public Economics* 1988, 333 ff.). They studied more specifically the impact of competition on two variables where a race to the bottom is often feared: tax benefits and environmental standards, and conclude that "relatively homogeneous communities, where the benefits and costs of public programs are clearly understood and where public decisions reflect the well-being of the jurisdictions' residents (...) tend to select both incentives for new industry and standards for local environmental quality that are socially optimal".

22 Description from Horatia Muir-Watt, "Integration and diversity: the conflict of laws as a regulatory tool", in Fabrizio Cafaggi (ed.), *The Institutional framework of European private Law* (Oxford: Oxford University press 2006), (107) 138.

23 This can in some cases happen where e.g. tort victims can make a unilateral choice of law, such as under art. 7 Rome-II Regulation for environmental damage.

24 Horatia Muir-Watt, in *The Institutional Framework of European Private Law*, with examples of conflict rules as regulatory tools, esp. in labour law (p. 138 ff.) and environmental protection (p. 144 ff.).

*D. Summary of the actual situation in the EU and its evaluation*

17. The actual situation can be summarised as follows:

- the European Union has only attributed powers (but relatively wide);
- most of these are non-exclusive and thus concurring (with the Member States);
- the exercise of these concurring powers is governed by complex rules (different procedures depending on the legal basis, use of the so-called coordination method, etc.)
- Union law issued within those powers has always priority over the law of the Member States and their subdivisions;
- the power of the Union is *de facto* extended enormously by the doctrine of *effet utile*;
- within the – thus extended – scope of Union law, European judges have found and often also invented ‘principles common to the law of the Member States’ (e.g., in the case *Mangold*[25]).

18. For the state of private law in the European Union, this has led to very unsatisfactory results. Jan Smits has characterised the Acquis even with the "four harsh words": fragmentary, arbitrary, inconsistent, and ineffective[26]. Although the situation may have improved slightly since (e.g., by moving from minimum harmonisation to targeted partial full harmonisation), we are far from a comprehensive and coherent European private law. Moreover, European private law is not built in its own right, but as a distorted by-product of a different logic. Especially where private law is developed by case law, too often generalisations take place from specific rules that do not represent the default private law but are products of political purposes of the Union.

19. Most proposals to improve European private law do not question the basic mechanisms of power as summarised *supra* n° 17. They usually propose either more or less European rules. They fail to use the benefits of decentralisation and competition by either diminishing it or allowing it in a way that it does not work properly. We must at least try to find and test alternative methods, maintaining federalism and maintaining the

25 See i.a. L. Gerken, V. Rieble, G.H. Roth, T. Stein, R. Streinz, *"Mangold" als ausbrechender Rechtsakt* (München: Sellier 2009).

26 J. Smits, "European private law: a plea for a spontaneous legal order", in D. Curtin e.a., *European integration and Law* (Intersentia 2006).

advantages of harmonisation but in a better way. It is time to propose a very different alternative, that to some extent puts things upside down.

### *E. An alternative*

20. How can we use the benefits of competition without losing the benefits of common rules? By having both: common rules that can be displaced by decentralised lawmakers provided they abide by several competition rules.

Let me plead for the reversal of the existing situation. Instead of national codes that are overruled in a fragmentary way by Union law, in itself extensively construed by European judges, we should rather have a European Civil Code, leaving however to national parliaments the right to deviate from its rules in certain ways. This principle is nothing new: it is basically the model of the American UCC, and it is basically the way the old *ius commune* related to *ius particulare*. A balance requires that the rule that has priority, is interpreted restrictively and not extensively.

This balance was found in the dialectic of *ius commune* and *ius particulare*, or if you like between common law and statute law: the *ius particulare* or national statute must be allowed to deviate from the common law / *ius commune*, at least under certain conditions (*infra* n° 21 ff.), but must then be interpreted in a restrictive manner (*statute stricte sunt interpretanda*[27]) and the “common” law (ECC) on the contrary in such case interpreted in an extensive manner.

In more concrete terms, this would mean a European Civil Code with a wide possibility for the Member States to opt out of its single rules (wide in the sense of possible for all of them except some essential ones) under certain rather strict conditions.

21. The question then remains how this competition can and should be organised. There is a lot of literature on competition between legal systems (although not much on private law), but much less on a *competition law* for competition between them, i.e., between lawmakers and their rules[28]. This competition law in itself must be a “supranational” (in casu EU) com-

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27 See W. Zwalve, 'Interpretatieproblemen voor de codificatie' in J. Erauw (ed), *Liber memorialis François Laurent* (Brussel: Story Scientia 1989), 447 ff.; R. Zimmermann, '*Statuta Sunt Stricte Interpretanda?* Statutes and the Common Law: A Continental Prespective', 56 *Cambridge Law Journal* (1997), 315.

28 The main article being W. Kerber, "Zum Problem einer Wettbewerbsordnung für den Systemwettbewerb", 17 *Jahrbuch für neue politische Ökonomie* 1998, 199 ff.

petition law, which determines the conditions under which jurisdictions can compete, i.e., in our model can deviate from the common law (the European Civil Code).

I see mainly three types of rules to organise such a competition in a meaningful way.

22. First of all, it is necessary to have federal / supranational conflict of law rules with the function already mentioned *supra*, especially limiting negative spill-over effects or regulatory dumping. Conflict of law rules are regulatory tools against regulatory dumping (by internalising the costs). This implies limiting private autonomy for those rules which do have important effects on third parties (a good example can be found in *Kornhaas*, where the ECJ[29] qualified a liability rule as within the category of insolvency rules rather than company law and thus restricting choice of law). Conflict of law rules will also limit *depeçage,* short-term switching of applicable law, etc.

23. Secondly, it is appropriate to have minimum rules for certain cross-border situations (e.g., obligatory motorcar insurance if you travel)

24. Thirdly, opting out of the common rules should be subject to several conditions for which inspiration can be found in classical competition law (for competition on markets for goods and services). They consist mainly of the following:

1° Transparency rules. They would include information duties and standardizing. This could include a rule that every national rule must indicate specifically which common rule precisely is wholly or partially replaced by the national rule. A derogation from the common Code can then only be made expressly and in a precise manner, namely by specifically replacing a named rule by another one ('art. X.1 ECC is replaced by / supplemented by ....'). In order to enhance transparency, derogatory provisions should be published in all official languages of the Union.

2° Rules protecting the choice of law in those cases where the conflict of law rules provide for such choice, by restricting the way in which states could impose costs on exit or switching to a competitor, and by limiting or counterbalancing network effects that disable competition.

3° Remedies against unfair practices (misleading practices, retroactive modifications, etc.).

25. If we can thus organise a meaningful competition between these decentralised lawmakers, we have the best of both world: the advantages of

29 ECJ 10 December 2015, C-594/14 *Kornhaas*.

common rules, such as economies of scale and limiting negative spillovers, and the advantages of competition such as the homogeneity bonus and institutional learning. I believe this alternative is largely possible under the existing Treaties but requires more than anything else a shift in our minds and the minds of all those preparing EU instruments.