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The limits of contract law harmonization

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Abstract Contract law harmonization in the European Union has met with some significant but limited success. This Essay explores some of the psychological and political forces that can complicate or even hinder law reform efforts. Even when there is a general institutional drive for law reform, as there is in the EU, scarce reform resources force attention to be focused on salient issues, while a status quo bias in individual member states by government officials can provide a braking inertia regarding nonsalient legal reforms. This braking influence can be seized upon and enhanced by interest groups that oppose reforms, especially where there is an alternative to proposed law reforms for private entities. In the case of contract law harmonization, contract doctrine that is not focused on providing consumer protections remain nonsalient, commercial entities can solve the confusion of diverse laws by choosing their own, and interest groups in nations whose laws and dispute resolution forums are commonly chosen will oppose harmonization. Thus, the current state of affairs may prove relatively difficult to alter.

Keywords Contract law · Harmonisation · Law reform

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1 Introduction

Many believe that cross-border trade within the EU is at least somewhat hindered by the multiplicity of nation-state laws applicable to the parties' contracts and that the harmonization of such laws could therefore serve to enhance the efficient

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functioning of an EU market. The problem rose to the level of a European Commission Communication to the Council and the European Parliament on European contract law (2001/c 255/01), which stated, as justification for further harmonization of EU member state contract law, the following:

> For consumers and SME's in particular, not knowing other contract law regimes may be a disincentive against undertaking cross-border transactions….Suppliers of goods and services may even therefore regard offering their goods and services to consumers in other countries as economically unviable and refrain from doing so (2001/c 255/01 at para. 30.). In a similar vein, Germany's former chancellor Gerhard Schröder (2005) has argued that legal diversity in the EU is one of the obstacles to the smooth functioning of a single EU market and to European economic growth in general.

Despite this belief, relatively little harmonization of nation state contract law has occurred to date. To be sure, there has been some harmonization of contract law in the EU, and more harmonization efforts have been consummated. Minimum consumer contract protections have been put forth in several EU directives, including the Package Travel Directive,[1] the Distance Selling Directive,[2] the Unfair Contracts Terms Directive,[3] the Timeshare Directive,[4] and the Directive on the Sale of Goods and Associated Guarantees.[5] And efforts are underway to encourage a uniform common law of contracts through a Draft Common Frame of Reference,[6] with varying reports on its potential success. Contract law harmonization has apparently met with more success than have other EU harmonization goals.[7] Notwithstanding this relative success, however, most contract law has not been touched by the harmonization efforts, and there is some indication that harmonization efforts have not only stalled but actually backpedalled.[8] Efforts to put into place a mandatory European Civil Code and plans for a European Standard Form Contract have both ceased.[9] The measures that have been put in place tend to state minimum contract protections rather than mandating an actual harmonization of substantive laws, and even then directives must be implemented by EU member

[1] Council Directive 90/314/EEC, On Package Travel, Package Holidays and Package Tours, 1990 O.J. (L 158) 59.

[2] European Parliament and Council Directive 97/7/EC, On the Protection of Consumers in Respect of Distance Contracts, 1997 O.J. (L 144) 19.

[3] Council Directive, 93/13/EEC, On Unfair Terms in Consumer Contracts, 1993 O.J. (L 95) 29.

[4] Council Directive 94/47/EC, On the Protection of Purchasers in Respect of Certain Aspects of Contracts Relating to the Purchase of the Right to Use Immovable Properties on a Timeshare Basis, 1994 O.J. (L 280) 83.

[5] Council Directive 99/44/EC, On the Sale of Goods and Associated Guarantees, 1999 O.J. (L 171) 12.

[6] *Communication from the Commission to the European Parliament and the Council on a More Coherent European Contract Law—An Action Plan,* COM (2003) 68 final (March 15, 2003).

[7] Jan M. Smits, Introduction to this special issue.

[8] Gary Low, *'Bounded' Regulatory Competition in the Market for European Contract Laws,* this issue.

[9] COM (2007) 447 final—Second Progress Report on The Common Frame of Reference.

legislatures, and variations in those implementations are inevitable.[10] In addition, almost all EU successes have occurred for consumer contracts rather than for business to business contracts.

If harmonization is indeed in the interests of EU market participants, why has more not occurred? Why has harmonization been largely confined to consumer contracts? And why do EU efforts tend to take the form of minimum protections rather than actual legal harmonization? I approach this question with some speculations stemming from behavioral, public choice and organizational theory. Two caveats are in order: First, I am no expert in the substantive contract laws and regulations outside of the US, so this essay does not approach the problem with particular policies or proposals in mind. Second, I am no expert in the institutional politics of Europe, so I am unable to state with confidence the degree to which the institutional or public choice analyses presented here actually manifest themselves in particular European lawmaking institutions.[11] I leave to others an assessment of whether the analysis here in fact helps to explain what appear to be significant limits on contract law harmonization.

This Essay argues that legal reform, through harmonization or otherwise, requires more than the fact that change would on balance be good.[12] Rather, attitudes on the part of state officials are often biased in favor of the status quo and solidified by scripts. As a result, state officials will often be resistant to change except on the face of relatively strong competitive or other countervailing forces. Put differently, the critical question is not whether resistance to increased harmonization will be sufficiently significant to defeat it but rather whether there are interest groups with sufficiently strong incentives to overcome parochial status quo biases to put in place harmonized laws.

Part I of this Essay describes this problem of sticky nation state laws. Part II then argues that on balance firms and third-party intermediaries are unlikely to strongly support harmonization, but consumers and firms that serve consumers might push for harmonization in the form of minimum consumer protections. For consumers the relationship between harmonization and increased trade is poorly understood, but minimum contract protections across the EU could possible promote trust in foreign firms. For firms engaged in sophisticated commercial transactions the risk of harmonizing in ways that fail to improve trade is significant and much of the improvement can be obtained through private contract terms. Indeed, given that firms and trading environments are both heterogeneous, choice-of-law clauses enabling firms to choose among diverse substantive law options would prove superior to harmonized laws. Firms engaged in cross-border trade with consumers

[10] For more information on member nation incorporation of consumer protection directives, see Unfair Terms in Consumer Contracts Regulations 1999 (No. 2083 UK); Atamer and Micklitz (2009).

[11] For an analysis of the constitutional limitations on EU contract law harmonization efforts, see Weatherill (2006).

For an analysis of EU institutional competence to achieve contract law harmonization, see Vogenauer and Weatherill (2006).

[12] This Essay assumes, *arguendo,* that increased harmonization is desirable. A vigorous debate on the desirability of further harmonization continues. For a summary of arguments for and against further EU contract law harmonization, see McKendrick (2006).

are less able to use choice-of-law clauses to tailor their business practices, so they are more inclined to support harmonization efforts, through minimum contract laws or otherwise, so long as resulting laws do not unduly raise their costs. For trust intermediaries, business likely is not significantly affected by marginal changes in law. And lawyers in nations that garner a litigation or contracting advantage from desirable commercial laws can be expected to strongly oppose harmonization efforts. In nonconsumer contexts, then, support for harmonization can be expected to be lukewarm or ambivalent at best, and such weak or nonexistent support will likely prove insufficient to produce state official buy-in for the harmonization effort. Interest group support for harmonization of consumer contract law is much more likely, but minimum contract protections might provide a more workable compromise.

2 State officials and their present-law scripts

Some nations have a significant stake in harmonization efforts. Nations that produce consumer goods for export to other EU nations benefit most from harmonization efforts because then its businesses are able to transact according to a single set of company policies that are calibrated to the governing law. In addition, those nations can be expected to promote harmonization that takes the form of relatively low consumer contract protections. On the other hand, nations that are net importers of commercial legal business, including contract drafting, litigation and arbitration, can be expected to oppose harmonization efforts in order to maintain their competitive advantage. Perhaps this contrast in nations' incentives explains the differing views of Germany and England regarding the need for contract law harmonization. If Schröder's views are representative of those of his nation, Germany appears to strongly support harmonization efforts. Contrast Schröder's public statements with those of Lord Falconer, the U.K. Constitutional Affairs Secretary, who in the same year spoke out against harmonization efforts in favor of diverse laws and jurisdictional competition, citing the importance of London as a competitive center for international contracting and the provision of related legal services.[13]

Other EU nations may simply experience bureaucratic inertia which creates a more passive resistance to contract law harmonization efforts. It is well known that people adopt psychological short cuts for processing information and making decisions (*See generally* Gladwell 2005). We use heuristics, stereotypes, scripts, and schema as tools to make decisions in the face of uncertainty and to economize on the costs of processing available information relevant to decision making.[14] In the context of organizations, people must also coordinate their actions in the sense that participants need to forecast the actions of others in the institution and they must

[13] Kenny (2006), at p. 793 and n.85 [quoting Lord Falconer of Thoroton, Opening Speech at the European Contract Law Conference in London (Sept. 26, 2005)]; see also McKendrick (2006), at 19–21 (describing British resistance to EU contract law harmonization).

[14] Tversky and Kahneman (2002) (discussing human beings' dependence on schemas and short-hand strategies in place of careful analysis of evidence).

find a way to act consistently with one another and with the basic mission of the organization. In these circumstances, participants are, not surprisingly, even more likely to adopt behavioral regularities, or scripts, and supporting attitudes (Cf. Zucker 1977), that reduce the transactions costs associated with coordinating behavior in complex and uncertain environments.

Although these scripts can simplify the behavior within the organization, they can also create rigidity on the part of the organization when it must interact with, respond to, and/or negotiate with others. This rigidity can cause the organization to resist change even when the change is desirable (Macey 2010). And the supporting attitudes developed by the organization's participants can result in more than a passive inertia or mere lack of creative thinking about how to solve problems. Instead, the participants can become convinced of the superiority of the scripts that are in place, especially when their conduct or their outcomes earn the approval of respected external evaluators who create institutions for guidance (Meyer and Rowan 1977). "As more of an organization's structure is derived from institutions, it adopts a 'logic of confidence,' exhibiting elaborate displays of confidence, satisfaction, and good faith." [Macey 2010 (citing Meyer and Rowan 1977)]

Government organizations surely are similarly riddled with scripts that enhance the ability of the organization to serve its purpose. Indeed, scripts might be even more prevalent and more powerful in governmental organizations than they are elsewhere, given that budget limits force decisional economies and market pressures are much less likely to create an offsetting need for nimbleness. Indeed, external demands for accountability by politicians and citizen groups can further increase the prevalence of scripts, because routines and protocols can help to justify the decision made by any one government actor.

With regard to those government organizations tasked with enforcing and/or administering law—courts and administrative agencies—other government actors, citizens, and dominant interest groups will all have a strong interest in fostering the institution of the rule of law and the complementary script of fidelity to current law for participants within the organization. An attitude of support for the governing law that the organization is charged with enforcing or administering helps to ensure that the organization's participants will act in ways that are consistent with the preferences of the legislators, constituents and/or dominant interest groups.

Although this commitment to the governing laws helps to simplify and organize government decisions in a way that enhances accountability to others, the scripts can also have the negative effect of making officials' viewpoints sticky to proposed changes in those laws. In markets the sticky attitudes of an organization's participants will be disciplined to some extent by market pressures that push firms toward efficient innovations (even if imperfectly), but in governments market pressures tend to be indirect and weaker. True, states face pressures from jurisdictional competition to provide mobile parties with laws they like, but these pressures are not always present, and when they are, they can be satisfied by allowing parties to arbitrate their claims or to choose their governing laws. The substantive governing law need not actually be changed (O'Hara and Ribstein 2009). In addition, other interest group pressures might create an expectation that government officials make changes to the status quo. My point here is not that

biases toward the status quo always prevail or necessarily will prevail in the context of contract law harmonization. Rather, those interest groups may need to work to overcome this institutional inertia.

To be sure, a status quo bias can be aided or hindered by existing institutions and rules. Societies satisfied with existing institutions will attempt to foster the status quo bias, while those perceiving a need for change will put in place mechanisms to more effectively fight that bias. The creation of the EU and the attempt to build a unified marketplace both reflect a desire on the part of member nations to help effect reforms. To help overcome the bias in favor of inertia, European institutions were put in place to make decisions largely independent of the pre-existing nation states, and the incentives of decision makers in the European institutions favor legal reforms, particularly those that help to better integrate EU markets.

European institutions can nevertheless be affected by national biases toward the status quo, however, for two reasons. First, the Council of Ministers, whose assent is necessary for the promulgation of EU directives, is made up of representatives from each member nation, and decisions emanating from it are likely to reflect individual nation attitudes to some extent. Second, legal reforms can address a very large number of topics in the EU, and inevitably scarce resources end up focusing EU energies on reforms that matter a great deal to some interest groups represented in EU institutions without garnering strong resistance from others. Relatedly, political salience also influences the direction in which scarce reform efforts shape law. As a result of these two forces, one can expect that national resistance to legal reforms will continue to influence EU decisions to some extent.

Given this predicted resistance to change on the part of governments, including EU member nation governments, harmonization is likely to be successful only in the event that advocacy efforts are launched on the part of firms, consumers, or others for legal reform. Ambivalence or lukewarm advocacy on the part of these groups likely will prove insufficient to overcome the bureaucratic inertia created by scripts that favor current law. Will firms, consumers, and/or others push for harmonization? Is harmonization more likely for some contracts than for others? And will harmonization be partial, in the form of minimum contract rules, or full? The next Part addresses these questions.

3 Market participant views on harmonization

Market participant reaction to proposed harmonization would depend on both the substantive outcome of harmonized laws and the group whose views are considered. Although some advocate that harmonization is valuable in its own right because it can eliminate the uncertainties created by multiple possible applicable laws, the assertion is of dubious validity. Harmonization that creates ineffective policy or that poorly suits valuable contracting environments could well prove inferior to diverse substantive laws, especially when parties are able to remove this legal uncertainty by inserting choice-of-law clauses into their contracts. In addition, market participant views will likely differ in the consumer contract and business-to-business contract contexts. Subpart A considers the political economy of consumer

contract harmonization, and Subpart B considers market participant views to harmonization in the context of more sophisticated commercial transactions.

3.1 Consumer contracts

It is not at all clear that consumer willingness to transact is affected by harmonization of laws. Consumers as individuals rarely pay any attention to legal differences. Concededly they might be leery of transacting with people and firms located in other nations. However, consumer reluctance likely stems primarily from uncertainties regarding the business norms in other places and the difficulty of obtaining reputational information about foreigners and has little or nothing to do with concerns about differences in the governing law. Indeed, consumers often are unaware of domestic legal rules let alone the subtle difference between domestic and foreign rules. My point here is not that harmonization would be irrelevant to all consumers; rather, it is unclear that harmonization alone will make a significant difference in consumer willingness to contract with foreigners. One might expect consumer groups to fight for greater consumer protections, and that effort might use the rhetoric of harmonization as a mechanism to obtain greater protections for consumers in some nations, but the effort in reality is one of providing protections, not harmonization. Moreover, protections obtained might well inure to the benefit of consumers or to a more desired world order, but greater protections are not likely necessary prerequisites to consumer willingness to contract.

In any event, the reaction of market participants to any harmonization that might result turns on the content of the harmonization. If EU harmonization does not change the substantive law in a member country (i.e. member states' laws all converge to that nation's laws), then we might expect little reaction from the nation's firms and consumers regarding the harmonization. True, the market participants in that nation might feel proud that their nation's laws have become the model for the EU, and they might be delighted to know that their local and cross-border business practices can continue interrupted, but in terms of the substance of governing legal rules, nothing changes for these market participants. Thus, we might expect little in the way of strong lobbying on the subject of the proposed substantive rules by the market actors themselves.[15]

Harmonization that lowers a nation's substantive contract protections likely will do little to increase its citizens' subjective confidence in cross-border trade. Consider, for example, harmonized consumer protection provisions that have the effect of raising the protections afforded in some nation states but lowering the protections afforded in others, including state X. For those relatively few market participants who do pay attention to the governing laws, the lowered protections can increase the sense of vulnerability associated with transacting with strangers, especially foreign strangers. It is therefore not surprising that EU harmonization in the context of consumer contracts has often taken the form of providing minimum

[15] Attorneys in nations whose laws may be exported could express ambivalence regarding the proposed harmonization. In the short term, these attorneys could garner advantage in sharing their expertise with other nations. In the long term, however, the comparative expertise in this advantageous law will dissipate as experts of this law evolve in other nations.

rules and standards protecting consumers (a strategy likely supported by consumer groups that care more about the protections than about the harmonization).

More explanation is in order here. Much market activity takes place in an economy only because the participants trust one another to do what they promise. This trust can take two forms: "trust in" trust and "trust that" trust.[16] "Trust in" trust occurs when one participant holds a belief about the character of another that leads her to believe that the other will act to her benefit. I trust in the woman who cleans my house to refrain from stealing my valuables because I know her well and believe that stealing from me is inconsistent with her value system. Market activity that occurs in close-knit social groups often thrives as a consequence of "trust in" trust. When legal and other external mechanisms cannot be relied on to enforce agreements, parties are likely to attempt to deal only with those in their tight-knit social groups. For example, Landa and Wang (2001) interviewed Chinese rubber dealers who felt unable to rely on contract law to enforce their arrangements and found that they structured their transactions on the basis of personal trust and that they adopted a clear hierarchy of preference for trading partners, which, in preference order, included (1) kinsmen in the same nuclear family; (2) extended family kinsmen; (3) clansmen; (4) fellow villagers; (5) Chinese persons speaking the same dialect; (6) Chinese speaking another dialect; and (7) non-Chinese.

Market efficiencies are enhanced when people can be induced to trade with strangers as well as with those that they know. After all, goods and services are apt to go to more highly valued users if more sellers and more providers are introduced to the potential trading circle. Strangers cannot rely on "trust in" trust but a thinner "trust that" trust can often prove sufficient to induce people to trade with those they do not know well enough to assess personal character.

"Trust that" trust occurs when a person feels confident that another will do as he promised because the surrounding circumstances create incentives for that person to do what he promised. Some "trust that" trust can be created by trust intermediaries. For example, I trust that independent book sellers will send me the books that I order online in part because amazon.com provides reputational information about the track record of the sellers. Professional licensors similarly act as trust intermediaries because they can deprive an individual of her ability to practice her trade if she fails to act in accordance with professional norms.

At least in theory, a willingness to trade can also be enhanced by the presence of safety nets that serve to protect vulnerable individuals in the event that a trading partner does not do what he promised. I enter into a contract to sell my home to an interested buyer, and thereby forgo entering into a sales agreement with other potential purchasers. I do not know the buyer and although trust intermediaries can provide me with assurances that the buyer has the financial ability to purchase the home (i.e. mortgage lender prequalification), they cannot provide me with assurances that the buyer will not back out if his personal circumstances change (a broken engagement to marry, for example). I might nevertheless be willing to enter into this contract because the buyer has provided an earnest money deposit

[16] For a more detailed discussion of these two different types of trust, see Hill and O'Hara (2006).

that we turned over to an escrow agent that can serve as compensation in the event that the buyer fails to do what he promised.

Legal rules can help to bolster trust and/or to fortify the safety net provided to market participants. Legal rules can help to bolster "trust that" trust if the law mandates standards of conduct that either reflect positive business norms or strengthen weak ones, and if the effective punishment meted out for failing to comply with those standards is large enough to help assure contracting parties that the other party will perform within reasonable bounds of conduct. Legal rules also provide us with safety nets to explore trade with strangers if those who fail to keep their promises are required to provide compensation to those injured by the breach. To the extent that legal rules do matter to cross-border trade, lowered standards of conduct and/or lowered remedies are unlikely to make vulnerable market participants in one nation comfortable trading with outsiders.[17]

Consider instead a harmonization effort that has the effect of increasing the protections afforded to market participants in the nation (i.e. harmonization that takes the form of spreading the most protective contract laws across the member states). In this case, increased protections could produce asymmetric effects on trade. Increased protections could have the effect of fostering cross-border trade for the reasons stated earlier. But this increased trade could occur at the expense of reduced intra-group trade. To understand how this could happen, we must return to our discussion of the law's relation to interpersonal trust.

Recall that increased legal standards and protections can have the effect of making strangers more comfortable trading with one another. Protections that reduce rather than fully eliminating vulnerability can nevertheless stimulate market activity with strangers by encouraging experimentation with small scale trading. Small scale transactions that go well can cause contracting parties to increase their business dealings and "trust that" trust and/or safety net induced experimentation can produce "trust in" trust that becomes the basis for more valuable trade interactions. At some point, however, it is possible that strong legal protections have the effect of hindering trustworthy behavior. For example, in Wilkinson-Ryan's experiments involving liquidated damages provisions, contracts with these protections have resulted in subjects being less likely to keep their promises (Wilkinson-Ryan 2010). This experimental situation differs from the situation posited here because in the experimental situation the contracting parties were pricing the value of performance, and the breaching party clearly seemed more comfortable breaching when the other party effectively stated his or her value of performance in the liquidated damages clause. If the legal protections afforded to contracting parties become sufficiently generous, however, then contracting parties are likely to assume that they make the other party whole and they could therefore be less inclined to engage in trustworthy behavior.

[17] Note that the analysis in the text presupposes that the purpose of harmonization is to get individuals and businesses to feel comfortable trading across borders. One might instead think of harmonization as a mechanism for encouraging businesses to expand their trading operations to as many locations within the EU as possible. Jurisdictional competition for firm activity might well be bolstered by lowering the standards and protections afforded by the contract laws in the more protective states. This Essay focuses on the desire to foster trust rather than on the desire to lower the costs of doing business.

Moreover, vulnerability through lack of legal protections can serve to increase the payoff to trustworthy behavior. In a state where legal protections are weak, people want some assurances that the person that they transact with will do what they've promised to do, so they seek out and retain trading partners who are known to be trustworthy. In a state where legal protections are very strong, the competitive benefits to trustworthy behavior might not be so strong, and, if so, both intragroup trade and expensive promise keeping could suffer.

If correct, this analysis suggests that efficient governing legal rules could vary with the contracting environment depending on the incidence of stranger versus close-knit trading. Lynne Zucker has traced the rise of formal legal institutions in the US to increased immigration and urbanization and the consequent increased stranger-based trading opportunities that required institution-based production of trust to thrive (Zucker 1986). Lisa Bernstein has traced the rise in the incidence of close-knit trading groups attempting to opt out of the standard legal structure that has developed over the last century (Bernstein 1992, 2001). And the author has argued that trust issues involved in Internet commerce might justify the adoption of enhanced consumer protections for that environment (O'Hara 2005). If cross-border trading in the EU comes at the expense of inhibiting trust-in based close-knit trading, then perhaps increased contract protections should be available only for cross-border trade and the pre-existing domestic rules should continue to apply for domestic contracts. This solution makes sense in light of the possibility that each member state already has the contract laws that best suit the domestic contracting environment. Rather than jeopardize that balance, proposed harmonization should perhaps apply only to cross-border deals.

Note that the preceding argument equated close-knit and trust-in trading with domestic trading and stranger trading with cross-border trades. No doubt these categories are not equivalent, so a formal rule separating out domestic and cross-border trades is unlikely to do a very good job fitting governing laws to particular trust situations. Instead of a less expansive harmonization of the substantive law applied to cross-border contracts, the legal treatment of contracts might best be left to the parties themselves. If more assurances need be provided to encourage trade, then a party can promise more, charge less, or agree to the law of a state that provides greater contract protections. If fewer assurances are necessary, then a party can promise less, charge more, and agree to stick with less protective law (all ways of reaping the benefits of a reputation for trustworthiness).

Firms might therefore decide to oppose harmonization for fear that one rule will inevitably poorly suit individual contract environments and instead support legal provisions that enable contracting parties to choose their own governing laws. Consumers, on the other hand, probably pay little attention to the content of governing laws and are unlikely to ever oppose greater protections afforded to them. And, although trust relationships could in theory be negatively influenced when contract protections are too great, this fear of overprotection applies more to the safety net situation than to situations where the law mandates reasonable commercial standards. In the former case, it is possible that fully compensated consumers (including compensation for time and frustration) will generate more breach and less trustworthy behavior. In the latter case, using the law's expressive

function to bolster better behavior in contract relationships can generate more trustworthy behavior and therefore greater trust on the part of consumers. We might then think about harmonizing standards of conduct but not remedies for breach or failure to comply with these standards. In any event, any positive effects generated by using the law's expressive function will be subtle, indirect, and long-term. As a matter of interest-group advocacy, then, it does not seem that enhancing trust provides either consumers or firms with a strong interest in lobbying for harmonization of contract law.

Firm interest in lobbying for harmonization could be further tempered by the fact that optimal governing contract rules depend in part on firm attributes such as the nature of the goods or services provided and the firm's cost structure and technological ability to tailor product and contract to particular legal regimes.[18] Add these variations to the differing needs to promote trust and it becomes essentially impossible to envision firms as a coherent interest group prepared to promote any single version of harmonized laws.

Harmonization of governing laws can provide additional benefits to firms, however. Firms that provide homogeneous goods and services to consumers in many nations might benefit from contract law harmonization because it can be cheaper to be able to do business according to a single company production, marketing, contracting, and consumer service plan, and company policies in each of these areas must take into account the governing legal standards. Firms can achieve much of these transactions cost reductions in the US, despite diverse state laws, by incorporating choice-of-law clauses into their contracts and then conducting business according to the law of the chosen state. In the EU this strategy is much more limited because under the Rome I Convention and consumer protection directives, a choice-of-law clause cannot be used to circumvent consumer protections in the consumer's nation of habitual residence.[19] Thus, one might expect international firm support for some harmonization efforts. In contrast, intranational firms might oppose harmonization because the costs of multiple firm business methods raise foreign rivals' costs of doing business in the nation. And no firm will support harmonized laws that significantly raise the costs of it to provide its goods or services to consumers. Put differently, harmonization that provides very high consumer protections at some point becomes so costly that those costs trump the transactions costs savings from doing business according to a single legal standard: even certainty-seeking international firms will oppose costly harmonization in favor of uncertain but less costly legal rules.

When consumer groups fight for consumer protections, international firms seek legal certainty with minimal consumer protections, and intranational firms oppose legal certainty but join in the fight for low-level contract law protections, perhaps it is no surprise that harmonization of consumer contracts tends to take the form of minimum contract protections that can be added to by member states.

[18] *See* Juan Jose Ganuza and Fernando Gomez, *Optimal Standards for European Consumer Law: Maximum Harmonization, Minimum Harmonization, and Coexistence of Standards,* this issue (discussing the fact that optimized standards will depend on the technologies of firms).

[19] Council Regulation 593/2008 on the Law Applicable to Contractual Obligations (Rome I), Article 5, paragraph 2.

3.2 Nonconsumer contracts

In more sophisticated contract settings, the parties tend to be more aware of governing laws and differences across legal regimes. Despite this awareness, however, firms engaged in commercial transactions are unlikely to desire the harmonization of substantive contract laws. These firms can remove uncertainty about governing legal rights by either building those rights into the negotiated contract terms or by inserting a choice-of-law clause designating the applicable law for the parties' relationship. Because these choices can be tailored to the needs of the parties, choosing among a diverse set of substantive law might be preferable to substantive harmonization. True, the multiplicity of possible governing laws can increase the transactions costs associated with choosing the best governing law,[20] but companies can minimize these costs by choosing a law reputed to be fair, impartial, and workable without delving into the specifics of the substantive law of that nation.[21] Thus, it is not surprising that choice-of-law rules for contracts have been harmonized significantly under Rome I and substantive contract rules outside of the consumer context have been left largely unaddressed.

Indeed, international commercial pressures have caused nations to provide contracting parties with significant freedom to choose not only the laws that will govern their agreements but also the forums in which future disputes will be resolved. Firms can circumvent private regulatory enforcement by choosing to resolve disputes in arbitration rather than courts. And firms that prefer courts (to provide declaratory, injunctive or other relief) can choose the courts that will hear disputes. In all of these contexts, a diverse array of choices benefits the parties because it enhances the parties' abilities to find the proper fit between their activities and the procedural and substantive laws that are applied to disputes that might arise from these activities. These choices can matter even when the contracting parties place their own hostage-taking provisions into their contract to induce conscientious performance and provide for a remedy in the event of future problems. Such privatized measures can sometimes require enforcement assistance which can be enhanced with the parties' choices of law and dispute resolution forums.

In the EU, England is considered to have a comparative advantage in the provision of law, courts and arbitration forums desirable to international contracting parties, and interest groups within that country have been quite vocally opposed to further contract law harmonization out of fear that this comparative advantage will be eroded (McKendrick 2006). Third parties whose livelihoods depend on the provision of these dispute resolution services have a strong interest in attempting to preserve the distinctiveness of English law. The next section discusses the role of other third parties in transactions—those that help to enhance "trust that" trust for stranger transactions.

[20] Stephan Vogenauer and Stephen Weatherill conducted a survey that indicates that diverse laws do impose costs on firms engaged in international commerce, although those costs seem to impede transactions only at the margins of profitability (Vogenauer and Weatherill 2006). Gary Low, this issue, discusses the problem of choice overload.

[21] Alternatively, firms can insist on the application of local law, a preference for most firms surveyed (Vogenauer and Weatherill 2006).

3.3 Trust intermediaries

As a matter of political economy, there is a third group that could have a stake in substantive contract law harmonization: the trust intermediaries. Bonding and insuring entities, rating agencies, escrow agents and others owe their financial successes to the fact that deals are more likely and more profitable when the parties' vulnerabilities are reduced. If the law could perfectly ensure party performance, most trust intermediaries would be driven out of business. Perfect performance assurance is more a theoretical possibility than a reality, however. The practical question is whether trust intermediaries primarily are complements to or substitutes for legal protections. In a sense, they are both. Rating agencies and other entities that produce and disseminate reputational information would not exist unless parties were willing to trade with one another in the first place. Insurers can provide affordably priced insurance against breach in part because they rely on using a cause of action for breach as the basis for their right of compensation from the breaching party. Transactions attorneys can enhance the likelihood of performance and protect the parties in the event of breach only if legal protections make contract construction worthwhile, and their due diligence efforts require the same basic willingness to transact needed to employ the rating agencies.

Although some legal protections can facilitate the business of trust intermediaries, extensive legal protections could begin to crowd out some of the demand for their services by reducing party vulnerabilities. In practice, however, trust intermediaries might alter their business methods with small variances in governing laws but they are unlikely to be driven out of business. Unless the current state of the law is either extremely protective or extremely unprotective, then, it is not clear that trust intermediaries have a strong incentive to either support or oppose proposed harmonizations.

4 Conclusion

Even assuming that cross-border trade can be enhanced by measures that increase trust in these transactions, it is not clear that harmonization will effectively produce such trust. Harmonization alone is unlikely to do the trick; instead, the law to be harmonized must be carefully calibrated and perhaps contextualized to enhance trust in the appropriate settings. Moreover, interested parties are unlikely to strongly lobby for efficient harmonized rules.

Consumers know little about the governing laws in their own and other member states. Consumer confidence comes from observed trustworthy marketplace behavior, which in turn creates a willingness to experiment with new, even foreign trading partners, which then creates more opportunities to observe trustworthy marketplace behavior. The governing laws can influence the trustworthiness of the behavior observed in the marketplace and therefore the trust that consumers place in their transactions, but the relationship between consumer trust and these laws (particularly harmonization) is indirect, uncertain, and, most importantly, largely unknown to most consumers. Thus, consumers are unlikely to lobby hard for the

harmonization of substantive contract law even though consumer groups may push for protections.

Firms are more likely to understand the relationship between contractual obligations and consumer confidence, but they can produce more trust-generating governing rules by tailoring the terms of the contract and by incorporating choice-of-law clauses. Where such choice is possible, businesses thus have no need to lobby for the harmonization of substantive contract law, particularly given that there is always a risk that the product of harmonization efforts will fail to provide optimal trust for their particular contracting situations. Given that choice-of-law clauses cannot be used by businesses to provide a single business platform in the context of consumer contracts, some support for harmonization is possible, but only if the proposed harmonization does not raise the costs of bringing the goods or services to market.

Finally, the incentives of trust intermediaries to alter the trust levels provided by law seem unclear and therefore weak. Without knowing more about the influence of marginal legal changes on trust intermediary profits, it seems that the intermediaries also have little, if any, incentive to lobby for harmonization. Indeed, some trust intermediaries, such as transactions lawyers, who are located in nations with desirable commercial laws could lose their market advantage if harmonization eroded the relative benefits of local laws.

Legal reforms often need dedicated interest group proponents to help overcome bureaucratic inertia from scripts and to focus reform-minded institutions on this potential reform rather than on others. On net, political forces are not clearly predicted to fight for harmonization, at least outside of the consumer context. Thus, even if harmonization could increase trust in cross-border trade, the potential for such harmonization in the EU may be inherently limited.

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