The position of small and medium-sized enterprises in European contract law: an introduction

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The position of Small and Medium sized Enterprises in European Contract Law – An introduction

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1. Introduction – the development of a consumer policy

In 1975 the European Council accepted the first Consumer Policy Programme.[1] As was mentioned in the introduction to a previous book in this series,[2] European consumer law was justified as being a measure to improve the quality of the life of the peoples of the Member States of (then) the European Economic Community. According to the 1975 Consumer Policy Programme the consumer was entitled, among other things, to protection of his economic interests and to redress. With regard to the protection of the consumer's economic interests, it was noted that the consumer needed to be protected against the abuse of power by the seller, in particular against one-sided standard contracts, against the unfair exclusion of essential rights in contracts and harsh conditions of credit, against demands for payment for unsolicited goods and high-pressure selling methods, as well as against damage to his economic interests caused by defective products or unsatisfactory services. Moreover, the presentation, advertising and promotion of goods and services, including financial services, should not be designed to mislead, either directly or indirectly, the person to whom they are offered or by whom they have been requested. Information provided by a producer, seller or service provider should be accurate, and the consumer should be offered an adequate choice between different goods available to him.[3] As regards the right of redress, the European Commission stated that if damage or injury resulted from defective goods or unsatisfactory services, the consumer should receive advice and help in order to file complaints, and that swift, effective and inexpensive procedures were needed in order to allow the consumer proper redress.[4] The right of redress mentioned in the 1975 Consumer Policy Programme therefore reflects what is more commonly referred to as the matter of *access to justice*. Therefore, the consumer policy program in this respect was justified by the notion that consumers lack equal bargaining power and are entitled to bring their claims in front of a court or tribunal.

From 1975 onwards, consumer policy and consumer protection measures have been on the political agenda. Until the 1992 Maastricht Treaty came into force,[5] consumer policy measures could only be taken with a view on the improvement of the internal market, as there was no other specific legal basis that could be relied on.[6] It may be doubted whether measures taken in the area of consumer protection in the 1980s actually contributed to the improvement of the internal market – in particular, it is hard to see how the 1985 Doorstep Selling Directive[7] could make a serious impact on cross-border trade.[8] This suggests that it was not so much the improvement of

[1] Council Resolution of 14 April 1975 on a preliminary programme of the European Economic Community for a consumer protection and information policy, *OJ* 1975, C 92/2.
[2] M.B.M. Loos and A.L.M. Keirse, The Optional Instrument and the Consumer Rights Directive: Alternative ways to a new Ius Commune in contract law – Introduction, in: M.B.M. Loos and A.L.M. Keirse (eds.), *Alternative Ways to Ius Commune, in particular in Private Law*, Cambridge/Antwerp/Portland: Intersentia, 2012, p. 1-4.
[3] *OJ* 1975, C 92/2, no. 19.
[4] *OJ* 1975, C 92/2, no. 32.
[5] *OJ* 1992, C 191/1. The treaty came into force 1 November 1993.
[6] Since then, the treaties do contain such specific legal basis; see currently Article 12 of the Treaty on the Function of the European Union (TFEU).
[7] Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, *OJ* 1985, L 372/31.
[8] See Loos/Keirse 2012, p. 7-8.

the internal market, but the European legislator's political desire to award protection to a particular type of buyers – consumers –, which was the basis of the European directives in the area of consumer law.

2. Protection of other parties lacking bargaining power?

The flexible approach to the matter of competence in the years until the mid-1980s suggests that the aim of improving the internal market could also constitute a valid legal basis for the European legislator to award protection to other parties that lack bargaining power or have difficulty in getting access to justice. Yet, the political will to expand such measures to non-consumers on a structural basis at that time was missing at the European level. Moreover, when the European Commission argued in favour of a broad interpretation of consumer protection rules to protect also small businesses that find themselves in a similar position as an ordinary consumer – in this case: where small businesses were canvassed in a similar fashion as consumers and therefore were equally unprepared for the attempts of the other trader to persuade them to contract with that trader – in the famous *Di Pinto*-case the European Court of Justice denied such protection as a normally well-informed trader simply could not be considered to be in a similar position as a consumer since he may be expected of his legal position and his interests.[9] Moreover, in 2001,[10] the Court confirmed that only natural persons could qualify as consumers within the sense of European legislation and that legal persons for that reasons cannot invoke the protection of the Unfair Terms Directive.[11] Nevertheless, as the protection of non-consumers is outside the scope of the European consumer protection directives, Member States are free to award similar protection to such non-consumers if they see the need to do so, as the Court of Justice considered explictly in the *Di Pinto*-case.[12] And in some cases Member States indeed do so.[13]

If European law does provide a legal basis, and national law already in some cases extends consumer protection rules to non-consumers, one could argue that it is only a matter of time until such extension will occur on a European scale as well. However, there is a pragmatic reason *not* to award non-consumers similar protection as consumers: how should one distinguish between those businesses that are worthy of similar protection as consumers, and those that are not? In 2006, *Hondius* argued that even though legislators have tried, no convincing criteria have been found to draw the line between these categories.[14] However, he points to two separate developments that could offer some hope for small business. Firstly, he argues that consumer protection claims have often served as a catalyst in reforming the law in general, especially contact law.[15] This has proved to be true in particular with regard to the Consumer Sales Directive,[16] which has led to a major reform of German contract law, and to a lesser extent also

[9] See ECJ 14 March 1991, case C-361/89, [1991] ECR p. I-1206 (Criminal case against Patrice di Pinto), nos. 17 (for the position of the European Commission) and 18 (for the decision of the Court).
[10] See ECJ 22 November 2001, joint cases C-541/99 and C-542/99, [2001] ECR p. I-9057 (Cape Snc/Idealservice Srl and Idealservice MN RE Sas/OMAI Srl
[11] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, *OJ* 1993, L 95/29.
[12] See no ECJ 14 March 1991, case C-361/89, [1991] ECR p. I-1206 (Criminal case against Patrice di Pinto), nos. 21-22.
[13] See E.H. Hondius, The notion of consumer: European Union versus Member States, *Sydney Law Review* 2006, p. 96.
[14] Cf. Hondius 2006, p. 95-96.
[15] Hondius 2006, p. 96.
[16] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, OJ 1999, L 171/12.

with regard to the Package Travel Directive,[17] which (through the case-law of the Court of Justice)[18] has led to the introduction of compensation of pain and suffering in Member States' legislation. Secondly, *Hondius* points to the fact that where in a Member State specific consumer protection rules is accompanied by an open clause that is applicable also in the case of a B2B-contract, the consumer protection rules may play a (secondary) role when interpreting that open clause.[19]

3. Recognition of the position of weaker commercial parties in European B2B-contract law

Next to consumer law, however, a European business-to-SME contract law is slowly developing. The notion of SME, an acronym for small and medium-sized enterprises, is defined in the Annex to Commission Recommendation 2003/361/EC.[20] In Article 2 of the Annex, a division is made between microenterprises, small enterprises and medium-sized enterprises. Medium-sized enterprises in fact are pretty large companies employing fewer than 250 persons and having an annual turnover not exceeding € 50 million and/or an annual balance sheet total not exceeding € 43 million. On the other hand, microenterprises employ fewer than 10 persons and have an annual turnover and/or annual balance sheet of no more than € 2 million. Between these two extremes, small enterprises employ fewer than 50 persons and have an annual turnover and/or an annual balance sheet of no more than € 10 million.

Attempts to protect SMEs have been undertaken through two different schemes: on the one hand, sector-specific legislation could protect specific categories of SMEs, often next to consumers. On the other hand, generic measures may be taken to protect *all* businesses.

The first example of the first kind is the 1986 Commercial Agency Directive (which obviously does not protect consumers).[21] The preamble to this Directive makes clear that the existing differences in national laws concerning commercial agency not only substantially affect the conditions of competition and the carrying on of that activity within the European Union Community, but that these differences are also 'detrimental both to the protection available to commercial agents vis-a-vis their principals and to the security of commercial transactions'.[22] This indicates that even though the Court of Justice in 1991 denied small business the same protection as consumers in the circumstances that have led to the enactment of the Doorstep Selling Directive on the basis of the assumption that businesses are supposed to look after their own interests, the European legislator had already recognised that commercial parties may very well be in a weak position as against their contractual counterpart and that for that reason they may be worthy of legal protection.

A second example is offered by the 1990 Package Travel Directive,[23] where the notion of consumer in Article 2 under (4) is defined in such broad terms that also some business travellers

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[17] Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, OJ 1990, L 158/59.

[18] See ECJ 12 March 2002, case C-168/00, [2002] ECR, p. I-2631 (Simone Leitner/TUI Deutschland GmbH & Co. KG).

[19] Cf. Hondius 2006, p. 96, referring to the so-called *Indizwirkung* or *Reflexwirkung* of the black and grey lists of terms that are deemed or presumed to be unfair in consumer contracts in Germany and The Netherlands.

[20] Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361/EC, *OJ* 2003, L 124/36.

[21] Council Directive of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, *OJ* 1986, L 382/17 (Commercial Agency Directive).

[22] See Whereas no. 2 in the preamble to the Commercial Agency Directive.

[23] Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, *OJ* 1990, L 158/59.

fall within the protective scope of the Directive. Similarly, the scope of the 2004 Denied Boarding Regulation[24] is not restricted to consumers, but protects all air passengers.[25]

Another example is offered by the legislation in the energy sector. The 2003 Directives on the internal market for energy and natural gas[26] require Member States to take appropriate measures to protect final customers and to ensure high levels of consumer protection, and, in particular, to ensure that there are adequate safeguards to protect vulnerable customers, including appropriate measures to help them avoid disconnection.[27] Final customers are customers purchasing electricity or natural gas for their own use and include both consumers and businesses. According to the Annex to both Directives, standard terms in the contract between the energy provider and the final customer must be fair. Similar provisions have been included in the Third Energy Directives that have replaced these Directives.

Until recently, the second scheme of protection, which is made available to all businesses, was exemplified only by the 2000 Late Payment Directive,[28] and its successor, the 2011 Late Payments Directive.[29] In its proposal for the 2000 Late Payment Directive, the European Commission recognised the specific position of SMEs. While late payment of contractual debts may lead to cash-flow difficulties, undermine profitability and damage competitiveness of all business, the European Commission indicated that the damaging effects on SMEs are particularly severe. According to the Commission, the differences in payment practices within Europe are striking, with on average debtors in South European countries taking three times as long for paying their bills than debtors in Nordic countries. The differences in payment times and the problems of late payments affect the competitiveness of businesses and deter them from engaging in cross-border trade, the Commission indicated.[30] Moreover, the European Commission suggested that the enactment of the Late Payment Directive should not be restricted to the private sector as in many countries the public sector is one of the worst payers, and that apart from setting a bad example for other economic operators, 'there is an imbalance between the parties' as many SMEs are dependent on public contracts and may fear losing their only or main client if they insist on speedy payment. The Commission continues its argument by saying that '[b]ecause of their respective bargaining positions and the public sector's own rules regarding payments conditions which do not allow or encourage negotiations on payments conditions, firms cannot genuinely negotiate with the public sector.'[31] Although the final wording of the 2000 Late Payment Directive does not expressly reflect the idea that some businesses need to be protected because of their weak bargaining position, this element can clearly be identified as underlying the 2000 Late Payment Directive. The protection of SMEs as

[24] Regulation (EC) 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation (EEC) No 295/91, *OJ* 2004, L 46/1.
[25] Cf. Hondius 2006, p. 96.
[26] Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, *OJ* 2003, L 176/37, and Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, *OJ* 2003, L 176/57, commonly referred to together as: the Second Energy Directives.
[27] See Article 3(5) of Directive 2003/53/EC and Article 3(3) of Directive 2003/54/EC.
[28] Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions, *OJ* 2000, L 200/35.
[29] Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (recast), *OJ* 2011, L 48/1.
[30] See the Explanatory Memorandum to the European Commission's Proposal for a European Parliament and Council Directive combating late payment in commercial transactions of 25 March 1998, COM (1998) 126 final, p. 2.
[31] Explanatory Memorandum, p. 5.

creditors is even explicitly addressed in Article 3 of the Directive, which grants creditors the right to claim interest in case the payment period has elapsed and determines the interest rate. Obviously, the parties may derogate from these provisions. However, Article 3 paragraph (3) of this Directive introduces the notion that such contractual derogations may be considered grossly unfair, taking into account all circumstances of the case including good commercial practice and the nature of the product. The Member States are required to provide that in the case of such a grossly unfair term, the term is either unenforceable or will give rise to a claim for damages, and the court will either have to replace the term by the statutory (default) rules or determine different conditions that are fair.[32] Article 3 paragraph (3) of the 2000 Late Payment Directive thus introduces the notion that a contractual term in a commercial contract may be unenforceable due to its grossly unfair nature. Whereas the scope of the provisions is restricted to interest clauses in B2B-contracts, it could be a seen as a first indication that the European legislator is opening up the possibility of unfair terms legislation for B2B-contracts in order to protect SMEs' weak bargaining position from exploitation by stronger parties.

The 2011 Late Payments Directive goes a step further in this direction. Article 7 of this Directive, entitled 'Unfair contractual terms and practices' requires, in its first paragraph, Member States to provide that a contractual term or a practice relating to the date or period for payment, the rate of interest for late payment or the compensation for recovery costs is either unenforceable or gives rise to a claim for damages if it is grossly unfair to the creditor. This provision indicates that the Directive also provides protection against grossly unfair commercial practices that harm SMEs as creditors. Moreover, paragraphs (2) and (3) even blacklist and greylist certain contractual terms and commercial practices, indicating that contractual terms or practices that exclude interest for late payment deemed to be grossly unfair, and contractual terms or practices excluding compensation for the creditor's own recovery costs are or presumed to be grossly unfair. With regard to these terms the protection of the 2011 Late Payments Directive even goes further that the protection of the Unfair Terms Directive, which merely contains in its Annex an indicative list of terms that *may* be considered unfair within the meaning of that Directive.

4. The Draft Common Frame of Reference and the proposal for a Common European Sales Law

Whereas the provisions on the protection of SMEs against unfair terms in the 2000 and 2011 Late Payments Directive is restricted to contractual terms relating to payments, the Draft Common Frame of Reference (DCFR) again goes a step further. In the Introduction to the Outline Edition published in 2009, it is remarked that the use of standard contract terms lead to new forms of inequality that need to be addressed and that such problems can also occur in contracts between businesses, particularly when one party is a small business that lacks bargaining power. For that reason, the DCFR – following the example of Member States such as Germany and The Netherlands – extends the protection against unfair terms to contracts of all types.[33] However, the fact that a different text is introduced for the wording of the unfairness test for B2B-contracts using the wording of the 2000 Late Payment Directive instead of the wording of the Unfair Terms Directive suggests that for B2B-contracts a more restrictive approach to the

[32] Paragraph (4) adds that in the interests of creditors and of competitors, have to provide for adequate and effective means to prevent the continued use of such grossly unfair terms.

[33] Cf. C. von Bar, E. Clive, H. Schulte-Nölke a.o. (eds.), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR), Outline Edition, Munich: Sellier: 2009, Introduction, no. 10.

unfairness test has been taken.[34] In addition to the unfairness test for contract *terms*, Article II.–7:207 DCFR introduces protection for weaker parties, including businesses, from unfair exploitation by the stronger party by construing the exploitation as a defect of consent allowing the exploited party to invalidate the contract as a whole.[35]

The Proposal for a Common European Sales Law draws upon the text of the DCFR and introduces rules on unfair contract terms in B2B contracts into hard law. According to Article 86 CESL, a contract term in a contract between traders is unfair if it forms part of not individually negotiated terms and if it of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing. As the DCFR, the difference in wording seems to indicate that the fairness test for terms in B2B contracts is less stringent as in B2C contracts. Moreover, the CESL offers further protection for weaker parties in general. Pursuant to Article 51 CESL, a party (consumer or trader) that was unfairly exploited can avoid the contract.

The personal scope of the CESL is limited. According to the first paragraph of Article 7 of the proposed Regulation, it is only applicable if the seller of goods or the supplier of digital content is a trader. Where all the parties to a contract are traders, the CESL can only be used if at least one of those parties is an SME. The second paragraph of Article 7 reiterates the definition of SME as it is found in the Annex to Commission recommendation 2003/361/EC.[36] An SME is a trader which employs fewer than 250 persons and has an annual turnover not exceeding € 50 million or an annual balance sheet total not exceeding € 43 million. Member States can, however, decide to make the CESL also available for all B2B contracts, even if none of the businesses is an SME.

5. A brief description of the papers in this book

This introduction made clear that the position of SMEs, under the CESL in particular and European Contract Law in general, deserve particular attention. Therefore, the research programme Contract Law of the Ius Commune Research School (www.iuscommune.eu) chose the topic as theme of the workshop contract law during the 17th Ius Commune Conference in Amsterdam on 29 and 30 November 2012. The workshop focused on the contractual relations of SMEs with other SMEs (SME2SME), consumers (SME2C and C2SME) and larger companies (B2SME and SME2B). The general research question was: 'Is there a need for a kind of "consumer law for professionals"?' This book is the result of the fruitful collaboration within the research programme.

In the first chapter, **Fernando Dias Simões** discusses the concept of SME in the CESL. He finds that the definition of SME which is used in the CESL creates uncertainty and that it would therefore be preferable to extend the concept of consumer. He raises doubts whether the introduction of the CESL will significantly reduce the transactions costs of cross-border business, as the Commissions asserts. **Sonja Kruisinga** raises in the second chapter the question whether the CESL can do without the definition of an SME altogether. She discusses the uncertainties relating to the definition of SME in the CESL and compares it with the definition of small and large enterprises in Dutch private law. She concludes that the restriction to SMEs in

[34] See Articles II.–9:403 DCFR for consumer contracts and II.–9:405 DCFR for commercial contracts (whereas Article II.–9:404 DCFR even introduces a third, intermediate, test for contracts between non-business parties.
[35] In doing so, the DCFR has taken over, in different wording, the provision of Article 4:109 of the Principles of European Contract Law on excessive benefit or unfair advantage.
[36] Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, *OJ* L 2003, 124/36.

the Regulation on the CESL should be deleted or (at least) one Member State should use its option to extend the CESL to larger businesses. The third chapter, written by **Pieter Brulez**, is devoted to the role which general contract law rules can play in protecting weaker parties. In his comparative discussion, he underscores the benefits of applying open norms in protecting weaker parties as this allows for contextualization and a concrete assessment of which party is the weaker one.

Josse Klijnsma considers in the fourth chapter the unfair terms protection for SMEs in the CESL. He discusses the potential rationales for a fairness control on unfair contract terms: an internal market element and a weaker party protection argument. This renders him sceptical about the different fairness tests for terms in B2C and B2B contracts, as neither of the potential rationales can justify such a distinction. In the fifth chapter, **Sander Van Loock** takes the rules on the protection against unfair contract terms in B2B contracts in the CESL as a starting point to embark on a functional comparative analysis of such rules in Germany, the Netherlands, Belgium, France and the United Kingdom. He criticizes the CESL's restriction to SMEs and favours a general norm against unfair contract terms in B2B contracts as such an open norm offers the possibility to take into account the position of SMEs. **Bert Keirsbilck** assesses in the last chapter the possible option for the further harmonisation of rules on business-to-business practices. He gives a critical analysis of the dualistic approach underlying the current European law of unfair commercial practices. He ends with the broader issue of the need and desirability of harmonisation of rules concerning unfair B2B trading practices. He advocates the extension of the scope of the Unfair Contract Terms Directive to cover terms in B2B contracts and to amend the scope of the Directive on Unfair B2C Commercial Practices to cover both B2B and B2C (marketing) practices at the pre-contractual stage.