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An Optional Instrument and Social Dumping Revisited

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An Optional Instrument and Social Dumping Revisited

Jacobien W. Rutgers

I Introduction

In the Green Paper on ‘policy options for progress towards a European Contract Law for consumer and businesses’, the European Commission presents choices as to the future of contract law in the European Union (EU). Much can be said about this document. For instance, the critique of the Manifesto on social justice on the Action Plan of the European Commission can be repeated. In both instances, the European Commission presents the exercise as a technical one. It poses questions, inter alia, as to the form and the scope of an optional instrument. However, important questions are missing, for instance the issue concerning the legal basis of an optional instrument. In addition, the Green Paper does not address the level of protection to be provided. Should the point of departure of the optional instrument be either freedom of contract or a balance between freedom of contract, on the one hand, and fairness, solidarity or social justice on the other.

The hypothesis of this paper is that in order to be chosen the optional instrument must include less protection than the protection provided in the national legal systems. This phenomenon is also referred to as social dumping. The risk of social dumping is more likely to occur in the case of b2b-contracts rather than in the case of b2c cases, since the European Commission stresses that there should be a high level of consumer protection and does not express an opinion as to the level of protection concerning b2b transactions. The level of protection with respect to b2b transactions differs in the Member States. For instance, in

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* This paper will be published in the European Review of Contract Law.
* J.W. Rutgers, j.w.rutgers@vu.nl; earlier drafts of this paper were presented during the Symposium groenboek Europese contractenrecht: naar een optioneel instrument?, Amsterdam, November 2010 and the Secola conference in Leuven (January 2011). I would like to thank the participants for their comments. The usual disclaimer applies.
4 See Ruth Seton-Green, More choice: less certainty. How questions do not give us answers.
6 Green Paper, fn 1, above, 11.
Germany there are mandatory rules with respect to general conditions which apply in b2b transactions, whereas other legal systems, for instance English law, do not provide this type of protection. Moreover, it has been argued that an optional instrument could solve the problems of SME-entities in cross-border and domestic trade.\(^7\)

This hypothesis is tested by considering empirical research with respect to another optional instrument in the EU, the Societas Europea (hereafter the SE)\(^8\), and empirical research with respect to a choice of law in the case of international contracts\(^9\). It is submitted that the SE differs from an optional instrument on contract law. However, there is anecdotal evidence that the European Commission uses the SE as an example in the discussion on an optional instrument on contract law. Moreover, there are also similarities between the SE and an optional instrument. First, pursuant to the ECJ-Centros, Inspire Art case law\(^10\), one is free in the EU to select the legal system of a Member State under which a corporate entity is incorporated. Within the EU there used to be two conflict rules with respect to corporate entities: the real seat doctrine and the incorporation doctrine. In short, according to the former, the legal system of country where a firm has its main activities, governs a corporate entity, whereas according to the latter the legal system of the country where the firm is registered governs it. From these judgments it can be inferred that the real seat doctrine is contrary to the freedom of establishment as it is included in

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the TFEU, unless it is justified. These decisions have started a debate as to whether there is regulatory competition concerning the corporate charter in the EU.

In the case of international contracts, the main rule is that parties are free to select the legal system that governs their contract under the applicable conflict rules. This is reflected in the fact that Member States and legal professional organisations consider their legal system of contract law a selling point, which was pointed out by Kötz in a recent paper. Considering these circumstances, it is considered worthwhile to compare the SE with an optional instrument on contract law. However, this paper does not pretend to be an empirical research, its aim is to provide an educated guess, which, of course, could be considered in future empirical research.

II. The Societas Europea (SE)

The Societas Europea was introduced in the Member States by Regulation 2157/2001 and EC Directive 2001/86 on employee involvement in the SE. The SE is a legal entity that can be established provided that certain requirements are met. One of these conditions is that there must be already a national corporate entity. A characteristic of the SE is that a choice can be made between either a one-tier or a second-tier board system. Under national legal systems, corporate entities have a one-tier, two-tier board system or a combination of the two. A one-tier

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corporate structure implies that an ‘administrative organ’ is the highest body that has management powers in the corporate entity.\textsuperscript{16} In the case of a two-tier system, there is a supervisory board which controls the board of directors, which is the management authority.\textsuperscript{17} The German and Dutch system have, for instance, a two-tier system, whereas, the law of England and Wales provides a one-tier system. Another feature of the SE concerns the involvement of employees. A SE can only be registered when employee involvement in the SE has been arranged (Article 12 II of Regulation 2157/2001). Under Directive 2001/86 it is for the parties involved in the SE to negotiate about the employees’ involvement. If the negotiations fall through, the national law of the company determines the issue of employee participation. Under the national legal systems of the Member States, there are some legal systems, which include mandatory rules concerning employee co-determination, for instance in Germany and the Netherlands, whereas in other countries no such thing exists.

There are surveys as to the use and the existence of the SE in EU Member States. In 2009, the European Commission asked Ernst & Young to conduct research concerning SE’s use in the EU.\textsuperscript{18} One of their results is that there were 369 SEs in the EU and the EFTA countries.\textsuperscript{19} This was based on data collected till 15 April 2009. 37.7% of SEs is a shelf SE and most of these shelf SEs are registered in the Czech Republic. In addition, the Czech Republic has the largest number of SE’s in the EU.

A conclusion of the Ernst & Young Survey is that employee involvement, regardless of whether it was either present or absent in a given legal system, is decisive as to whether a SE will be established. In Member States, where the legal systems include employee co-determination, the SE is popular.\textsuperscript{20} In those countries, the SE is regarded as a means to avoid employee co-determination. Moreover, the negotiations about employee participation also hamper the creation

\textsuperscript{17} Study on the operation and the impacts of the Statute for a European Company (SE)- 2008/S 144-192482 Final report, 9 December 2009, Ernst & Young advocates, 248.
\textsuperscript{18} Study on the operation and the impacts of the Statute for a European Company (SE)- 2008/S 144-192482 Final report, 9 December 2009, Ernst & Young advocates, 9.
\textsuperscript{19} Idem. 11.
\textsuperscript{20} Idem. 244.
of SEs in Member States where there is no employee involvement in corporate entities.\(^\text{21}\) According to this survey the issue concerning employee co-determination is more important than, for instance, the European image of the SE.\(^\text{22}\)

As said before, in the EU there are Member States which have a one-tier board system and Member States that have a two-tier board system and finally there are Member States which include a combination of the two. From this survey it follows that the SE is popular in Member States which have a two-tier system, for instance Germany, the Netherlands, the Czech Republic and Slovakia. In addition, the SE is not that popular in Member States which have one-tier system.\(^\text{23}\) Moreover, in countries which have both systems, the SEs only have a one-tier system.\(^\text{24}\) Another observation of this survey concerns the European image of the SE. It is ‘not … a primary driver for the choice of the SE but always a key factor in this decision. It helps easing the acceptance of the employees, shareholders, creditors and other parties involved.’\(^\text{25}\) Nevertheless, the European Commission presents the European image as one of the main drivers for the creation of a SE.\(^\text{26}\)

Another survey concerning the SE was published in 2009. The research was conducted by Eidenmüller, Engert en Hornuf. Despite different figures in their research, they draw conclusions similar to the Ernst & Young Survey.\(^\text{27}\) Their paper focuses on the issue as to whether the market uses the opportunities which are offered in the area of corporate law, to which they refer as legal arbitrage.\(^\text{28}\) Their survey consisted of telephone interviews of 75 % of the SEs which were incorporated in Germany at that moment.\(^\text{29}\) In addition they tested their data by an econometric analysis. Their most striking result is that German firms use the SE to avoid the German rules on employee co-determination.\(^\text{30}\) In addition they argue that national corporate law should resemble

\(^{21}\) Idem. 241.  
\(^{22}\) Idem. 243.  
\(^{23}\) Idem, 14.  
\(^{24}\) Idem, 248.  
\(^{25}\) Idem, 266.  
\(^{26}\) COM (2010) 676, fn, fn 14 above, 3.  
\(^{27}\) Eidenmüller et al., fn 8 above, 1-33.  
\(^{28}\) Idem.  
\(^{29}\) Eidenmüller, fn 8 above, 11, 13 ff.  
\(^{30}\) See also Reichert, fn 15, 26 ff.
the rules concerning the SE. Another result was that the European image of the SE was important for 75% of the German SEs. However, it was not the overriding consideration to establish a SE.

Finally, the European Commission also produced figures as to the number of SEs in the EU. As already stated, as to the number of SEs, the figures differ in the surveys. This may be explained as follows. First, the surveys were conducted at different moments in time. Secondly, a SE must be registered in the Member State, where its registered seat is (Article 12 of Regulation 2157/2001). Subsequently, the SE must be published in the EU Official Journal. However, there is no sanction if this does not take place (Article 14 of Regulation 2157/2001). Eidenmüller et al. checked both the national trade registers as well as the EU OJ, whereas the Ernst & Young Survey was based on the trade registers in the Member States. The figures produced by the European Commission are retrieved from a different source again. According to this collection of data dated 25 June 2010, there were 595 SEs registered in the EU.

<table>
<thead>
<tr>
<th>EU Member State</th>
<th>Number of Societates Europeae Per 2008</th>
<th>Survey Ernst &amp; Young, 15 April 2009</th>
<th>Survey European Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>144</td>
<td>91</td>
<td>134</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>123</td>
<td>137</td>
<td>281</td>
</tr>
</tbody>
</table>

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31 Eidenmüller et al., fn 8 above, 33. See Deakin (fn 12 above, 451 ff) who pointed out this effect. Cf McCahery, Vermeulen, fn 12, above, 801.
32 Eidenmüller et al., fn 8 above, 28.
34 Eidenmüller, Engert, Hornuf, fn 8 above, p. 12; Ernst & Young, fn 18 above, 11.
37 Eidenmüller, Engert, Hornuf, fn 8 above, 20.
38 Fn 18 above.
It is true that the results of these surveys on the SE cannot be directly transposed to an optional instrument on contract law. However, there are no proper data available (yet) as to the use of an optional instrument on contract law. Secondly, the SE is one of the very few or may be the only optional instrument in the area of private law. This taken together with insights of law and behaviouiral economics or psychology may provide indications as to whether an optional instrument on contract law may result in social dumping.

One striking result is that there is strong preference for national corporate entities rather than for the SE. The number of SEs is not that great if it is compared to the number of other
corporate entities. This corresponds to findings of law and psychology, that people have a status quo bias, which results in an indirect choice for the default option. This indicates that if the optional instrument will be an opt-in instrument, it will not be used that much. If it is used there must be reasons to do so. From the surveys discussed, it follows that, at least in Germany, the overriding reason to use the SE is to circumvent the mandatory rules on employee participation. This could also be coined social dumping.

III Choice of Law

Other research which may shed light on the use of an optional instrument is empirical research with respect to choice of law conducted by the Oxford Institute for European and Comparative Law. Several observations follow.

First, 100 firms within the EU were interviewed. 95% of the interviewees belong to the category of firms which have 250 or more employees. Usually a firm which has 250 or more employees, does not belong to the category of small and medium sized entities (SME), whereas 90% of the firms in the EU, belong to the category of SME-ties. Secondly, according to this survey the law of contract is quite an influential factor affecting cross-border trade. It must be noted though that 90% of the interviewees was legally trained. As is well-known from sociological research of the law, the law of contract is not that important for running a business, unless persons who are legally trained are interviewed. Thirdly, the businesses interviewed were asked which legal system was considered best to govern their contracts. However, this criterion is only relevant when one party is much stronger and can impose its conditions on the

40 For instance, in the Netherlands there were approximately 13,000 companies that had 50 employees or more in 2006. Centraal Bureau voor de Statistiek at "http://statline.cbs.nl/StatWeb/publication/?VW=T&DM=SLNL&PA=37912&D1=0-10&D2=a&HD=110302-0805&HDR=T&STB=G1". This agency does not seem to provide figures concerning the number of corporate entities.


42 Vogenauer, fn 9 above.

43 Question 8 of the Survey.


45 Question 2 of the Survey, fn 9 above.

other party. If parties have equal bargaining power, the applicable legal system is more likely to be the outcome of negotiations and thus unpredictable. The latter does not seem to be considered in this survey. However, research carried out by Stefan Voigt, relating to the applicable legal system in arbitration proceedings, draws roughly similar conclusions.47

The results of the survey are:

<table>
<thead>
<tr>
<th>Countries</th>
<th>Firms interviewed48</th>
<th>Choice of law and first choice49</th>
<th>Choice for another legal system than its own50</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>17 %</td>
<td>21 %</td>
<td>23 %</td>
</tr>
<tr>
<td>France</td>
<td>16</td>
<td>14</td>
<td>7</td>
</tr>
<tr>
<td>Germany</td>
<td>19</td>
<td>16</td>
<td>12</td>
</tr>
<tr>
<td>Italy</td>
<td>16</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>9</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>3</td>
<td>14</td>
<td>28</td>
</tr>
<tr>
<td>USA</td>
<td></td>
<td></td>
<td>10</td>
</tr>
</tbody>
</table>

In the first column, the percentage of the interviewed firms in each country is provided. In the second, the legal system that is the first choice is included. In the last column, it is indicated which legal system is chosen if the parties do not select their own legal system.

From this survey, it follows that there is a preference for the legal system of the country where the firm is based. When another legal system is chosen, Swiss law is very popular.51 Swiss

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47 See fn 51, below.
48 Question 1, fn 9 above.
49 Question 17.1, fn 9 above.
50 Question 17.3, fn 9 above.
51 Voigt, fn 9 above, 15. Voigt draws similar conclusions on the basis of a research concerning choice of law in arbitration cases which were at the International Chambre of Commerce in 2004. His research question concerned the efficiency of civil and common law. 24 % selected English law, 20 % Swiss law, 19 % French law. Only in 10 % of the cases a choice for one of the legal systems of the US or Canada was made. According to the model which Voigt used, Swiss law is more attractive than English law, 15.
law is more attractive than English law, whereas 59% of the interviewees thought that English law would be chosen rather than Swiss law.\textsuperscript{52}

Only with respect to German companies, more data are available concerning the choice for Swiss law. They are presented in the table below.

<table>
<thead>
<tr>
<th>21 German companies that are interviewed</th>
<th>First choice of law</th>
</tr>
</thead>
<tbody>
<tr>
<td>German law</td>
<td>14</td>
</tr>
<tr>
<td>Swiss law</td>
<td>5</td>
</tr>
<tr>
<td>English law</td>
<td>1</td>
</tr>
<tr>
<td>Legal system of the other contracting party</td>
<td>1</td>
</tr>
</tbody>
</table>

Neutrality and language are provided as reasons for the choice of Swiss law in German literature.\textsuperscript{53} In addition, a preference for Swiss law is a means to circumvent the mandatory rules concerning general conditions under German law (§§ 305 ff BGB), according to German authors.\textsuperscript{54} If Swiss law is chosen rather than German law, one could argue that the result is social dumping, since it is a way to circumvent the strict German rules on general conditions.

**IV Conclusion**

From the surveys with respect to the SE it follows that one of the main reasons to establish a SE is to avoid the rules on employee involvement under the national rules. Also the opposite seems to apply. There are less SEs in countries where there is no employee involvement, which is considered troublesome. If the survey on choice of law is taken into account, the results are more ambiguous. There seems to be a preference for Swiss law, if parties do not choose their own legal system. In the case of German companies, an explanation may be that in this way the German rules on standard terms can be circumvented.

It could be argued on the basis of the surveys discussed above, that there is an indication that an optional instrument should provide less protection than the national legal systems, if it is

\textsuperscript{52} Question 18 of the survey, fn 9 above.
\textsuperscript{54} Ibid.
to be chosen. The result therefore could be less protection in the EU, or to put it differently, social dumping. The question is whether it is desirable if an optional instrument is to be introduced in the EU without a proper discussion about the level of protection. In other words, a discussion about an optional instrument on contract law should also include a dimension about a social Europe.