The paradoxes of the theory of imprévision in the new French law of contract: a judicial deterrent?

Pedamon, C.

This is a copy of the final version of an article published in Amicus Curiae, (Issue 112), pp. 10-17. It is available from the publisher at:

http://journals.sas.ac.uk/amicus

Article

The paradoxes of the theory of *imprévision* in the new French law of contract: a judicial deterrent?

by Catherine Pédamon

Much has already been written about *imprévision*, frustration and impracticability in commercial contracts (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (Paris Legal Publishers, 2013)). It is however necessary to revisit the theory and practice of hardship in light of the new legal provision (Art 1195 CC) of the rewritten Civil code (CC) that now enshrines the theory of *imprévision* (unforeseeability) in French law.

The *Ordonnance* no 2016-131 of 10 February 2016 has implemented a reform of the law of contracts, the general regime of obligations and the proof of obligations that had remained nearly untouched since the original iteration of the Civil code in 1804 (See Pédamon, The New French Contract Law and its Impact on Commercial Law, in Heidemann, M and Lee, J (eds) *The Future of the Commercial Contract in Scholarship and Law Reform: European and Comparative Perspectives,* (Springer, 2018)). It has introduced a new article – Article 1195 CC – that ushers in a radical change from the well-anchored rejection of the theory of *imprévision* set in case law that dates back to the 19th century. It grants the judge power to review the contract upon the request of one party. In the Parliamentary debates for the ratification of the Ordonnance, the Senate attempted to limit this judicial power by requiring both parties to ask for this. It considered the unilaterally triggered power contrary to legal certainty as it could generate more litigation. After debate, the senators did agree upon the unilateral formulation of the current article on the basis that the provision is only a default rule and that in the case where a party asks the judge to adjust the contract, the other party is likely to request its termination, termination that the judge is likely to uphold. The senators nevertheless excluded securities transactions and financial contracts from the article (see the report prepared by Houlié and Pillet for the *Commission mixte paritaire* – Report no 352 (2017-2018)). The *Ordonnance* was ratified by the Act no 2018-287 of 20 April 2018.

So what did motivate the introduction of a provision allowing judicial review of contracts? Was it policy or commercial considerations? Is the new Article 1195 CC only an evolution in the footsteps of other European domestic rules and transnational legal principles or a response to commercial needs? Does this erode the principle of *pacta sunt servanda* and herald a more radical judicial approach to unforeseeability?

History traces the theory of *imprévision* back to the 12th and 13th centuries in the Roman rule – *contractus qui habent tractum successivum et depentiam de future rebus sic stantibus intelliguntur* – that set limits to contractual sanctity because of economic instability. Its implementation led to commercial uncertainty that reduced its popularity. With the rise of scientific positivism and the philosophy of Enlightenment cherishing the freedom of contract, the Napoleonic code did not incorporate any provisions on unforeseeability. Over time, the French courts continued to reject the theory of *imprévision* as they upheld the principle of *pacta sunt servanda* strictly.

This theory raises the questions whether an unforeseeable change of circumstances that renders the performance of the contracts commercially impracticable may be considered as an excuse to non-performance, and what remedies are available to the parties. It mainly applies to commercial contracts, particularly instalment contracts whose performance consists of performance of repeated actions over a period of time and long-term contracts. These commercial contracts are the focus of this paper. As businesses negotiate the terms of their contract, they are expected not only to consider the existing circumstances but also to anticipate the circumstances that might affect the performance in the longer term. The contract therefore becomes an exercise of foreseeability. This is consistent with the doctrinal theory of *imprévision* that focuses on the *unforeseeability* of the event itself rather than its economic effects.

The new Article 1195 CC reflects the influence of other European country responses to unforeseen circumstances, including the German *Wegfall der Geschäftsgrundlage* or the Italian *eccessiva onerosità sopravvenuta*, and international legal projects, such as the Principles of European Contract Law (PECL) and the Unidroit Principles of International Commercial Contracts (Unidroit Principles). The *Rapport au Président de la République* (Report to the President of the Republic relating to the *Ordonnance* no 2016-131 of 10 February 2016) in its explanatory notes on Article 1195 CC stresses the importance of the European context as part of the justification for the reform:

> *France is one of the last European countries not to recognise the theory of imprévision as a moderating factor to the binding force of contract. Its enshrinement inspired by comparative law as well as European harmonisation projects makes it possible to combat major contractual imbalances arising during performance, in*

accordance with the objective of contractual fairness sought by the Ordonnance.

These notes explain the objective of the theory of *imprévision*, which is to balance the principle of *pacta sunt servanda*, promoting the security of transactions, and contractual fairness. More importantly, the reform has a utilitarian dimension, which aims to keep the contract alive where it still has an economic and perhaps social role to play (Mekki and Kloepfer Pelese, "Hardship and Modification (or Revision) of the Contract (2010)", available at SSRN: https://ssrn.com/abstract=1542511.

The reform is also a response to concerns of small and medium sized businesses about the absence of default rules on hardship in the Civil Code, which is more problematic for a sector where contracts tend to be less complete. This contrasts with larger companies that carefully insert detailed hardship provisions, dealing with matters such as material adverse change or price adjustment mechanisms, in their more complete contracts.

In light of these considerations, the *Ordonnance* now enshrines the theory of *imprévision* with some specificities. Article 1195 CC is concerned with adjusting the rights of two *innocent* parties – on the one hand, the right of the affected party that must continue to perform but needs a way out from a situation of commercial impracticability, and on the other hand, the right of the other party entitled to the performance of the contract. As the parties are better placed to understand their respective position in the transaction and make decisions, the preferred mode of resolution envisaged in the first paragraph of 1195 CC is renegotiation. When this fails, the next port of call – and ultimate one – is the court. The novelty of the article lies in the power of the court to adjust the terms of the contract or bring it to an end. The court now appears to have a greater degree of discretion to review the contract. This raises the usual questions about the conditions under which this can be exercised and the resulting effects.

As this paper shows, Article 1195 CC raises three paradoxes:

- *the first one in the nature of the article itself as a default rule that encourages a voluntary ex-ante contractual solution over a judicial solution through careful pre-emptive drafting;*
- *The second at the renegotiation phase as the affected party has the right to request renegotiation whereas the other contracting party the right to refuse to renegotiate; and*
- *The third in the new judicial powers that play as a deterrent and favour an ex-post contractual solution through renegotiation.*

Overall, this article demonstrates a clear bias for a private contractual and negotiated solution (over a judicial one). Small and medium sized businesses are likely to avail themselves of the new framework to redefine their contractual relationship. By contrast, larger commercial enterprises are further incentivised to enhance their self-reliance by boosting forward-looking contractual and expert determination provisions dealing with changed circumstances. In the words of the rapporteur for the Senate, "(t)he hypothesis where the judge will be asked by a party to review the contract will remain theoretical" (Pillet, in the report prepared by the *Commission mixte paritaire* –Report no 352 (2017-2018)). The fear of a snowball effect with the provision generating a a more interventionist judicial attitude appears exaggerated.

To understand Article 1195 CC and the new power of the courts to review the contract, it is necessary to explore (1) the context and particularly the judicial approach to hardship in commercial contracts overtime until the recent Ordonnance, (2) the conditions for the exercise and effects of the new provision on *imprévision*, and (3) the perspectives this article opens up in the case of chain or group of contracts.

A CALL FOR REFORM

Until the reform enshrined in the Ordonnance, commercial impracticability could not be invoked as an excuse for non-performance on the ground of the principle *pacta sunt servanda*. Despite the rigour of this constant rejection, courts nevertheless gradually ascertained the existence of an obligation to renegotiate on the basis of the principle of good faith. The conditions of application of this new obligation had remained however unclear as case law shows, thus calling for legislative clarification.

The consistent rejection of the theory of imprévision

The judicial rejection of the theory of *imprévision* can be traced back to the seminal decision of *Canal de Craponne* (Civ. 6 Mach 1876, DP 1876. 1. 193). In that case, the *Cour de cassation* refused to increase the fees that landowners had to pay in exchange for the maintenance and operation of the canal that were set more than three centuries ago despite an increase by more than 400 per cent of the actual costs. It based its decision on the principle of *pacta sunt servanda* enshrined in the former Article 1134 CC that provided that *agreements lawfully formed have the force of law for those who have made them*. As a result, it firmly prohibited courts from considering time and circumstances to adjust the terms of the contract, however equitable their decisions might appear. In successive cases, the *Cour de cassation* systematically quashed any such consideration of equity by lower courts to increase the contract price in light of the changed circumstances. As such, it embraced a strict interpretation of the intangibility of contracts, even where the performance of the contract had become commercially impracticable. The rigour of the solution was aimed at reinforcing the legal certainty ascribed to the contracts. Only a few cases have actually come to the attention of the Cour de Cassation; clearly not enough for this court to give up the well-anchored rejection of the theory of *imprévision* and any judicial intervention in the contract. A few variants have however emerged over time.

A gradual emergence of a duty to renegotiate in good faith

In a couple of cases in the 1990s (Com. 3 November 1992, Huard, nº 90-18.547, Bull. civ. IV, nº 338; Com. 24 November 1998, *Chevassus-Marche*, nº 96-18.357, Bull. civ. IV, nº 277), the *Cour de cassation* ascertained an obligation to renegotiate based on the principle of good faith in circumstances of commercial impracticability. In these cases, the court acknowledged that the party claiming hardship, ie the distributor or the commercial agent, had been deprived of the ability of charging competitive prices due to the changed circumstances and their state of economic dependency. The continuing participation of the parties in the market was threatened by the intangibility of the seriously imbalanced contract and justified a renegotiation of the terms of the contract by the party benefitting from the circumstances In another decision of 2007 (CA Nancy 26 September 2007, D. 2008.1120), the Court of Appeal of Nancy expanded the scope of application of the obligation to renegotiate in a supply contract on the legal basis of good faith performance. The introduction of a new legislation for the reduction of greenhouse gases had caused a significant disequilibrium in the contract against the economic interest of the supply company that justified such obligation. The generality of the obligation to renegotiate was however questioned since all the cases examined related to the distribution industry.

In the context of an international sales contract subject to the Vienna Convention on Contracts for the International Sale of Goods (CISG) (1980), the issue of hardship has come up too. Whereas it is well-established that Article 79 CISG provides an excuse for a failure to perform any obligations in case of impossibility, domestic courts have to decide if it also applies in case of commercial impracticability. The now well-known case *Scafom International BV v Lorraine Tubes SAS* (Belgian C. Cass, 19 June 2009, C.07.0289.N, available at http://cisgw3.law.pace.edu/cases/090619b1.html) confirmed the existence of an obligation to renegotiate in good faith; it also showed the confusion of the courts when faced with a dispute on hardship. This case related to a number of contracts of sale between a Dutch buyer and a French seller for the delivery of steel tubes in Belgium. Following the increase in the price of steel by 70 per cent, the seller tried to renegotiate a higher contract price but in vain as the buyer refused and requested delivery of the goods at the contract price. The lower Commercial Court of Tongeren highlighted the failure of the parties to insert a clause in their contract for price adjustment and confirmed in line with French case law that "in the absence of such provisions, it was for the buyer to bear the risk of non-performance without being able to benefit from the provisions of Article 79 CISG…" (Civ 30 June 2004, RTDC 2004.845, obs Delebecque). The Court of Appeal of Antwerp overturned the lower court's decision and, applying French law, held that the buyer had an obligation to renegotiate the terms of the contracts. Finally, the Belgian *Cour de cassation* rejected the application of French law. That said, it reached the same conclusion as the Court of Appeal and confirmed the obligation of the buyer to renegotiate the contracts (in good faith) as the unforeseen price increase gave rise to a "serious disequilibrium (in the obligations of the parties) that rendered the subsequent performance of the contract in the same conditions particularly detrimental (to the seller)." It based its decision on the Unidroit Principles as the general principles of international trade law that can be used to fill the gaps in the CISG in a uniform manner. Paradoxically, it confirmed that Article 79 CISG could, in certain cases, cover cases of hardship as changed circumstances that were not reasonably foreseeable at the time of conclusion of the contract and were unequivocally of a nature to increase the burden of performance of the contract in a disproportionate manner could constitute an "impediment."

A case of judicial confusion?

A succession of cases thereafter showed the confusion of the *Cour de cassation* in its quest for a legal doctrine that could ground the theory of *imprévision* and justify an obligation to renegotiate – either on the basis of "cause" (Com. 29 June 2010, no 09-67.369; Com 17 February 2015, no 12-29550), , or more recently on the basis of a duty of loyalty between the franchisor and franchisee (Com. 15 March 2017, no 15-16.406), or even the principle of good faith, as already mentioned. In passing it should be noted that the concept of "cause" has been removed from the rewritten law of obligations. Nevertheless, against the emergence of a contractual and amicable solution, the *Cour de cassation* re-asserted that courts did not have the power to adjust the terms of the contract (Civ 3e, 18 March 2009, No 07-21.260).

Another case – *Dupire Invicta Industrie (D21) v Gabo* (Com. 17 February 2015, no 12-29.550, 13-18.956 and 13-20.230) – once again considered the excuse of hardship in international sales. It related to a contract of sale between a French seller and a Polish buyer for the delivery of heating units. The buyer was also the seller's exclusive distributor in Poland and Slovakia. The sale contract was governed by Polish law and did not contain a hardship clause as commonly done in the trade for these specific goods. Following an increase in the market price of raw materials, the seller refused to deliver the goods at the contract price invoking a case of hardship. As a result, the buyer sought compensation for the actual loss and loss of profit, as well as the payment of a penalty for late delivery as provided for in the contract.

The Commercial Court of Sedan denied the seller's contention that it was entitled to withhold performance, even in a case of hardship. The Court of Appeal of Reims (Reims, 4 September 2012, nº 11/02698) also refused to grant any relief to the seller as it had failed to produce evidence that the price increase it suffered satisfied the requirements of hardship and, that even if he had suffered losses, the Unidroit Principles did not authorise the affected party to suspend performance. It held that the CISG did not exclude hardship, and that the Unidroit Principles could be used to interpret and supplement the CISG. It added that the seller had not demonstrated that the buyer had violated the principle of good faith when it had failed to renegotiate the price or postponed meetings to discuss the situation.

In its decision of 17 February 2015 (Com. 17 February 2015, no 12-29550, 13-18956, and 13-20230), the *Cour de cassation* held that the Court of Appeal had failed to ascertain whether the price fluctuations exceeded normal variations in the relevant marketplace and changed the additional burden on the seller into an excusable hardship, thus depriving its decision of a legal basis under the former Articles 1131 CC ("An obligation without a cause or with a false cause or with an unlawful cause cannot have any effect") and 1134 CC ("Agreements lawfully formed have the force of law for those who have made them. They may be revoked only by their mutual consent, or on grounds which legislation authorises". (…)), and Article 6.2.1 of the Unidroit Principles ("Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.") Nevertheless, it upheld the appellate decision on this point as the seller failed to prove that the increase in the cost of performance of its contractual obligations, or the new situation that profoundly altered the balance of the contract, constituted a case of hardship. It also implicitly adopted the conclusions of the Court of Appeal that hardship falls within the CISG and that the Unidroit Principles define the scope and consequences of hardship. On the *renvoi*, the Court of Appeal of Nancy (Nancy, 14 March 2018, no 15/01554) confirmed the decision of the Commercial Court of Sedan on hardship, and rejected all the claims made by the two parties. Even in international sales, these cases show the difficulty for the courts in determining hardship.

Lessons to be drawn from these cases

These cases highlight a few interesting points. The first one is the confirmation from the *Scafom* and *D21* international sales cases that the *Cour de cassation* is of the opinion that the CISG covers hardship, and that the Unidroit Principles can be used to interpret and supplement the CISG, particularly in a case of hardship. With the introduction of the theory of *imprévision* into the law of contract, there is now a risk of discrepancy in the application of the rules relating to hardship in domestic and international sales contracts. Such discrepancy may however be mitigated if the new Article 1195 CC is read itself in light of the Unidroit Principles, something that needs to be kept in mind. In any case, a contractual term can always set aside Article 79 CISG as well as Article 1195 CC. The second point relates to the emergence of an obligation to renegotiate in changed circumstances. This obligation is the precursor to the new right to request renegotiation in Article 1195 CC. It is very much in the spirit of settling the dispute through conciliation. Paradoxically, there is no obligation that the renegotiation leads to a common solution, even pursuant to the principle of good faith. As acknowledged in *D21*, a failure to renegotiate the price or the postponement of meetings to discuss the situation does not amount to a breach of good faith. This is consistent with previous decisions (Com. 3 October 2006, D.2007, at 765-770) that in the absence of abusive behaviour, the party that refuses to modify the terms of the contract does not attract liability. The limits to renegotiation are clear - if and when renegotiation fails, the next port of call remains the court. This leads to the third point that shows the traditional consistency of the *Cour de cassation* that always refused to adjust the terms of the contract in a case of hardship on the ground of *pacta sunt servanda*.

In the wake of these cases, and a growing sense of confusion, a legislative framework was therefore expected. It is now done following the *Ordonnance* as the new Article 1195 CC enshrines the theory of *imprévision* in the Civil code.

THE PARADOXES OF THE (NEW) THEORY OF IMPREVISION

Except in rare cases where statutes were enacted to address specific economic circumstances had the French legislator ever allowed judicial adjustment of contracts. Examples of these instances are the Act of 21 Jan 1918 (*Loi Failliot*) (supplemented by the Act of 9 May 1920) and the Act of 23 April 1949 that provided for the termination of commercial contracts concluded before the beginning of the two World Wars, and the circular no 90-72 of 18 October 1990 that admitted *imprévision* in the context of the Gulf War if one of the parties suffered a prejudice exceeding the reasonable expectations at the date of conclusion of the contract. In a (radical) move, the *Chancellerie* has now granted (ultimate) powers of review to the courts in case of changed circumstances when parties have exhausted means of conciliation. It is one of the most striking novelties of the reform. It is however interesting to note that French law is already familiar with the well-established theory of *imprévision* in administrative law (Compagnie générale d'éclairage de Bordeaux, CE, 30 March 1916, Rec. 125). It also follows in the footsteps of the recent Article L 441-8 of the Commercial Code that requires that a "clause relating to the terms of renegotiation of the price" be inserted in contracts of sales of products whose "costs of production are significantly affected by the fluctuations of prices of agricultural commodities and food products" (see Pédamon, The New French Contract Law and its Impact on Commercial Law, in Heidemann and Lee (eds) *The Future of the Commercial Contract in Scholarship and Law Reform: European and Comparative Perspectives,* (Springer, 2018)).

Article 1195 CC is contained in sub-section 1 on the binding force (of contract) that is part of section 1 on the effects of contract between the parties, itself in Chapter IV on the Effects of Contract. Article 1195 CC deals with the effects of hardship, but is silent as to whether it is an exception to the binding force principle. Is the new provision an exception, or simply a "moderating factor", as claimed in the *Rapport au Président*? Regardless of which it is, the juxtaposition of the binding force principle with the unforeseeability paradoxically reinforces the primary rule. By contrast, the equivalent provision in the PECL and Unidroit Principles is written as an exception. More substantively, the aim of this article, as expressly stated in the *Rapport au Président de la Republique*, is to "play a preventive role: the risk of destruction or adjustment of the contract by the court should encourage the parties to negotiate." It could not be clearer – in its activism for a conciliatory solution, the legislative focus is on the *renegotiation* of the contractual terms by the parties. This is consistent with the spirit of the overall reform, which empowers the parties *to avoid litigation or settle the dispute without judicial interference*.

Article 1195 CC is furthermore a default rule that is commonly set aside in sophisticated and complex commercial contracts that provide for hardship terms or indexation clauses, thus leaving the applicability of this article mainly to smaller commercial contracts as well as standard and non-commercial contracts. A distinction must be drawn between voluntary or anticipated renegotiation and involuntary renegotiation (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (2013), p 86). A hardship term commonly provides for renegotiation if and when certain defined or undefined events occur. As it has been contractually negotiated, the renegotiation is voluntary. By contrast, where there is no such clause in the contract, the statutory right to call for a renegotiation leads to involuntary renegotiation. Only with the threat of judicial review will this type of renegotiation succeed. Article 1195 CC provides as follows:

> *If a change of circumstances that was unforeseeable at the time of conclusion of the contract renders performance excessively onerous for a party who had not agreed to bear the risk of such a change, that party may ask the other contracting party to renegotiate the contract. This party must continue to perform her obligations during the renegotiation.*

In the case of refusal or failure of renegotiation, the parties may agree to terminate the contract from the date and on the conditions which they determine, or ask the court, by a common agreement, to set about its adjustment. In the absence of agreement within a reasonable time, the court may, upon request of one party, adjust the contract or put an end to it, from a date and subject to such conditions as it shall determine.

The conditions of application of this new article and its effects must be considered.

A limited application due to stringent conditions

Several conditions must be met before any effect can be produced – the first one relates to the unforeseeable change of circumstances at the time of conclusion of the contract; the second one implies that the risk of changed circumstances has not been allocated to the party who is affected by the change, that is for the most part the seller; and the third one relates to the financial excessive performance of the contract.

An unforeseeable change of circumstances at the time of conclusion of the contract

The broad formulation of Article 1195 CC covers all kinds of changed circumstances – from a legal event, such as the introduction of a new legislation to an economic or financial one relating to a market fluctuation or bankruptcy or an environmental disaster. It is assessed against a test of unforeseeability that relates to the occurrence of the event itself as well as its scale (Deshayes, Genicon, Laithier, *Réforme du droit des contrats, du régime général et de la preuve des obligations*, Commentary, LexisNexis, 2016, p 393). Although not explicitly stated, the test of unforeseeability is objective in the sense that it requires that the affected party proves that a reasonable party in the same circumstances would not have foreseen the changed circumstances. It is commonly read in accordance with Article 1218 CC that defines *force majeure* as "an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of conclusion of the contract (and whose effects could not be avoided by appropriate measures…)" despite the (unfortunate) difference in formulation (see Chantepie & Latina, *Le nouveau droit des obligations*, (Dalloz, 2nd ed) no 524, p 474). This analysis is consistent with the approach already adopted by the *Cour de cassation* despite the absence of the adverb "reasonably" qualifying "unforeseeable" in Article 1195 CC. The reasonable unforeseeability of changed circumstance must be assessed at the time of conclusion of the contract. In *D21* v Gabo, previously discussed, the *Cour de cassation* criticised the Court of Appeal as it did not consider if the increase in costs of raw materials amounted to *abnormal* fluctuations in the relevant market.

Given the absence of clear standards and the imprecision of the notion, the test of *unforeseeability* leaves a rather wide margin of appreciation to the court, particularly as the market and relevant commercial practices evolve and become complex. How will the courts decide whether the changed circumstances – ie a labour shortage or an increased cost of production due to Brexit - fall within the ordinary range of commercial probability?

A risk of change that has not been allocated to the party who is affected by the change

The allocation of risks must be assessed as at the time of conclusion of the contract; it requires that courts ascertain the contemporaneous intention of the parties pursuant to the principles of contractual interpretation. These risks may not necessarily be expressly allocated in the contract; they may follow implicitly from the nature of the contract itself or by implication from the absence of any contractual provision. In a case of 2004 (Civ. 30 June 2004, RTDC 2004.845), the *Cour de cassation* held that:

as a professional who is familiar with the practices of international trade, it was for the buyer to provide contractual mechanisms of guarantee or revision of contract. (…) (I)n the absence of such provisions, it was for the buyer to bear the risk of non-performance without being able to benefit from the provisions of Article 79 CISG (…).

If that party bears the risk, it has to support the losses due to the changed circumstances.

Underlying this condition is the assumption that the parties are in a better position to make decisions about the risks associated with their transactions. Professor Gillette in "Commercial Rationality and the Duty to Adjust Long-Term Contracts" (69 Minn L Rev 521, 524 (1985)) argues that even if parties cannot foretell the future accurately, they can anticipate the existence of uncertainty and rationally provide mechanisms to estimate and control the consequences. His view is that rational planners tend to eliminate those risks at a cost less than their perceived cost. The presumption of completeness can however be rebutted if evidence of incomplete contracting is established. Parties can be prevented from writing complete contracts if the cost of actually negotiating the contracting terms is high – higher than the perceived cost of the risk itself. The function of contract law is therefore to provide default terms that a majority of parties would have chosen, thus reducing the cost of contracting *ex ante*. To what extent is it the case with respect to Article 1195 CC? This must be answered when considering the effects of the new legal provision.

It should be noted that, as a compromise negotiated by the senators during the parliamentary debates for the ratification of the Ordonnance, a new provision – Article L 211-40-1 of the Monetary and Financial Code – was adopted that excludes from the scope of application of Article 1195 CC, the promises arising from securities transactions and financial contracts (Art L. 211-1 I-III of this (same) code). These contracts escape the new statutory provision because of their speculative nature.

The excessive financial burden of performance

The formulation of Article 1195 CC reproduces Article 6:111 of the PECL that requires an "excessively onerous" performance that may be the result of an increase or diminution in cost; it is a formulation centred on the economic value of the performance due. How excessive should the performance have become to be excused, in other words, how significant should the financial losses be? As there is no set test to assess the excessive financial burden, lower courts can exercise their discretion in their consideration of the relevant factors. Furthermore, these considerations are matters of fact that escape any control from the Cour de cassation. The vagueness of the criteria is problematic as it may lead to unpredictable outcomes, but from the cases already discussed, courts have been inclined to avoid assessing the financial losses. Additional questions remain unanswered, such as whether the undue financial burden can cover the loss of profits. Such uncertainties are an incentive for the parties to find a contractual solution.

A formulation closer to Article 6.2.2 in the Unidroit Principles would have been preferable as it refers to a fundamental alteration of the *equilibrium* in the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished. It sets an objective test anchored in the contract itself as it consists of assessing the equilibrium as originally agreed upon in the contract compared with the disequilibrium caused by the unforeseen circumstances. As held by the Belgian *Cour de cassation* in the *Scafom* case, the unforeseen price increase had given rise to a "serious disequilibrium (in the obligations of the parties) that rendered the subsequent performance of the contract in the same conditions particularly detrimental (to the seller)." The disequilibrium raises the question as to what the effect of this should be contractually.

The effects of imprévision – the bias for a contractual solution

The novelty of Article 1195 CC lies in the effects of the *imprévision* in terms of remedies available to the parties – either to find a common contractual solution further to (involuntary) renegotiation or to request by common agreement or unilaterally that the judge finds the appropriate remedy – by either adjusting the terms of the contract or avoiding the contract itself. Although the court may decide to keep the contract as is, it is quite unlikely since the excessive financial burden calls for a solution.

The right to request renegotiation

Once the conditions of hardship are met, the first remedy now available is the right for the party to call for a renegotiation of the contract. Such request may be accepted or refused (as indicated in the following sentence of Article 1195 CC – ie in the case of rejection or failure of renegotiation). Was legal permission necessary to grant this right as Article 1195 CC only provides for the ability to request renegotiation? Paradoxically it even departs from previous case law that had asserted an obligation to renegotiate in good faith. Underlying this provision is the idea that parties are willing to overcome together a situation of hardship and work out a solution to save their contractual relationship and avoid economic waste. During the phase of renegotiation, performance of the contract must continue. Does it imply *a contrario* that the affected party is entitled to suspend performance when the renegotiation stops or the other party refuses to renegotiate? Courts are likely to consider this remedy in light of the circumstances and against good faith.

Even if good faith permeates the whole life of the contract (as stated in the new Art 1104 CC – ("Contracts must be negotiated, formed and performed in good faith" (...)), courts have however traditionally narrowly interpreted the obligation to renegotiate in good faith. There is no obligation to reach an agreement so long as the parties do not act contrary to good faith. As seen in *D21*, a failure to renegotiate the price or the postponement of meeting to discuss the situation does not amount to bad faith. Article 2.1.15 of the Unidroit Principles defines negotiations in bad faith in case where a party enters into or continues negotiations when intending not to reach an agreement with the other party; bad faith may consist of actual misrepresentation or non-disclosure of facts that should have been disclosed. It goes beyond foot dragging or even walking away.

More surprisingly is indeed the ability of the party who benefits from the unforeseeable changed circumstances to refuse to renegotiate. Refusing (involuntary) renegotiation is a right and does not amount to a breach of good faith. It is another paradox of Article 1195 CC given that renegotiation is the option pushed by the legislator to avoid unnecessary economic waste, but it is also a more realistic understanding of the commercial reality. What is the point to force a party to attend renegotiations against its will? The refusal to renegotiate must however be understood against the other remedies now available to the affected party, particularly the ability of the party to request the judge to review the contract or put an end to it. As a result, the beneficiary of the changed circumstances would lose its ability to bargain, and, in the worst-case scenario, the benefit of the contract itself. There is potential for double disadvantage for the party benefitting from the changed circumstances: loss of the ability to demand performance on favourable terms and need to supply itself in an altered (more expensive) market. This party is arguably penalised for having planned and contracted its original bargain carefully. (This disadvantage is nonetheless mitigated by incentives within the provision which re-balance the rights of both parties. Article 1195 CC operates a double set of incentives. The incentive for the benefitting party to maintain as much of the economic advantage as possible and therefore to renegotiate against the threat of a judicial intervention. In parallel, the incentive for the suffering party to settle the matter quickly since it must continue to perform its obligations during the renegotiation and may only request a court to review the contract *in the absence of agreement within a reasonable time*. The obligation to continue to perform is aimed at defeating opportunistic tactics from the affected party. Paradoxically it could be used by the benefitting party to drag out the renegotiations, but this could amount to a breach of good faith pursuant to Article 1112 CC ("The beginning, continuation and breaking-off of pre-contractual negotiations are free. They must mandatorily meet the requirements of good faith") by analogy. Additionally, by failing or refusing to renegotiate the advantaged party may commit a breach that leaves it exposed to liability pursuant to Article 1112 CC. This article provides however that "(i)n case of fault during the negotiations, the reparation of the resulting loss may not compensate either the loss of benefits expected from the contract or the loss of the chance of obtaining these benefits."

Article 1195 CC implies that the affected party has approached the other party to renegotiate the contract, at least as a pre-condition to lodging a claim. In practice, in light of previous case law, this is what happens, and what should happen.

The next step to the phase of renegotiation that has failed or been refused is the ability of the parties by common agreement to terminate the contract. This is a manifestation of *mutuus dissensus*, as already expressed in Article 1193 CC ("Contracts can only be modified or revoked by the parties' mutual consent or on grounds which legislation authorises.") Termination occurs in an amicable fashion (*résolution amiable*). The concept used in French to refer to this mode of termination (résolution) is surprising given that termination can be agreed upon without any breach of performance (Chantepie & Latina*, Le nouveau droit des obligations*, (Dalloz, 2nd ed) no 529, p 480). How realistic is this option since the renegotiation has failed showing the unwillingness of parties to accommodate each other's interests? It is even more unrealistic to expect that the parties jointly "ask the court to adjust the terms of the contract."

Judicial review of the contract – the choice between adjustment and termination

This judicial solution – the solution of last resort - is the one that gives rise to much controversy, as it legalises the judicial review of the contract in a case of changed circumstances. Any fear of excessive judicial interference in the contract is however ungrounded. The paradox that emerges here lies in the deterrent effect of the judicial option as parties are now encouraged to work out a contractual solution. As such, this article reinforces the binding effect of the free will of the parties.

Where the renegotiation fails or the other party refuses to re-negotiate, the parties may jointly request the judge to adjust the terms of the contract. How likely is this judicial voluntary adjustment in a commercial context? Given that it is so unlikely, the practical consequence of this option is for the parties to reach agreement between themselves at an earlier stage. More relevant, is the ability of one party – any party? – to request the judge to adjust the terms of the contract or terminate it in the absence of agreement within a *reasonable time*. This is the novelty so much expected, and *de facto* so limited.

The judicial power is very much framed as a recourse of last resort. The threat of judicial review plays as a deterrent for the party that has an interest in keeping the contract in force to find a renegotiated solution. Although it is phrased quite unclearly, the purpose of this provision is to request that the affected party engage first with the other party for a renegotiation before going to court. The other party may refuse and go to court instead, so what can the judge do?

The judge has a choice between adjusting the terms of the contract or bringing it to an end "from a date and subject to such conditions as it shall determine". There is no hierarchy between these remedies. The choice depends on the claim of the party. Can the judge impose an adjustment of the terms if the party has lodged a claim for termination, or vice versa? (T Revet, *Le juge et la révision du contrat*, RDC 2016, nº 16). The civil procedure rules appear to prohibit this. The judge may in fact exercise greater discretion if the claim made by one party is contested by the other party since under this scenario the judge will have to make a decision for the parties. In such a case, the court may consider the parties' intention as expressed in the terms of the contract, the circumstances at the time of conclusion of the contract, and, as suggested in Article 92 of the *projet Terré,* the *legitimate expectations of the parties*, together with the usage and practice of the market. The distinction between adjustment and termination may not be so easy to draw in practice.

It is striking how difficult it might be for the court to adjust the terms of the contract. How can the parties' mutual practices in long-term contracts be discerned as they evolve and develop over a period of time? Which are relevant? However, courts are already familiar with the practice of adjusting the terms of the contract in other circumstances defined by the legislator. For instance, pursuant to Article 1231-5 CC, the judge may, even at her/his initiative, adjust the terms of contractual performance by moderating or increasing a contractually agreed penalty if it is manifestly excessive or derisory, or, pursuant to Article 1343-5 CC, defer payment of sums that are due or allow payment in instalments. A straightforward way of adjusting the terms of the contract will be for the court to modify the price in light of the indexes or other formulae extracted from the relevant market. An expert or any other neutral third party may be involved in the process of determining the appropriate adjustment terms. Other types of adjustment – at least in theory – may be considered as the term "revision" is broad; it can consist of reviewing the terms of delivery, the quantity of the goods, or any other contractual terms. Termination is the other option available to the judge. To do so may defeat the objective pursued in Article 1195 CC that is to avoid economic waste by forcing the parties to renegotiate the terms of the contract. However, there might be circumstances where adjustment is impossible for economic or opportunistic reasons.

Overall, the solution will depend on the (economic) benefits for one party to save the relationship and renegotiate the terms of the contract, or even on their common decision to terminate the agreement. Parties in an ongoing long-term relationship – the usual situation here – have a strong incentive to work out disagreements amicably rather than see the relationship destroyed by litigation. Through this lens, the (new) power of judicial review is limited, another paradox of Article 1195 CC. As a default provision, it rather encourages the parties to include in their contracts *ex ante* price variation clauses defining the parameters and mechanism for adjusting prices in cases of sudden and unexpected market fluctuations. Even if this inevitably adds up to the cost of contracting – ie the front-end costs – it may also save the cost of litigation or arbitration – ie back end costs. In practice, long-term contracts and complex transactions commonly include highly detailed provisions relating to hardship. However, even in this case, the notions used and the dispute resolution mechanisms in place can be imprecise. In the context of changed circumstances, the contractual relationship tends to become adversarial as each party focuses on the short-term and its own partisan interests. The new article can create an incentive for the parties to refer the adjustment of their contract to a (neutral) third party well versed in their markets, or even private arbitrators.

The absence of such contractual provision can be held against the affected party, as seen in previous cases. As a point of attention, it must be noted that a waiver in a standard form contract that would be non-negotiable and determined in advance by one party and would cause a significant imbalance in the rights and obligations of the parties, may be deemed not written pursuant to Article 1171 CC. Careful drafting is therefore required.

NEW PERSPECTIVES – THE EFFECTS OF IMPREVISION ON OTHER CONTRACTS

Another aspect of this new provision that must be considered is how the theory of *imprévision* will have a knock-on effect for other contracts in a vertical chain or transactional group. It raises an issue of allocation of risks. Whereas the facts are quite similar in the case of a chain or group of contracts, their legal consequences are different. In both cases, the economic consequences can be significant. Special care will be needed to ensure consistent application of Article 1195 CC across the group or chain of contracts. There may also be timing issues if Article 1195 CC is invoked sequentially.

Imprévision in a group or chain of contracts – Article 1195 CC

As already discussed, Article 1195 CC implicitly requires that the affected party request a renegotiation before approaching the court. In theory, however, the party who benefits from the changed circumstances has no obligation to renegotiate, but in practice its conduct will be assessed against standards of good faith (See Com. 15 March 2017, no 15-16.406 for the liability of a franchisor who refused to renegotiate). It is likely that courts will be more robust with parties to groups or chains of contracts by forcing them to renegotiate because of the higher economic stakes. Although Article 1195 CC does not force the benefiting party to come to the table, the principle of good faith can be deployed by the court to bring pressure to bear on reluctant negotiators. If, as provided for in Article 1195 CC, the court is asked to intervene, it is likely that it will consider the economic operation as a whole and also the interdependence between the contracts, to understand the effects of *imprévision* and the remedies available. It may decide to adjust or terminate the contract. Termination can have serious economic consequences on the other contracts. One can imagine the courts exercising their powers of review with even greater caution in these scenarios? (Fauvarque-Cosson, "Does Review on the Ground of *Imprévision* Breach the Principle of the Binding Force of Contracts", in Cartwright and Whittaker (eds) *The Code Napoléon Rewritten*, (Hart, 2018), p 201).

Imprévision in a group of contracts – Article 1186 & 1187 CC

Article 1186 CC adopts a unique solution for groups of contracts. It provides for the lapse (*caducité*) of contracts whose performance is rendered impossible by the disappearance of one of them. It is consistent with the first paragraph of Article 1186 CC that states: "(a) contract which has been validly formed lapses if one of its essential elements disappears."

This article enshrines the legal notion of group of contracts (ensemble contractuel), a concept previously developed by case law. What matters in the definition is to establish the link of indivisibility (lien d'indivisibilité) between the contracts. This link can be an express term in the contracts or implied from the facts, particularly in light of the coherence of the contractual group that contributes to the same economic operation (Chantepie & Latina, *Le nouveau droit des obligations*, (Dalloz, 2nd ed) nº 495, p 441).

Although the effect of lapse is significant, it is justified since the performance of the other contract has become impossible. Lapse is however a remedy only if the party against whom it is held knew of the existence of the contractual group when it gave its consent.

Article 1187 CC furthermore provides that the lapse brings an end to the contract and may give rise to restitution as set out in Articles 1352 to 1352-9 CC. In that sense, it differs from the appreciation of hardship as the disappearance of an essential element automatically causes its lapse that the judge (or the parties) must uphold. Restitution triggers other considerations in its application by the courts that go beyond this paper.

CONCLUSION

In the footsteps of other European models and harmonisation projects, the theory of *imprévision* is now enshrined in the French Civil Code. The novelty of Article 1195 CC lies in the new judicial power of review. Some lawyers may fear a snowball effect of judicial intervention in commercial affairs. This paper should appease this anxiety as it is expected that French courts will exercise restraint when wielding their new power. Certainly, large businesses need not fear judicial discretion since they already have the know-how, which allows them to self-solve unforeseeability in detailed and sophisticated clauses. For smaller businesses, the framework for renegotiation, and when all else fails, the helping hand of experienced judges may be welcome.

The paradoxical attributes of Article 1195 CCC – the default rule, the dynamics of renegotiation and the judicial power of review – all operate to encourage parties to resolve disputes arising out of changed circumstances themselves. The strength of Article 1195 CC lies in its deterrent effect to avoid judicial interference and favour commercial solutions. The parties remain in control and the pact, albeit modified, is affirmed, thus reinforcing the principle of binding force of contracts. It highlights the importance of "the flexibility rather than the rigidity of the contract, its durability and its survival" in the face of unforeseeability as legal certainty requires some contractual flexibility (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (Paris Legal Publishers, 2013), p 37). This is consistent with a utilitarian and more pragmatic vision of the contract that concentrates on its economic value and the need for variation under the threat of contractual failure due to unforeseeable events that render the performance commercially impracticable (Mazeaud, La révision du contrat, Rapport Français aux journées Capitant, les Petites Affiches, 30 January 2005, nº 6).

Catherine Pédamon

Senior Lecturer and Deputy Head for the LLM in International Commercial Law at Westminster Law School, University of Westminster

Article

Commercial registers and transparency

by Maren Heidemann

INTRODUCTION

Commercial registers are a traditional source of information and a service for merchants. They have recently been subject to reform and modernisation and have been joined by additional registers and databases in the pursuit of transparency. This article highlights recent reforms of commercial registers in Europe as well as challenges and opportunities arising from transparency registers and their relationship to the traditional commercial register.

A. COMPARATIVE REGISTER LAW IN EUROPE – MAIN FEATURES AND DIFFERENCES

There are two major types of commercial registers in Europe. Unsurprisingly they can be grouped along the lines of the traditional split between "civil" (or "continental" law) and common law jurisdictions. More technically, the continental register and notary systems follow a self-confessed "Latin" (Roman law) origin while the English system does not. As typical representatives of each type, the German and the English commercial registers can be examined here to set out the major features and differences between these two.

A. 1 German commercial register

Commercial registers in Germany are hosted by the local courts of first instance (*Amtsgerichte*). The law governing the registers is mainly found in the Commercial Code (*Handelsgesetzbuch*, HGB). The traditional *Handelsregister* has been joined by the *Unternehmensregister* ("enterprise register", a database of company information in the context of financial transactions) in 2006 in response to the European Union's reform of companies registers and to improve transparency by way of Directives 2003/58/EC and 2004/109/EC. The implementing federal legislative act in Germany was the *Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister* (EHUG). Sections 8-9b HGB stipulate that both continue to be operated by the local courts. It is obvious that this generally establishes a significant level of fragmentation regarding the information on any corporate entity. Accessing information about any merchant or corporation used to require knowledge of the location of the relevant register court. Even though this would be part of the required information to be published by any merchant and displayed on stationery and official documents, there may be situations where an interested party does not have this information to hand. In a second step, the interested party would then have to contact the relevant register court and request information. This information comprises the name of the company (the firm, *firma*) details of the legal form and nature of a corporate entity, its constituting documents such as the shareholder agreement, its shareholders and their shares, its agents and representatives and in some cases its accounts and annual reports. This information is verified on the part of the merchant by notarisation and formal filing with the registrar. It is not verified as such by the register court. Companies and merchants can be held to account for the facts published in the commercial register. The published information constitutes a non-rebuttable presumption of correctness so that third parties can legally rely on it. This is called the publicity effect (*Publizitaetswirkung*) of the register. This legally binding declaratory effect is derived from the form and procedure vouching for the initial scrutiny of the content being filed.

A.2 English commercial register

By contrast, the English commercial register is hosted centrally by Companies House, a designated agency which hosts and operates the commercial register and acts as registrar. The registrar and the information required to be kept on file are governed by the Companies Act 2006, Part 34. The best-publicised difference to the continental register system is that the information on file is "not verified by Companies House" (when the difference is much rather that it is not notarised), but instead protected by rules contained in the Companies Act. Filing incorrect information constitutes an offence under the Companies Act (pursuant to Pt 35 of the Act, especially s 1112) and can lead to a company being struck off the register, its directors to be disqualified and even fined (see E below). The actual information to be filed is very similar to that contained in continental registers. However, UK companies are required to report annually on their shareholders and officers as well as on their accounts instead of merely publishing changes as and when they occur, as English company law differs from continental incorporation laws.

A.3 Commonalities, pros and cons

Both register systems share the aim of a declaratory effect of the information filed and published. Both registers also exclusively confer constituting effects for instance in relation to limited liability, fungibility of shares or merchant status. The purpose of the selection of the information to be published is to provide traders and merchants with basic knowledge of each other's business. This serves to provide a basis for decision-making when selecting business partners. Therefore, a degree of reliability has to be achieved and maintained. It is obvious that the English system places more trust into the self-regulatory forces of the merchant community than the continental system which has a more supervisory quality with a kind of guarantee function attributed to the local courts. The information to be published in the commercial registers needs to be authenticated by a notary public even after the reform of 2007 when the filing was taken over by the Federal Gazette (*Bundesanzeiger*) in order to simplify procedures both for the benefit of merchants and the justice system. The continental system is owed to historical development out of a highly fragmented political landscape that existed until deep into the twentieth century and a sense that trading was subject to licensing and privilege rather than an unconditional right and a natural occupation possibly even for the state itself. High aspirations as to the quality of the information are often paired with restrictions to access in this system, for example in land registries. The English system by contrast, fosters accessibility encouraging free flow of information in this sector, treating it as a commodity rather than a privilege.

B. REFORMS AT EU LEVEL: IMPROVING ACCESSIBILITY

A look around the world shows the variety of ways of organising commercial registers and of attitudes to accessibility, including the provision of technical facilities such as online access. The internet platform 'wikipedia' offers a list of commercial registers around the world including an indication whether they are publicly accessible or searchable online (https://en.wikipedia.org/wiki/List_of_company_registers). The UK Government also provides a list of and links to foreign registries (https://www.gov.uk/government/publications/overseas-registries/overseas-registries). The criterion of accessibility is the main anchor for a raft of modernisation and recent reform in the area of registers and databases. Closely related to the rather neutral aspect of accessibility is that of "transparency". The latter term carries high aspirations across a range of applications and subject areas. It has been used in social and political debate and processes as well as in business related contexts defining monitoring and reporting standards and denoting access to information generally. It is certainly owed to this aspiration that the EU pushed for a modernisation and uniformisation of accessibility of commercial registers within the EU and the single market. Directive 2012/17/EU of the European Parliament and of the Council of 13 June 2012 – amending Council Directive 89/666/EEC and Directives 2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers – has been operational since July 2017. The result is a significant improvement of ease of access and online accessibility of commercial registers throughout Europe. What used to be standard in the UK in terms of online access is now introduced in regard of German registries, too.

In the UK, this may not be news, whereas in Germany, for the first time now, a company can be searched directly online from anywhere in the world. But is it really the same in terms of ease of use and scope of information?

The new German Register Portal (*Gemeinsames Registerportal der Länder*, joint register portal of the German states, English language version accessible at https://www.*Handelsregister*.de/rp_web/welcome.do?language=en) has an English language user interface to initially access information. A simple name search without the actual company number to hand may be a little onerous (A name search can return a huge list of companies with the same initials or in alphabetical order. Furthermore, identical numbers are often assigned to several companies, clubs and associations only distinguished by the place of affiliation, ie the place of the local court, and the letter indicating the relevant section of the register – partnerships, companies, associations, patents – such as A, B, V or P) but will lead the user to the local court where a company or trader is registered where the search can be refined. Some ("published") information is freely downloadable. Other information requires registration of the user and the payment of a small fee – much after the model of the UK Companies House. This is, however, where the difficulty arises for non-German speaking users: they are required to fill in the respective form to request such information in German. Whatever the limitations there, this initiative by the EU to create an EU wide standard for accessing company information online is truly splendid and provides a huge service to the international merchant community as well as to consumers.

C. DIGITAL ACCESSIBILITY: BLESSING OR CURSE?

Information in digital form is certainly a blessing for users and providers of information services and operators of databases because they can catalogue, process, update, organise and distribute data timely and efficiently. It increases autonomy for users who become less dependent on the actual service provider and their opening times as well as postal and telecommunication services and it extends the geographical reach of the service provider as well as the data generally beyond its original jurisdiction into a virtually boundless space. This is certainly commensurate with the global trading space which has been growing through digital technology. At the same time, it can create an appetite for more data to be made accessible in this way. Besides the fact that data is also becoming a traded commodity as such – as commercial register content is being re-sold by third party providers – the idea of collecting and publishing facts and information about not only relevant themes but about anything at all in the form of registers and databases gains more feasibility with the advent of digitisation and digitalisation. This has most likely supported the creation of further new registers at EU level or at the initiative of the EU. The term transparency has emerged in this context and applies to a range of different subject areas and policies. In view of the general possibilities that digital information offers it is therefore necessary to distinguish by the aims of each transparency initiative, its intended addressees and the content to be made accessible and to whom.

Closely related to this is of course the area of data protection and privacy as bastion of civil liberty or even a human right. Self-determination is probably one of the key criteria by which to measure the quality of data protection initiatives. Technical data safety has to be accompanied by a strong commitment to the protection of individual persons' and companies' right to "informational self-determination" (*informationelle Selbstbestimmung*) recognising the legal position of the data owner. Whether the EU has done enough in this respect with its latest General Data Protection Regulation (EU) 2016/679 (GDPR) is doubtful, given the strong interest in the generation of databases as described in this paper. This interest is shared by the state along with commercial enterprises and constitutes a pull factor into the opposite direction. Prioritising correctly within this conflict of interest is a central and indispensable task of the legislature and judicial organs (see further D.2 below).

D. TRANSPARENCY REGISTERS AND RELATED ONLINE DATABASES

One of the so-called transparency registers was established in the course of the European Transparency Initiative and aims to provide transparency in the area of political lobbying of the EU organs. The register is freely accessible and searchable by everyone and contains the details of organisations and individuals who aim at influencing law-making in the EU. Official lobbying meetings where stakeholders can explain their views and interests with EU policy makers can only take place with registered parties. This is to serve the public's interest to remain involved as much as possible in the selection of policies and legal instruments prior to the formal legislative process which is public. It also serves to counteract an impression of behind the scenes manipulation of the political process by powerful economic interests and therefore maintain the trust of the public in the integrity of the process of lawmaking and governing, or even reinforcing a sense of being in control. Critique of the new register has included the fact that registration was voluntary which has now been counteracted by a requirement that official lobbying meetings can only take place with registered persons or entities. Another point of criticism was the lack of control regarding the figures given by lobbyists about the budget which they allocate to their activities (on the evolution of the EU transparency register see Godowska, Magdalena, Y B Polish Eur Stud 2011 (14):181-200; Milicevic, Aleksandra, 2017; the Mandatory Transparency Register Initiative – Towards a Better Governance of Lobbying in the EU, Revija za evropsko pravo 19 (1):71-113.). Whether this register really eliminated any "behind the scenes" activity must remain doubtful, therefore. It is certainly a welcome innovation and a step into the right direction.

D.1 Transparency in relation to private corporate entities

Using the same term, transparency, a new type of register has arrived on the scene in recent years in relation to the registration of information relating to private corporate entities. Germany has introduced the so called "transparency register" in respect of those entities which are not already obliged to register with the commercial register, *Handelsregister*. This new database is called the *Transparenzregister*. It has been made operational and searchable as of July 2017 and can be consulted by visiting the website https://www.*Transparenzregister*.de. This register is not searchable by everyone but only by certain specified persons and entities for specified reasons upon formal registration of their own details with the registry (according to s 23 of the German federal money laundering act (*Gesetz über das Aufspüren von Gewinnen aus schweren Straftaten (Geldwäschegesetz* - GwG) and the regulation *Transparenzregistereinsichtnahmeverordnung* of 19 Dezember 2017, *Official Bulletin* (BGBl) I p 3984). It can be said that it effectively functions as a residual or fall-back register in relation to the obligation to provide the relevant data. It may be understood to make up for the "deficiency" of the commercial register of not being mandatory and comprehensive in relation to all corporate entities. The register was prompted by the obligation of the Federal Republic of Germany to implement the so-called Fourth Money Laundering Directive (Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing) as well as the Directive regarding financial transactions (Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds). A similar register was introduced in the UK, of course relying on the identical EU Directives. In the UK, the respective data collection is called the "Persons with Significant Control" register (PSC register). This "register" has to be kept and publicised by each company according to Part 21A (section 790M) of and Schedules 1A and 1B to the Companies Act 2006 as well as the Small Business Enterprise and Employment Act 2015, Part 7 and Schedule 3 (See also https://www.gov.uk/government/news/people-with-significant-control-companies-house-register-goes-live.). Number 64 of the Explanatory Notes to the 2015 Act reads:

> *At the G8 summit in Lough Erne in June 2013 the UK, alongside the rest of the G8 [n: now G7], committed to a number of measures to enhance corporate transparency in order to tackle the misuse of companies. The Government published a discussion paper on these proposals in July 2013, and published the Government response to the views received on the discussion paper in April 2014. The measures included in Part 7 of the Act (linked to measures in Parts 8 and 9) are intended to deliver*

these commitments. These include the commitment to introduce a register of individuals who exercise significant control over a company; the removal and prohibition of the use of bearer shares; the prohibition of corporate directors, except in certain circumstances and measures to deter opaque arrangements involving directors and make individual controlling directors more accountable.

The PSC register consists of additional information to be filed with the regular Companies House returns. Other than the German counterpart, it is not a separate register, and the information is accessible (for a fee) to all who search the Companies House records.

D.2. Transparency in relation to taxation – country-by-country reporting

Another recent arrival on the scene of registers and databases professing to enhance transparency is the so-called country-by-country reporting devised by the Organisation for Economic Cooperation and Development (OECD) through their so-called Base Erosion and Profit Shifting (BEPS) Action Plan, Action 13 (Published as OECD 2015, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13* - 2015 Final Report OECD/G20 Base Erosion and Profit Shifting Project (Paris, OECD)). The OECD introduce their report with reference to transparency efforts:

The Base Erosion and Profit Shifting (BEPS) Action Plan adopted by the OECD and G20 countries in 2013 recognised that enhancing transparency for tax administrations by providing them with adequate information to assess high-level transfer pricing and other BEPS-related risks is a crucial aspect for tackling the BEPS problem (see http://www.oecd.org/tax/beps/country-by-country-reporting.htm).

This database will collate information regarding the amount of tax paid by multinational enterprises, so-called MNE groups, in each of their countries of operation by way of a report to be filed by MNE groups to the national tax authorities who are then entitled to exchange this information according to the recently entered into force Multilateral Convention on Administrative Assistance in Tax Matters as well as Tax Information Exchange Agreements (TIEAs) and so-called Model Competent Authority Agreements (MCCAs). Based on this legal framework, the OECD reports:

As of September 2018, there are over 1800 bilateral exchange relationships activated with respect to jurisdictions committed to exchanging CbC reports, and the first automatic exchanges of CbC reports took place in June 2018. These include exchanges between the 72 signatories to the CbC Multilateral Competent Authority Agreement, between EU Member States under EU Council Directive 2016/881/EU and between signatories to bilateral competent authority agreements for exchanges under Double Tax Conventions or Tax Information Exchange Agreements, including over 35 bilateral agreements with the United States. Jurisdictions continue to negotiate arrangements for the exchange of CbC reports and the OECD will publish regular updates, to provide clarity for MNE Groups and tax administrations

These requirements far exceed previous entitlements of the tax authorities. As for Germany, the courts had strictly rejected this type of "fishing expedition" in earlier case law. In the case decided in 2016 by the tax court in Cologne (*Finanzgericht Köln*), 2 V 1375/15, the tax authorities of the E6 group exchanged information to create a "case profile" about the W group, their corporate structure and business model in order to derive information about similar cases and how to adapt laws and practices accordingly. BEPS was said to be the basis for this. The court barred the German fiscal authority from sharing this profile because there was no concrete reason for this and hence no legal basis, it was a fishing expedition. In a case decided by the FG Baden-Württemberg (Tax Court Baden-Wuerttemberg) on 25 June 2015 (3 K 2419/14) a German tax authority sought to gather information from a German company about its Italian business partners on behalf of the Italian tax authority (*Guardia di Finanza*). The court barred this enquiry due to the lack of relevance of the requested information for the taxation of the German company as well as due to the availability of the requested information in the public domain. The enquiry by the tax office was based on the EU Directives 2011/16/EU and 2014/107/EU (Revised Directive on Administrative Cooperation, DAC). On successful revision, the Federal Tax Court, *Bundesfinanzhof*, reversed the decision (judgment of 12 September 2017, I R 97/15) and reverted to the state tax court for reconsideration, albeit purely on procedural grounds rather than deciding on the merits of the case. (The case has not be re-decided yet.) The new laws emanating from international platforms like the OECD may be understood to provide enabling norms for the very action barred by the courts earlier. As I have explained elsewhere (Heidemann, Maren, 2017, "Is Internationalisation Going Too Far? – Constitutional Challenges of International Data Exchange Programmes", EBLR 28 (5):847-78), there is little or no constitutional evaluation of the legitimacy of this recent campaign to order comprehensive reporting duties on the part of enterprises which enable general fishing expeditions by tax authorities. The aim of these enquiries is to gather information to be able to discern 'patterns' which might indicate unlawful behaviour (eg incorrect transfer pricing) as a prompt for official investigations. This has been criticised as inviting error and unfounded suspicion (Borges, Alexandre Siciliano, and Caio Augusto Takano, 2017, "The Improper Use of Country-by-Country Reports: Some Concerns on the Brazilian Approach to BEPS Action 13", Intertax 45 (12):841-51; Grotherr, Siegfried, 2017, Automatischer Informationsaustausch im Steuerrecht ueber laenderbezogene Berichte von Konzernunternehmen– Rechtsgrundlagen, Inhalt, Datenschutz und Probleme beim CbC-Reporting, RIW 63 (1-2):1-17).

E. EVALUATION

The legal initiatives and registers described above provide a whole cluster of sources of information. Does the accumulation of these sources equal an increase in transparency, though? And what ends would this transparency serve? Are the intended aims achieved by the traditional and more recent registers and reporting duties mentioned above?

There are two distinctions to be made in an evaluation of the new facilities: whose transparency do they serve; and what are the legal consequences of non-compliance?

First, the mission of traditional commercial registers is to enable traders to make prima facie judgments about their potential business partners and monitor existing business partners. They collate and publish selected key information which indicates basic facts about the commercial standing of the business partner, such as companies and partnerships as well as their individual officers. It indicates the size of the business, its success or failure, its compliance standard, whether it is in administration or a director is suspended. While this information is not exhaustive and cannot replace further research and an individual risk assessment for any business partners or investors, it is primarily directed towards the merchant community and the markets. It wants to ensure a minimum standard of transparency and integrity in the marketplace. To achieve this, the information has to be accurate and up to date. Annual reporting and enforcement rules serve this aim.

In line with this, the mission behind the digitisation of commercial registers, or company registers as they may be referred to, is aimed at improving access to this relevant information to merchants across a larger geographical area by creating registers which reach in fact across borders, so in a way these registers are now transnational without adding to the administrative burden for companies.

By contrast, the mission behind creating transparency registers seems somewhat different. Beneficiaries of the EU transparency register of lobbyists can be said to be the general public or the integrity of a political process in general. The mission can be described as signalling to the EU public that efforts are made to disclose the economic interests being "peddled" at EU decision-making bodies and to enforce certain guidelines and red tape in order to prevent undue influence on any holders of public office. Due to the weaknesses that remain in this system as sketched above this mission may not be accomplished just yet.

A mission of similar nature can be discerned in the further registers and databases created under the heading of transparency register registering 'beneficial ownership' and 'CbC' reporting. The public interest that seems to be served here consists of a rather suggestive understanding of crime prevention. It also serves the day to day business of the national tax authorities in helping to compile a global mosaic of information provided by multi-national enterprises which combined may reveal patterns which may indicate illegal behaviour. It is submitted here that the latter type of database lacks relevancy and exceeds any justifiable public interest. The former 'register' of beneficial ownership conflates legal and factual relationships of individuals with their businesses and corporate entities and may therefore lead users without legal training to conclusions which are unjustified and legally wrong. The interest in some of this information seems to lack relevancy to the merchant community and remains of a purely anecdotal quality to the general public if disclosed.

Second, as described above, accuracy of the information published in commercial registers is monitored and enforced differently in different jurisdictions. Information may be actively verified by a notary or the official registry or accuracy may be protected by corresponding offences contained in the law. In the UK, Part 36 of the 2006 Act contains a list of offences, breach of which can lead to convictions including imprisonment and the payment of fines. The "first ever" case of such a conviction of a persistent offender was reported in March this year: businessman Kevin Brewer was fined £12,000 upon repeated fraudulent incorporation of companies and registering prominent figures of pubic life as directors and shareholders without their knowledge, thereby breaching section 1112 of the Companies Act 2006 (see https://www.gov.uk/government/news/uks-first-ever-successful-prosecution-for-false-company-information). The declaratory function of the information is also primarily utilised as evidence within private enforcement mechanisms, for instance by precluding a defence in civil proceedings against an innocent creditor who acts in reliance on the information published.

Similarly, the EU lobbyists' transparency register has a conditional gateway function if and when lobbying is undertaken.

By contrast, in the case of the transparency registers and CbC reporting providing the information is mandatory and not directed at business partners or serving civil enforcement of private claims as described above. It is part of internal public administration and an end in itself.

F. CONCLUSIONS

The traditional commercial registers have been joined over the past decade by a number of additional registers and databases to be populated by information about companies, merchants and private individuals. Adding to the traditional function of providing information and a level playing field in the market place, new functions are being performed by these. In addition to increasing the range of users of commercial registers by making them electronically accessible across the EU, electronic accessibility is used to provide transparency for a number of objectives. Transparency is not always that of the general public, investors or potential trading partners, though. Some of the new registers are register in name only; they are either databases collated by the authorities to whom the respective information is disclosed, or just additional content in regular reports or constituting documents. The EU lobbyists' transparency register for instance could be called a freely searchable public database with information more of an informational nature rather than a legal basis for further action or decision making. The CbC reporting at the other end of the spectrum by contrast could be said to form a register in the hands of the fiscal authorities who collate the information covertly by way of international data exchanges. It is not as such freely accessible by the public, in fact it remains hidden from the public, and therefore contributes little to transparency in this respect, but rather to the authorities' transparency only. Finally, the so-called transparency register listing "beneficial owners" of companies and other corporate entities in Germany is also not freely accessible and so cannot contribute to transparency as may be desired by the general public, but provides a rather elusive basis for consideration to those authorities who are entitled to refer to it. As regards the information collated, this is to a great extent already in the public domain. As far as it imposes duties and obligations on persons who were not previously required to be listed in this way, it may lack a constitutional basis for this duty. Scrutiny has not yet been exercised in regard of these registers. It is assumed that "transparency" is desirable and prevents crime, presupposing that there is crime on a level that justifies and necessitates the imposition of mandatory disclosure of this nature.

By way of example, one detail may illustrate the legal problem that the new "register" poses: in Germany charitable foundations are private non-commercial corporate entities. They do not have members and they have no beneficiaries in a strict legal sense. The volunteer directors of German charitable foundations are now required to be listed in the new German transparency register as "beneficial owners" (*wirtschaftlich Berechtigte*). This is not helpful at all for German charitable foundations who already suffer from the very weak infrastructure that German law provides for them. Not only are foundations creatures of state law rather than federal law, there is also no register for them as there is for commercial entities (which would be comparable to the UK register of charitable bodies). This makes it very hard for foundations to deal outside their state of incorporation (their seat) and specifically abroad where they lack a presentable means of identification such as a registration number. Foundations are listed by their regulatory bodies, but even if this is in electronic form, these lists are not proper registers but mere databases. The advent of the transparency register may be seen to help this situation. The classification of boards of directors of charitable foundations as beneficial owners, though, can be misleading – it can induce the erroneous belief that directors are members of the corporate entity or have any financial entitlements or interests in it. This is not the case under the German law of incorporation of private charitable foundations. The notion of "persons with significant control" is not used in the German terminology. It can therefore be said that the German transparency register creates false impressions rather than transparency. In the UK, the requirement for example to list shadow directors as "beneficial owners" or persons of significant control poses a similar problem in that relationships between individuals and businesses or corporate entities are created which have no precise legal description. Percentages in shareholdings are often used to describe the notion of significant control. It is, however, a well-known problem that in the context of large scale professional asset management, persons (clients) are not always aware of their ownership at any given moment and so rather large grey areas are left by the legislation. It creates the illusion of simplicity where there is none. This is even more so in the description of a shadow director whose role may manifest gradually over a long period of time and the threshold for triggering the registration duty may be unclear especially for legally untrained persons who after all constitute the majority of the business community.

As for the value of the information logged, a word of caution may also be in order. Much of the information in the PSC or transparency registers will be in the public domain, so that bundling the information in a different format may lead to confusion rather than clarification as adding more layers of the same thing is not normally a recipe for simplification. This approach may create the impression of added disclosure and hence greater transparency. In order to understand and use the information properly the user needs some basic knowledge of the law or business practice. To users without such a minimum level of experience the registers may once again be misleading, especially because they were promoted as having been prompted by crime committed, for instance by the owners of so-called letter box companies. It has to be asked whether there is added value in relation to ordinary electronic freely searchable commercial registers or rather an increased compliance burden and significant defaulting risk for the obligated parties with the registers stating the obvious or lacking relevancy. On the one hand investors and potential business partners would certainly benefit from information for instance about shadow directors. Information about ultimate beneficial owners would save the user researching potentially across a multitude of registers globally some of which may not be freely and remotely searchable. This should be considered to be a service, though, rather than an act of crime prevention. Ownership and entitlement as such are no crime. The onus of detection investigation and legal evaluation of criminal activity remains with the public authorities. A certain preventive effect may be assumed. It is questionable though, whether the above described corresponding risk (reputational, compliance risks) has been scrutinised sufficiently prior to enacting the new mandatory and rather harsh legislation in terms of relevancy, effectiveness, proportionality, due process and other constitutional values. In case of the CbC reporting, the desired effect is only achieved by way of the international data exchange agreements as proposed and headed by the OECD.

The quality of the collated data described above resembles that of the transparency registers and PSC register in terms of availability in the public domain and indicator function for criminal or non-compliant behaviour. While the users of CbC reports may always be professionals in fiscal authorities around the world, this does not resolve the risk (involuntarily) undertaken by the owners of the data as to misuse and misunderstanding owed to the nature of electronic data as well as the discrepancy between where the likely damage is to arise and where the benefit is expected to materialise. The compliance risk on the part of the users, ie the tax authorities, is particularly high due to an inherent conflict of interest caused by a discrepancy between infringement and damage: monitoring and enforcing compliance is in the interest of the data owners but not controlled by them whereas the same is not necessarily in the interest of those who actually control and enforce.

In conclusion it can therefore be said that the combination of instantaneous worldwide electronic accessibility and the widening of data to be provided to registers in connection with commercial acting poses as yet unresolved legal risks to the data owners and even to the integrity of the market place, for instance by lowering thresholds and pushing more participants into niches and even illegality. The boundaries between mere additional content, databases and registers are blurred by the use of ambitious terminology in this field and by responding to expectations which have been extensively promoted to the public by way of news reporting ("Panama papers") and in some cases activism in the form of Parliamentary scrutiny committees (most prominently, Dame Margaret Hodge led the public enquiry as chair of the Commons Public Accounts Committee into the tax affairs on multinational enterprises, MNEs, which led to reputational losses and in some cases voluntary and random tax payments, see for instance "Starbucks, Google and Amazon Grilled over Tax Avoidance," BBC News website, 12 November 2012, Business) but which may much rather be prompted by long standing desires for more competences of the fiscal authorities to collate information which they were previously prevented from by the courts as well as by a vague expectation of an increase in tax revenue. There is a regrettable lack of judicial review in this area of legislative activity, in particular that originating from the OECD which lacks democratic oversight and a rule of law-based infrastructure comparable to that of the EU. So, despite a welcome innovative progress in this area of law, caution should be exercised in extending reporting duties and registration facilities without corresponding safeguards for the benefit of both users and data owners. Innovation should benefit the data owners as much as the users of the data and must take issues of privacy and due process into account.

Dr Maren Heidemann

Assessor Iuris (Germany), PhD, LLM (Nottingham), Associate Research Fellow and postgraduate supervisor, Institute of Advanced Legal Studies, School of Advanced Studies, University of London