Legal Certainty and Contract Arrangements

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1. Definitions

1.1. Legal Certainty

The principle of legal certainty

Legal certainty is a fundamental principle which contributes in the rule of law. According to some authors this principle is an “imperative necessity for the European Union”. Indeed the European case-law recognized the principle of legal certainty.

One the one hand, through the European Court of Justice in 1962 in the Bosch judgment. As well, the principle of legitimate expectations – which is part of the legal certainty – was first recognized in 1957 in the Algera judgment, and then in the Dürbeck judgment in 1987 as a “fundamental principle of the Community”.

One the other hand, the European Court of Human Rights recognized the principle of legal certainty as “inherent in the right of the Convention for the Protection of Human Rights” in its decision Marckx in 1979.

Thus, the legal certainty is an important principle in the EU.

- Now let's see what IS the legal certainty.

Substantial definition of legal certainty

To define the different features of the legal certainty is the best way to understand it. There are several types of legal certainty characteristics, but all converging. Thus the principle of legal certainty can be divided in three sub-principles :

- first the predictability, which means accessibility and anticipation possibility thanks to information and consultation procedures ;
- second the stability, which should not be absolute and means that normative changes should be provided by law ;
- third the guarantee of the respect of the law and the subjective rights, which means effectiveness and moderation in law enforcement.
A double face principle

But legal certainty is a multifaceted principle. Indeed according to the branch of law in which we are, the approach is not the same. The “public” legal certainty is the expression of the necessary protection of the subjective rights in front of the State. Here we have a principle which has the goal of a good relationship between the administration and the citizens, it can be understood as a kelsian Grundnorm, which guarantees the legal system coherence.

The legal certainty which rules relations between agents – and especially contractual relationship – is the transactions security understood as the contractors' confidence for the legal and factual environment they have, because of its predictability.

Thus, in this presentation we will focus on the second face of the legal certainty.

1.2. Contract
I will present to you two definitions of the contract. A legal one and an economic one.

Legal definition

A legal definition of contact could be given by Kelsen in his book Pure Theory of Law in which he states, I quote, “the fact called contract is composed of two or several persons matching their willing declaration on a particular behavior of these persons”. Moreover he stresses that “to have a legally compulsory contract, which means to create norms that contractors have to respect, the legal system can impose a particular form”.

An other definition comes from the French Code civil in article 1101 : “the contract is a convention, in which one or several persons decided of mutual obligations to one or several others”. Now we will see the economic definition.

Economic definition

The economic definition of the contract is not the same as the legal one. Indeed Brousseau considers the contract as a surrogate of the market, because the perfect market described by Walras is not a tangible reality, therefore agents use contracts as a coordination tool. Thus the economist and the jurist do not have the same vision of contract as they aren't interested in the same phenomena. To illustrate, Brousseau says that for an economist the question of the legality of the
contract does not matter, because the contract is a fact, the simply result of the personals willing interaction.

Thus the use of contracts permits to overcome the uncertainty which is inherent in every economic exchanges. We are here in front of one of the main economic issue : manage the uncertainty and the risk because of the risk aversion.

2. The legal certainty and contractual arrangements

The economists and jurist issues are not the same but it can be understood in terms of time. At the formation first and during the enforcement in a second time.

2.1. Formation of the contract

The different issues

At the formation of the contract the issues are those developed in the contract theory. The main issue at the formation of the contract is to manage the uncertainty about on the one hand the characteristics of the exchange and on the other about the contract unfolding.

Here it must be precised that limited rationality of the agents is obvious, and leads to a better understanding of imperfect information situations. Indeed at the formation of the contract, the talks take place in an asymmetric information context. This asymmetry leads cost, which will break to the Pareto optimum : the seller should signal to the buyer that his product is the good one and the buyer will have costs because of his willing to get information before signing the contract. This is actually the transactions cost analysis applied to the contract analysis. And this costs can be very high in a high asymmetric information environment.

This issue is a static one, but in a dynamic perspective, the repetition of contracting can lead by reputation, to anti-selection or moral hazard which are mainly described in insurance economics.

An other bias, which is a consequence of the asymmetric information, is the managing of the state of nature which are the random events independent of the contractor's willing.

An other issue at the formation of the contract is the substituability of the agent. It refers to the market power an agent can have.

The managing of uncertainty in contract formation

So the contract as a surrogate of the market must be safe and decrease the uncertainty
linked to economic exchange. That's why the contractual technique developed the use of clauses. The goal is very clear manage the information lack \textit{ex ante} and anticipate situations that could be very bad for the contract or modified its content \textit{ex post}.

Here I can just take an extreme example of clauses use to manage uncertainty and guarantee the best legal certainty. This is the stabilization clauses in international investment contract especially in extracting industries, which are often use to freeze the law at the signature of the contract.

The importance of clauses tends to make contract bigger and bigger, which is in a way the physical expression of the internalization of uncertainty and risks in the contract. Moreover the predictability willing leads to contract standardization on the form and law uniformization on the content.

But the problem of the guarantee of the respect of the contract exist and must be treats. In case of one contractor don't want to execute his obligations some procedures must exists because the contract alone is not enough. The incomplete contact theory answers at the idea that in an imperfect information context every behavior of the agents or every state of nature can not be predicted. That's why the judge has an essential function in the enforcement of the contract.

\subsection*{2.2. Enforcement of the contract}

Going in front of the judge is the supreme guarantee for the contract execution. But in his decision the judge appreciates the situation and may change the case-law using. Thus this instability creates uncertainty and so a form of legal uncertainty because the contractors cannot perfectly anticipate the judge decision. This topic has been studied by the theory of incomplete contract. We will quickly see that although the judge is the final protector of the contract he can be an uncertainty source, but not an insecurity one.

\textit{Correction of the contract}

The idea of the correction of the contract is that sometimes an unforeseen event occurs and break the equilibrium of the contract. So in case there is no clauses for re-negotiation, the judge will modify the content of the contract in order to recover the equilibrium. Thus the transactions security as an expression of legal certainty, impose that the judge can exceptionally touch the contract.

An other thing is the Habermas point of view on the procedure and the parties, which
influence the law and the judge decision.

**Accepted zones and discussion zones**

One of the most important point is the distinction between accepted zones and discussion zones in the contract. Indeed in a contract there are part you read and accept and some other which are never read.

That's what Bar Gill study, especially the accepted contract on internet or long-term ones like insurance or mortgage. The issue here is also the asymmetric information. In front of using conditions, on a web-site like facebook or youtube or any other selling contracts, which are often very long and difficult to read, the consumers just accepted them. He explains that because of limited rationality and imperfect information of the agents, plus the short term vision they often have and a kind of blind trust people can have in front of big firm, consumers sign without any reading the contracts proposed by firms.

To conclude, here we are in front of an issue, too many clauses in order to prevent everything make contract difficult to product and decrease the understanding.