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Dear Mr Penn,

European Commission Proposal for a Regulation on the Law Applicable to Contractual Obligations

The International Swaps and Derivatives Association (ISDA) is writing to express its concerns in relation to this proposed Regulation (commonly referred to as the "Rome I Regulation" as it would, in effect, substantially replace the existing Rome Convention on applicable law).

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry, a business which includes interest rate, currency, commodity, credit and equity swaps, as well as related products such as caps, collars, floors and swaptions. ISDA was chartered in 1985, and today numbers over 670 member institutions from 50 countries on six continents. These members include most of the world's major institutions who deal in, and leading end-users of, privately negotiated derivatives, as well as associated service providers and consultants.

Since its inception, ISDA has sought to reduce risk in derivatives transactions. One of the most important sources of risk is legal uncertainty and, accordingly, we are very concerned about a number of aspects of the proposed Regulation that would, in our view, create significant new uncertainties for parties to derivatives transactions. Our concerns are particularly acute in relation to contracts where the parties choose to rely on the English courts as the forum for settling their disputes. Parties to privately negotiated derivative transactions commonly select

English law as the governing law of their agreements and agree that the English courts should be the forum for settling any disputes arising between them (this is one of the two alternatives under ISDA's industry standard form master agreement - the other being New York law and the New York courts). They do this with the confidence that the English courts will give effect to their choice of law in a predictable way.

We have particular concerns that the proposed Regulation would, if adopted in its current form undermine that confidence. The proposed Regulation text (article 8.3) would override the UK's derogation from article 7.1 of the Rome Convention and would create significant uncertainty and additional costs for businesses that rely on the English courts to resolve their contractual disputes.

For example, it would mean that where an English law governed swap contract is litigated in the UK courts, the UK courts would now have to make a determination whether to give effect to the "mandatory rules" of other countries that are deemed to have "a close connection" with the matter. This will increase uncertainty because it will be difficult for market participants, in advance, to determine which countries would be regarded as having "a close connection" with the matter and which, if any, of their mandatory rules might undermine the enforceability of their contracts. Derivative transactions are often entered into in as part of complex financial transactions involving parties from a number of different countries, involving underlying assets located - or securities being sold or distributed - in yet other countries, making it very difficult to determine which countries might be regarded as closely connected to the transaction, let alone which mandatory rules might affect the transaction. The discretionary nature of article 8.3 adds to the uncertainty.

There would be additional concern if, under the final sentence of article 24, the change in choice of law rules could have retroactive effect in relation to existing contracts by requiring UK courts to consider the application of article 8.3 in cases where the same law applies to the contract under article 3 or 4 of the proposed Regulation, as would have applied under the equivalent rules in the Rome Convention.

We are also concerned because, as the UK has previously indicated, there are significant doubts as to the Treaty base for the Regulation, as it is unclear that the Regulation can be justified as necessary for "the proper functioning of the internal market". These doubts as to the validity of the Regulation would themselves be a source of legal uncertainty for the parties to transactions.

In addition:

- The rules for determining the applicable law in the absence of an express choice (article 4) will in many cases defeat the legitimate expectations of the parties, in particular in the case of interrelated groups of contracts, because they suggest that each contract should be looked at independently. Article 4(2) also appears to assume that it is possible to identify a service in all cases. In most derivatives transactions both parties deal with each other on arm's length basis in exchanging cash flows and it may be difficult to identify who is providing a service to whom.

- It is not entirely clear what is the intended effect of the proposed new rules on choice of law in agency situations (article 7(2)). However, they might have been intended to suggest that a counterparty should look to the law of the agent's country of habitual residence to determine the law applicable to the question of whether the agent has authority to bind the principal. A counterparty would not expect to have to investigate the law of the agent's place of residence to determine the binding nature of the contract. It is also unclear as to whether this provision would apply where an employee acts on behalf of his employer in entering into a contract - it is unclear whether an employee would be regarded as the agent of his employer for these purposes.

- The proposed rule on the effects of assignment as against third parties (article 13(3)) is unsatisfactory in that it refers in all cases to the law of the assignor's residence, rather than the law governing the assigned contract. This blanket rule is not even consistent with the approach in the UNCITRAL convention which, for example, specifically does not apply to a range of financial transactions, such as transactions under netting agreements, assignments of bank deposits and the grant of security over rights held with an intermediary. We are concerned that this proposed over-simplified approach could lead to unsatisfactory results. In addition to being contrary to the fundamental concept of party choice, it severs questions of priority between competing claims to be entitled to enforce a contractual obligation from questions of "the relationship between the assignee and the debtor" and "the conditions under which the assignment can be invoked against the debtor" (falling within article 13(2)), when the latter are governed by the law governing the assigned contract. At the very least, this proposal requires significant further study, given the potentially very critical impact on a range of business transactions.

- The proposed rules relating to offsetting (article 16) should not be limited to "statutory" offsetting when, under English law, some types of setoff arise by other means (e.g. in equity).

We have more general concerns about the quality of drafting of the proposed regulation and as to the process that has led to its proposal. The lack of a more detailed, public consultation after the Commission's Green Paper and the absence of any attempt at an impact assessment are not consistent with the Commission's commitment to better regulation. The Commission supports its decision not to carry out an impact assessment by suggesting that the proposal will have a "limited impact". We disagree.

The UK has a Treaty right to decide whether or not to opt in to the Regulation but must make its decision to participate within three months of the presentation of the Commission proposal (in effect by 15 March 2006). It is obviously encouraging that Latvia and Slovenia have recently joined the UK, Germany, Ireland, Luxembourg and Portugal in derogating from article 7.1 of the Rome Convention. This suggests that, if the UK opts in, there are a number of Member States that will be of a similar mind on the appropriate approach to article 8(3) of the proposed Regulation. However, we remain concerned that the outcome of the negotiations on the Regulation will be an unsatisfactory text which will have a significant adverse effect on choice of law rules in the UK (as well as in many other member states).

To our mind, it would be best if the Commission were to withdraw its proposal and submit it to full public consultation, coupled with a proper impact analysis. This would allow a proper consideration of the many complex issues raised by the Regulation.

We hope the above is of assistance. Please contact the undersigned (+1 212 901 6000; ksumme@isda.org) or Peter Werner (+44 20 7330 3550; pwerner@isda.org) if you have any questions or comments on this letter.

Yours sincerely,

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