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1 July 2011

Ladies and Gentlemen

Commission consultation on the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders' and legal practitioners' feedback

The International Swaps and Derivatives Association (**ISDA**) is grateful for the opportunity to comment on the Commission document "A European contract law for consumers and businesses: Commission consultation on the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders' and legal practitioners' feedback" issued in May 2011 (the **Study**). ISDA has had a longstanding interest in European and international efforts to strengthen the legal framework for cross-border financial transactions in the European Union and beyond, including both the substantive law aspects and the critical private international law rules that determine whose substantive law applies.¹

Information about the Respondent

The address of our European office appears above and our registration number in the relevant EU register is **46643241096-93**. The addresses of our other offices, including our head office in New York, may be found on our website at <http://www.isda.org> through the "Contact us" link at the top of the home page.

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry, a business that includes interest rate, currency, commodity, credit and equity swaps, options and forwards, as well as related products such as caps, collars, floors and swaptions.

ISDA has over 800 member institutions from 54 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

¹ See, for example, the various ISDA letters to the Commission on various financial law reform matters ranging from securities to insolvency, property and contract law as well as conflict of law issues, each of which is available on the ISDA website at http://www.isda.org/c_and_a/collateral-Financial.html. ISDA also actively participated in the consultation process leading on the EU single contract law ever since the Commission Communication of 12 February 2003 entitled "A More Coherent European Contract Law: An Action Plan".

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More than half of ISDA members are based in the European Union and neighbouring countries and most of the other members are active participants in the European financial markets as dealers, service providers or end users of derivatives. Promoting legal certainty for cross-border financial transactions through law reform has been one of ISDA's core missions since it was chartered in 1985.

As an industry association, ISDA's mission has included from its inception the development of standard contractual terms for privately negotiated derivative transactions, from its various standard form master agreements (ISDA Master Agreement), to various types of product-specific documentation templates for individual product types. Most of ISDA's documents including its most widely used ones, are designed for cross-border transactions and may be used by non-members without restriction.

ISDA's forms of master agreement currently provide for an election of either New York or English law. The fact that the choice of law (in the principal standard forms) is currently limited to those jurisdictions simply reflects market practice in the markets for cross-border transactions in privately negotiated derivatives. Indeed, certain ISDA forms are expressly governed by other laws, according to market needs. The possibility of electing the law of any other jurisdiction than England and New York will be driven by market demand in the future. Globally, most cross-border transactions documented under an ISDA Master Agreement are governed by English law. In the European region, virtually all such transactions are governed by English law.

ISDA's membership encompasses members carrying out European regulated activities, including banking and investment services, as well as many end-users of derivatives, who are not themselves regulated² but are protected by financial regulation. Further details of ISDA's membership structure, including a list of the names of its primary, associate and subscriber members, is available from our website at <http://www.isda.org> through the "Membership" link on the left side of the home page.

Overview

We welcome the Commission's continued engagement with industry on these issues and its determination to bring greater clarity to the issue of a possible future EU single contract law.

Scope of our response

Given our focus on the privately negotiated derivatives industry, we will confine our comments to the aspects of the proposals that will have the most direct impact on derivatives transactions under the ISDA Master Agreement. We will therefore not attempt to answer every question, but focus on certain questions and on certain key aspects of the study.

Specifically, we will respond to the aspects of the proposals that directly relate to the legal analysis and effects of the proposed Optional Instrument in the context of business-to-business transactions. Given the wide range of market participants in the derivatives markets and in light of the proposals in the study to extend several consumer protection provisions to certain types of businesses it is entirely possible that certain types of counterparties to OTC derivatives transactions fall within the scope of the proposed Optional Instrument.

² i.e., not regulated in relation to their derivatives activities, although many end-users may be regulated as to part or all of their other business activity, for example, insurance companies, pension fund trustees and administrators, licensed public utilities and so on. Many end-users are, of course, large industrial and commercial corporations using derivatives to manage interest rate, currency and other business-related risks.

The Study contains in its Annex IV a number of draft provisions for a future Optional Instrument largely based on the Draft Common Frame of Reference that has been published previously. The Annex deals with a number of other important, if not crucial, aspects of the contractual legal framework for transactions involving consumers. If we do not deal with this particular issue, it is not because we view it as unimportant but because we wish to focus on our areas of expertise as a trade association focused on privately negotiated transactions in derivatives and defer to other interested stakeholders with a more explicit focus and expertise on those issues.

Summary of our comments

Our comments are as follows:

1. We welcome the Commission's continuing dialogue with stakeholders on the issue of an Optional Instrument. We believe that it is even more important now to continue the discussion about the need for and, if so, the contents and scope of this initiative for the European Union.
2. We urge the Commission to provide more evidence of the need for such an instrument beyond the current scope of consumer protection law in the European Union. The timelines involved in the consultation on the Study and the Optional Instrument appear to be very short compared to the magnitude of the proposals as well as the changes that will come with the introduction of such an Optional Instrument.
3. In the previous consultation on the Green Paper that closed in January 2011 many stakeholders asked for further evidence as to the need for such an Optional Instrument. No such additional evidence is contained in the Study. It appears that decision has been taken to proceed with the Optional Instrument nevertheless. As far as professional financial markets are concerned, there appears to be no inherent value in the harmonisation of contract law between member states for its own sake. Legal certainty is the paramount concern. Provided that the applicable law is clear (which, as far as contractual matters are concerned, would normally be the case as a result of an express choice of law in a contract between professional financial market participants), then the parties can structure their transactions on the basis of that law, notwithstanding differences in the contract laws of other member states (or any non-EU jurisdictions).

We appreciate that in other areas of commercial life, notably, cross-border consumer transactions, there is unlikely to be a similar degree of access to professional legal support. However, the mere creation of yet another body of law such as a European contract law is unlikely to decrease the need for legal advice for any type of market participant. Also, it remains the case that parties may need to check the laws of other member states on matters such as insolvency law and property law to the extent that such laws would apply to conflict of law rules irrespective of the law chosen by the parties (including any future Optional Instrument/European contract law). Thirdly, mandatory rules of a forum court may affect the enforceability of a contractual arrangement governed by the law of any member state or any single EU contract law. In this aspect the Study seems to assume that certain mandatory rules of national law as well as conflict of law rules, e.g. Art.6 of the EU Rome 1 Regulation, do not apply to the Optional Instrument.

4. The Study proposes to extend the Optional Instrument from business-to-consumer (B2C) to business-to-business (B2B) transactions as well. The Study remains silent on how to improve the existing *acquis* in the consumer space to reach the same goal for B2C transactions by using existing EU legal instruments. With regard to B2B

transactions the Study and the Optional Instrument declare that certain types of businesses that are considered the “weaker” counterparty need to benefit from certain provisions that are usually meant for consumers. The Study does not appear to have considered reviewing existing legislation on unfair contract terms and related areas to assess if there is any group of small businesses that should benefit from consumer rules when dealing with larger businesses based on standard terms. It appears doubtful that legal certainty, which is imperative for B2B transactions, is achieved by the Optional Instrument.

5. Furthermore, the Optional Instrument does not take into account that B2B transactions happen on a wider geographical scale that just across borders of EU member states. The global instrument in this space is the UN Convention on International Sales of Goods (CISG) which 25 out of 27 EU member states are states party to. Several of the CISG provisions are also reflected in the EU consumer *acquis*. Provided one sees the necessity for an Optional Instrument, one could have considered working on the basis of an existing more global legal instrument in order to address any of the issues considered problematic by the Study.
6. We strongly urge the Commission to ensure that the choice of the law governing the contract remains solely up to both counterparties to a transaction. We believe that the Commission and any other participant in the further development of the Optional Instrument must always bear in mind the importance of party autonomy. This requires that the “optionality” gets preserved as opposed to mandatory use of the instrument (e.g., when considering “clicking the blue button” on any internet websites).
7. From ISDA’s perspective the paramount aim of strengthening the legal certainty of cross-border transactions between parties in different EU member states requires more urgent EU action in relation to other areas of law than contract law, in particular, securities law, insolvency law and property law as well as related conflict of law rules. Even in these areas, where full harmonisation is not feasible, minimum harmonisation and convergence on fundamental principles would yield considerable benefits in strengthening the internal market in financial services, and would help to level the playing field, in particular, with the large US financial market, where the legal framework for financial transactions is largely harmonised due to a combination of pre-emptive federal legislation (for example, in relation to securities law and bankruptcy law) and the adoption by all US States of a Uniform Commercial Code (UCC). Since the UCC is expressly referred to in the Study it is worth highlighting that the UCC does not harmonise contract law, principally, but rather commercial law, including, most importantly for present purposes, relevant principles of the law of personal property.
8. Draft article 150 of the Optional Instrument is of particular concern to derivatives transactions. It purports to exclude financial services from the Optional Instrument. The wording in draft article 150 is ambiguous. Does it exclude financial services from the Optional Instrument as whole or only from its Part V? This is also relevant to the interpretation of draft article 5 on “terms not individually negotiated” since the use standard documentation is the rule in cross-border transactions in derivatives.
9. The Study defines the material scope of the Optional Instrument as covering “sales contracts” as opposed to “financial contracts”. From a derivatives perspective this causes the question if physically delivered derivatives transactions (mainly in commodities that can be defined as “goods”) are considered “sales contracts” or “financial contracts” under the Optional Instrument. This issue mirrors the equivalent debate in the area of the CISG.



Should such physically settled transactions be covered by the Optional Instrument as “sales contracts”, does draft article in 150(2) exempt any physically settled sales contracts as well or only financially settled transactions ?

This letter addresses the questions of particular importance to the derivatives industry. We would be pleased to meet with you to continue our discussions with you regarding the issues arising out of the Study. We look forward to the next steps to be taken by the Commission.

In the meantime, please do not hesitate to contact either of the undersigned if we can provide further information about the privately negotiated derivatives market or other information that would assist the Commission.

Yours faithfully,

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