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31 January 2011

Ladies and Gentlemen

Green Paper from the Commission on policy options for progress towards a European Contract Law for consumers and businesses

The International Swaps and Derivatives Association (**ISDA**) is grateful for the opportunity to comment on the Commission document “Green Paper from the Commission on policy options for progress towards a European Contract Law for consumers and businesses” issued on 1 July 2010 (the **Green Paper**). 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

Paragraph 5 of the Consultation Document requests certain information from each 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.

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”.

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 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.

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.

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.

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 proposals.

Specifically, we will respond to the aspects of the proposals that directly relate to the legal analysis and effects of the proposed European contract law in the context of business-to-business transactions.

The Green Paper 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 a European contract law. We believe that it is important 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. This applies in particular to the proposed inclusion of business-to-business transactions in any future European instrument, bearing in mind existing international legal instruments on contractual law matters that apply to transactions globally and outside of the EU.

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).

This is subject to certain qualifications, of course. First, professional financial market participants normally have access to (in-house or external) professional legal advisers to help ascertain the relevant law and structure their transactions accordingly. 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. Secondly, 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 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.

3. We do not believe that it is necessary or appropriate for a European instrument on contract law aspects to become mandatory in any way.

If there were to be such an instrument, it would be crucial that it not contain any mandatory rules that might defeat the otherwise legitimate expectations of sophisticated counterparties to a professional financial market transaction. For example, a rule that permitted a party to be released from its contractual obligations in the event of undue economic hardship should not be included in any instrument, unless either (i) it would not apply to transactions between sophisticated market participants or (ii) at a minimum, it is possible to contract out of such a rule (or, simply avoid the application of the instrument altogether, by opting in or out of it).

In this context we like to emphasise the fact that all types of transactions to be covered by the proposed European instrument cover markets that are geographically much wider than the European Union. From a more global perspective it appears questionable to embark on a project that is limited to the European Union, while similar global instruments such as the UNIDROIT Principles of International Commercial Contracts and the UN Convention on International Sales of Goods (CISG)/Vienna Sales Convention already exist and cover large sections of what the proposed European instrument envisages. If one considers such instruments useful, it might be in the interest of further enhancements of international trade (including consumer as well as business-to-business transactions) within the EU as well as with its large number of trading partners worldwide to focus on the existing instruments (and amend these where necessary).

4. 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 Common Frame of Reference must always bear in mind the importance of party autonomy. This requires a distinction between those rules and principles appropriate for commercial transactions between professional market participants and those appropriate for transactions involving a consumer or small or medium-sized enterprises (SME). Clearly, in the former case, mandatory rules should be kept to a minimum, if not entirely excluded, and freedom of contract should be preserved and supported as far as possible.

5. The paramount aim of strengthening the legal certainty of cross-border financial 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 (which does not harmonise contract law, principally, but rather commercial law, including, most importantly for present purposes, relevant principles of the law of personal property).
6. We believe that there might be a value to the use of the Common Frame of Reference as an aid for the European legislator in order to improve the coherence and consistency of the *acquis communautaire* in the area of contract law. This could help in drafting future and amending existing EU legislation affecting contractual matters. It might also improve the consistency in the national implementation of

European directives and the translation of European regulations across all Member States. It might also be helpful in promoting uniform or consistent interpretation of EU legislation in national courts.

Such aid could come by way of glossary of terms or recommendations extracted from the expert advice gathered during the drafting of the Common Frame of Reference. It remains to be discussed if this advice could come as a “toolbox” for legislators (Option 2 of the Green Paper) or by way of “expert recommendation” (Option 1 of the Green Paper) or “Commission recommendation” (Option 3b in the Green Paper).

We would kindly ask the Commission to further clarify the difference between Options 1 and 3b and 2. We assume that Option 1 may be largely obsolete as certain versions of the Common Frame of Reference have already been officially published (but may be subject to further revisions). In any case, any such instrument must remain a mere option for the counterparties.

From ISDA’s perspective Options 3a, 4, 5, 6, 7 of the Green Paper appear unnecessary and too broad in scope.

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 Green Paper. 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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