

European Commission
Directorate-General for Justice
Directorate A.2 Contract Law
(Mr. Dirk Staudenmeyer)
(by e-mail to JUSTCOMMUNICATION-A2@ec.europa.eu)

1 July 2011

Dear Sirs,

A European contract law for consumers and businesses: Publication of the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders' and legal practitioners' feedback

The International Capital Market Association (ICMA) is responding to the above.

ICMA is a self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated bond issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Sub-committee¹, which gathers the heads and senior members of the syndicate desks of 27 ICMA member banks, and ICMA's Legal and Documentation Sub-committee², which gathers the heads and senior members of the legal transaction management teams of 19 ICMA member banks, in each case active in lead-managing syndicated bond issues in Europe.

ICMA sets out its response in the Annex to this letter and would be pleased to discuss it with you at your convenience.

Yours faithfully,



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¹ <http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Primary-Market-Practices-Sub-committee.aspx>.

² <http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Legal-and-Documentation-Sub-committee.aspx>.

Annex

ICMA welcomes the Commission's consultation.

Consulting on detailed draft instrument

ICMA welcomes in particular the fact that the Commission has chosen to seek comments from potential users on the draft text of the potential instrument rather than leaving it as a technical matter for a limited group of experts only. Ultimately a European contract law must be one that business can feel comfortable using and this means business must engage with its detailed preparation.

Scope limitation to sale of goods and related services relative

The stated scope of the draft instrument is currently limited to the sale of goods and to the provision of related services. It does not formally relate to the securities markets and the sale of securities or entry into other financial contracts. However, its general provisions are mechanically extendible to all contracts and, despite the Commission's stated scope, securities market participants must anticipate the possibility that the Commission might in future seek to add, to the superstructure of the instrument, further chapters dealing with other kinds of contract (such as loan agreements, financial services, leasing, custody and bailment, assignment, etc.). If this comes to pass, it is not certain that there will then be any potential to revisit the instrument's general provisions in light of the proposed new chapters. ICMA is consequently setting out various comments and concerns below.

Freedom of contract and legal certainty

Freedom of contract (subject to certain limitations only where consumers are involved) and legal certainty of outcome are the two elements that are essential to contract law. However, the core concept in the draft instrument currently further restricts freedom of contract (derogating from its general assertion that freedom of contract prevails for business-to-business contracts by including various mandatory 'protection' provisions aimed at "weaker" SMEs but actually covering all businesses, big and small) and creates uncertainty (with the restrictions on contractual freedom involving mandatory subjective and untried points of post-facto determination). Arguably the draft instrument seeks to regulate rather than empower.

Freedom of contract – At the heart of the draft instrument is the article 8 requirement that each party act "in accordance with good faith and fair dealing" (buttressed by the article 23 disclosure requirement), an obligation that cannot be excluded and which is defined as "a standard of conduct characterised by honesty, loyalty and consideration for the interests of the other party to the transaction or relationship in question". In this respect, "loyalty" conjures up thoughts of fiduciary duties, which systemically cannot be owed by all contracting parties to their counterparties. Each party loyally putting the other's interests (second-guessed, so undermining certainty as further discussed below) above its own would be like two very polite gentlemen who never get through a door because each is too busy inviting the other to go first.

Even if 'loyalty' were replaced by 'openness' (as per the draft Common Frame of Reference previously produced by the Commission), that still leaves the question of whether any obligation of good faith is appropriate. In the securities markets, it could, for example, be seriously problematical (with potential systemic consequences) if there were uncertainty over whether the exercise of a contractual right accorded with the requirement of good faith.

Aside the formally mandatory provisions, other provisions of the draft, though excludable in principle, are not really excludable from a practical perspective. For example, even if it is possible to sidestep the conundrum of what rules govern the interpretation of contractual interpretation clauses, businesses are in practice unlikely to ever lay down their own rules of interpretation (even if they consider the instrument's provisions to be inappropriate).

Legal certainty of outcome - Uncertainty is anathema to business. This is of particular importance in financial contracts. Parties need to know (for regulatory reasons amongst others) when they can set

off, or net, two sums against each other, when a sum is due and what they can do when faced with an event of default.

Aside the second-guessing aspect mentioned above, the effect of a failure to act in accordance with the requirement of good faith is also unclear. Article 8(2) provides that breach of the duty of good faith "may" preclude a party from exercising or relying on a right, remedy or defence it may otherwise have - is this discretionary, or does the obligation only have effect where the draft instrument subsequently refers to good faith, as in articles 23 and 27(2)? Further, it is unclear whether article 23 can be excluded (this is not expressly prohibited, but the article 8 obligation to act in accordance with good faith cannot be excluded).

Furthermore, once a contract has been made, article 48 (which cannot be excluded) allows a party to avoid the contract if that party was "improvident, ignorant, inexperienced or lacking in bargaining skills", and the other party exploited that by "taking an excessive benefit or unfair advantage." If the improvident party does not wish to avoid the contract, it can ask the court to "adapt" the contract so that it accords with what the parties would probably have agreed had the requirements of good faith and fair dealing been observed. In the securities markets, this would raise questions as to the validity of financial restructurings made under the shadow of insolvency – a key ingredient to confidence in such markets.

Articles 77 and 85 (which cannot be excluded) provide that a term is not binding if it forms part of non-individually negotiated terms supplied by one party, if it significantly disadvantages the other party, and if its use grossly deviates from good commercial practice, contrary to good faith and fair dealing. A term supplied by one party is not individually negotiated if the other party has not been able to influence its content, in particular because it has been drafted in advance, whether or not as part of standard terms (article 5(1)). A draft contract will generally be drafted in advance by one party, which may mean that any term of that draft which survives to the final version is vulnerable to post-facto attack.

More generally, aside the specific aspects mentioned above, the philosophy of the draft instrument is one of open-textured rules that give judges the flexibility to reach the 'right' answer in the cases before them. Thus, for example, the interpretation rules. Article 56(1) requires a judge to search for the common intention of the parties, even if it differs from the normal meaning of the words used in the parties' contract. In undertaking this search, the judge can take into account the negotiations and the parties' conduct, both before and after the contract was made, usages, and good faith and fair dealing (article 57). A usage includes anything "which would be considered applicable by persons in the same situation as the parties, except where the application of such usage would be unreasonable" (article 69(2)). A judge is therefore required to undertake a wide-ranging (and expensive) exploration of the contractual premises and their surroundings. This is not limited to the signed contract, but starts with the parties' first discussions about the contract, meanders through market practice, and on to the parties' (perhaps self-serving) performance. The parties will never be sure that what they wrote down means what it says, still less will an assignee.

An immediate practical consequence of the above will be the inability of contracting parties to obtain 'clean' legal opinions (ubiquitous in commercial transactions involving substantial sums) that are devoid of substantial reservations as to individual contracts being legally binding and enforceable in accordance with their stated terms.

Suggested advantages of the proposed instrument

Three particular problems are suggested that a European contract law would address: additional transaction costs; increased legal uncertainty; and lack of consumer confidence (with several examples cited).

Regarding the exemplified consumer's cross-border online purchase of goods, one would expect such a consumer's concern as to whether her legal rights in the seller's Member State would be less than those in her home Member State to imply some knowledge of the home legal rights and, in turn, of the fact that EU rules already provide (6(2) of the Rome I Regulation) that the law of the contract will not deprive the consumer of the home law protections that cannot be derogated from by agreement.

The challenges in this scenario would rather seem to be practical (troubleshooting in different languages, etc.) than stemming from legal uncertainty.

Conversely, from the seller's perspective, it is this same provision of the Rome I Regulation that requires regard to be had (with the concomitant expense) to the national laws of each EU member state. This problem will only be solved if the provision does not apply in the context of European contract law. This is highly unlikely as consumer organisations will likely prefer familiar home protections – EU contract law might, despite the Commission's focus on "a high level of consumer protection", not involve higher protection than the home protections. This is effectively a political issue (and hence the difficulties faced in progressing the proposed Consumer Rights Directive).

Regarding the potential savings to be made on legal expenses in using EU contract law rather than another Member State's law, there may indeed be some practical advantage in being able to retain one's usual home lawyers rather than needing to retain lawyers from the other Member State. It is not certain however that the home lawyers' fees will be less (let alone substantially so) than lawyers from the other Member State. It is unlikely that a multi-lingual European contract law would simply dispose of the need for lawyers (and their fees) altogether. The draft instrument is about 80 pages long, involving substantial complexity (to an extent unavoidably) and, as described above, uncertainty – it could undo a user unless it is careful (and care often involves lawyers).

That said, ICMA is aware some businesses seem to want a European contract law. For example, costs might be lower if a supplier could draft its contractual terms on the basis of a single law to which it could reasonably hope to adhere rather than potentially having to negotiate different provisions with buyers in different countries. An example is the insurance industry, which involves the sale of contractual rights. However, as stated earlier, such a contract law must be one that business can feel comfortable using.

In any case, electing to contract under a soundly developed European contract law will not enable the contractual parties to disregard national laws. Many disputes, especially those in the financial context, involve claims made in both contract and tort. Whilst contractual claims would be pleaded under a European contract law, tortious claims (e.g. negligence, misrepresentation – notably in the context of mis-selling) would remain to be determined under national law.

Likely reaction in the securities markets

If a European contract law is enacted and extended to the securities markets, it is unlikely that the governing law of international financial transactions would be freely and generally changed to such a law.

This will be so, even if the specific concerns highlighted in this response (and any similar concerns arising) are addressed, because of residual legal uncertainty due to the lack of established granular case law (some governing laws have established detailed factual positions over hundreds of years). Another disincentive might be any lack of logistical capacity by the European Court of Justice to manage its presumably massively increased case load (even if national courts are given competence at first instance) and consequent extended timelines prior to final judgment.

Conclusion

A European contract law could in time offer a useful alternative in some circumstances to national laws (but likely less so in the securities markets). In order to do so, a European contract law must meet the legitimate aspirations of business, including a commitment to freedom of contract and to certainty. As indicated above, substantial further work will be needed.