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City of London Law Society response to Ministry of Justice Call for Evidence on European Commission Green Paper on Contract Law

The City of London Law Society (the "**CLLS**") represents approximately 14,000 City lawyers including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared jointly by those CLLS Committees with an interest in contract law and related regulations.

EXECUTIVE SUMMARY

Whilst the CLLS are happy for the Results of the Expert Group to be published they do not believe that any of the other options put forward by the Green Paper are useful, appropriate or justified, given the paucity of statistical evidence and analysis identifying any problems or any need for action.

There is evidence that small and medium enterprises (**"SMEs"**) who choose not to engage in cross-border trade within the European Union (the "**EU**") are more influenced by factors other than the legal system prevalent in different Member States, such as cultural and linguistic differences and transport costs.[1]

The very competence of the EU to act on this matter is doubtful. Even if divergent national laws could be shown to deter trade, it would be difficult to show that any of the options in the Green Paper would actually reduce such effect. This means that Article 114 of the Treaty on the Functioning of the European Union ("**TFEU**") (formerly Article 95 of the EC Treaty ("**TEC**")) cannot be relied upon to provide a legal basis for enacting any of the options put forward by the Green Paper. It is also difficult to justify competence for action in this area under other legal bases in the treaties.[2]

Evidence also indicates that many companies prefer their international dealings to be governed by English law rather than the law of any other legal system.[3] A new instrument would dilute the effect of English law as a gateway for attracting trade into the EU and the UK and may be more likely to benefit the economies of New York or Switzerland whose law might increase in popularity.

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1 See reference to Eurobarometer 278 (2009) discussed in response to Question 1.

2 These are fully discussed by Hesselink, Martijn W., Rutgers, Jacobien W. and De Booys, Timothy Q., The Legal Basis for an Optional Instrument on European Contract Law (October 31, 2007). Centre for the Study of European Contract Law Working Paper No. 2007/04, available at SSRN: http://ssrn.com/abstract=1091119.

3 2010 International Arbitration Survey, Chart 9.

The loss of trade and revenue for the Government and businesses providing legal and related services may in fact exceed any supposed benefits from the creation of a competing legal system, while limited resources would be exhausted by the unnecessary costs and uncertainties of developing and applying new laws.

There could be particular difficulties for Europe's financial centres and for legal certainty. In particular, the proposals are wholly unsuited for major financial transactions where legal certainty is an imperative. Concerns that this might become a mandatory law, would lead to a flight to non-EU jurisdictions for choice of law and dispute resolution. It is notable that while an EU jurisdiction's legal system, English law, is probably the most popular in international transactions, New York and Switzerland provide strong competition. Even an optional law would be seen as a "slippery slope" towards enforced abandonment of Member States' own systems of contract law, and ultimately other laws and would damage not only England, but also other Member States attractiveness for choice of law and jurisdiction. We believe that it would damage the EU if EU institutions were to seek themselves to contract on the terms of the proposed optional law. It is simply not suitable for major commercial transactions, matching neither the legal certainty of common law systems nor even that provided by civil law systems with specific commercial codes.

At a social level, we would note that a system of law is part of the cultural fabric of a nation or state. The optional proposal would require all Member States to have an alternative legal culture. More extreme proposals require that all Member States abandon completely their own systems of contract law (radically in the case of common law countries). This cuts across principles of preservation of cultural identity and of subsidiarity enshrined in the Treaty.

Finally there is no economic impact assessment. This is not the time to embark on the education of all the EU's lawyers and establishing a European Commercial Court, yet these steps would be essential with the proposed optional instrument, as well as more extreme alternatives. Even with those steps it would be many decades before any modest degree of legal certainty and consistency would emerge for the new system. The costs, financial in terms of training and dispute cost and in time to resolve disputes, appear, even without detailed analysis, to far outweigh any supposed benefits. It could also, coupled with other moves in the legal field (European arrest warrants, proposed EU attachment orders etc.) unnecessarily add to the anti-EU feeling engendered by the current financial crisis.

So far as the consumer acquis is concerned, harmonisation measures (eg the Directive on Unfair Terms in Consumer Contracts) already in place and the proposals presently being debated are the right way to enhance consumer confidence and have a firm basis in the Treaties. It is a policy matter whether there are any circumstances where small businesses would benefit from being afforded some of the protections afforded to consumers.

QUESTION 1

Does the current regulation of contract law, and, in particular, any divergence of laws at national level, present problems or not?

It is not clear that the current regulation of contract law or any divergence of national laws present a significant barrier to trade as suggested by the Green Paper.

Even the introductory section to the Green Paper is only prepared to go so far as to say that "differences between national contract laws *may* entail additional transaction costs and legal uncertainty", and that consumers and businesses having limited resources "*may* be reluctant to engage in cross-border transactions" (emphasis added). In a survey undertaken by the University of Oxford, a slight majority indicated that they thought that the existing diversity of contract laws might have a negative impact on their business, but most surveyed indicated that this would not be a deal breaker.[4]

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[4] As discussed by Professor Stefan Vogenauer at page 8 of the "Evidence" section of the House of Lords European Union Select Committee Report on *European Contract Law: the Draft Common Frame of Reference*.

The Green Paper refers to the survey in Special Eurobarometer 292 (2008) to justify the argument that there is a demand for harmonised European contract law. The question in the survey was, however, unduly simplistic and only asked whether a party would prefer a contract to be based on the other party's national law or on harmonised European law. By contrast, other surveys (and particularly Flash Eurobarometer 128 (2002)) do not support contract law harmonisation as polls have shown that more than 50% of consumers already have the same or even greater confidence in cross-border transactions than in domestic transactions while only 26% have less trust in cross-border transactions, and for these 26% the perceived problems do not include the lack of a harmonised contract law.

Against the background of these figures it is very unlikely that harmonisation of contract law in Europe will significantly reduce trade barriers, not least because such an approach will not tackle obstacles of a more practical nature. Many consumers frequently travel on business or holiday to other countries and enter into contracts (hotels, car hire, purchases etc). If their ignorance of local laws does not significantly deter them from entering into such transactions, it is not clear that even consumers currently perceive the divergence of national laws to be problematic.

Additionally, from the point of view of businesses, according to Flash Eurobarometer 278 (2009), about 70% of retailers surveyed currently refrain from cross-border transactions with consumers and, even if the laws regulating such transactions were harmonised, about 60% would still not be interested in making sales to consumers in other member states. In the assessment of most businesses, even complete legal harmonisation would leave the proportion of cross-border sales either unaffected (49%) or lead to just a small increase (37%), while only 9% would expect a substantial impact. Thus, there is no evidence to suggest the optional law would add anything but cost and confusion.

Most importantly, the survey evidence suggests that any benefits would depend on legal certainty. Yet the work to date, focused on the needs of consumers, provides for legal uncertainty in its terms (with overrides of the strict terms of an agreement on a number of different bases) and also would wholly lack the jurisprudential basis needed to resolve those uncertainties. There is no evidence to suggest the optional law would add anything but cost and confusion (and resentment by those induced to choose the option on the basis the law would be simpler for them). On the other hand, targeted measures, such as the Directive on Unfair Terms in Consumer Contracts fit into the national legal systems and provide immediate benefits to consumers throughout the EU, have fewer costs to implement and impose fewer burdens on the European Courts. However, even there the lack of resources for speedy resolution at EU level is a burden for affected litigants.

QUESTION 2

What are your views on the relative advantages and disadvantages of each of the options and sub-options identified in the Green Paper? In particular, which should be preferred and why?

Option 1 ***Publication of the Results of the Expert Group***

Option 2 ***An official "toolbox" for the legislator***

2(a) ***via a Commission act; or***

2(b) ***via inter-institutional agreement***

Option 3 ***Commission Recommendation on European Contract Law***

3(a) ***via encouragement for Member States to replace national laws with the European Union instrument; or***

3(b) ***via encouragement to Member States to incorporate the European Union instrument as an optional regime***

Option 4 ***Regulation setting up an optional Instrument of European Contract Law***

Option 5 ***Directive on European Contract Law***

Option 6 ***Regulation establishing a European Contract Law***

Option 7 ***Regulation establishing a European Civil Code***

Option 1

Given the time and resources that have already been expended on this project the CLLS recommends that this option be selected. Care must, however, be taken to avoid causing further uncertainty or incurring excessive costs, especially in light of the questionable legal basis for any action beyond a mere publication of what has been done to date.

Professor Martijn W Hesselink has suggested compiling a list of the most important questions that must be addressed when drafting an instrument of European Contract Law[5]. He gives 50 examples of questions that could be asked, ranging from whether parties to a contract should be under a general duty of good faith and fair dealing to whether contracts should create third party rights. This could facilitate a wide consultation on the policy questions raised, allowing Member States to indicate what action, in each of these areas, they would or would not be prepared to accept. Thus the Commission would have a clearer idea as to whether achieving consensus is in fact possible or whether the idea of further integration should be shelved.

Options 2(a) and 2(b)

The CLLS does not support the options of a toolkit if these envisage the setting out of a range of certain, specific model laws. The cost of developing a more comprehensive toolkit may outweigh any real benefits that derive from it and should not be undertaken before the costs and benefits are properly identified and evaluated.

Picking and choosing from various rules that may happen to be common to various Member States risks by-passing the different checks and balances., that may have evolved in each individual legal system. Furthermore, given the diversity of legal traditions in the EU, it may be difficult to select an appropriate and universally accepted threshold of "commonality" that must be passed for certain rules or principles to be admitted into the toolkit. This may result in an unfair imposition on some Member States of concepts that may be common to a majority but alien to, and difficult to incorporate into, the legal systems of those Member States that are not represented amongst the majority. A detailed comparison of the legal systems of Member States and the solutions they have reached on key points (which may be materially different as between the Code Napoleon and Germanic civil law systems and different again in the EU's common law jurisdictions, with numerous variations within national jurisdictions) would be valuable for the European legislator in drafting new law and assessing its impact, as well as providing a proper basis for debate on areas where harmonisation might be of value.

It may also prove difficult for the three institutions to agree a toolbox under option 2(b), especially as it would presumably need to be updated, and the updates would need to be agreed, on a fairly regular basis to reflect evolving contractual practices. This poses a significant ongoing cost if a toolkit is created and is to be properly maintain. By contrast, it may be argued that there is a lack of democratic accountability in the Commission unilaterally adopting an act which will affect all future EU legislation.

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[5] *The Politics of a European Civil Code*, Martijn W Hesselink, ELJ 2004, 10(6), 675-697.

Option 3(a)

The CLLS opposes any encouragement of Member States to replace national laws with a new European instrument, for similar reasons as those discussed below in relation to the mandatory replacement of national laws. This option also has the additional disadvantage of failing to ensure any consistency as to where in the EU the new instrument would apply and where it would not, again undermining the stated aim of this project.

An objectionable cost would be imposed upon those Member States that do not wish to be involved – both in having to contribute to the EU resources that would be expended on the development of a whole new instrument and its enforcement via EU institutions (including the already overburdened European Courts), as well as in having to inform themselves of how the new instrument would impact upon their dealings with those Member States (if any) that would wish to participate. While states are free to engage in such projects, it is unfair to impose such burdens upon those who do not consider it acceptable for a new instrument to be created as an EU-wide initiative. Furthermore, similar projects have already been undertaken, such as UNIDROIT and, without any satisfactory form of cost-benefit analysis having been carried out, it is difficult to accept that creating a wholly new instrument would have any further benefits to offer at all.

Options 3(b) and 4

The CLLS strongly opposes these suggestions, which involve the creation of an optional instrument, whether its adoption is to be encouraged (Option 3(b)) or it is to be imposed (Option 4).

Such measures are particularly objectionable in light of the Directive on Consumer Rights (which is being considered by the Committee on the Internal Market and Consumer Protection) and other measures that have been and are being developed to improve the protection of consumer rights while recognising that some Member States may wish to provide even greater levels of protection.

Creating a new legal instrument would involve significant costs and cause great legal uncertainty in three areas. The first area relates to the legal basis for a European instrument. Measures can only be adopted on the basis Article 114 TFEU if it can be demonstrated that (1) disparities in contract law have an actual, rather than theoretical, effect on market integration and (2) the proposed instrument would actually contribute to eliminating these obstacles.[6] "[A] *mere finding of disparities between national rules and of the abstract risk of obstacles"* to trade is insufficient to provide a legal basis under this provision.[7] As set out above, there is a lack of any conclusive evidence of disparities in contract law actually deterring cross border trade in the EU. Furthermore, an optional instrument would, rather than reducing any such deterrent effect, increase it by adding yet another possibility to the equation.

Other potential legal bases for competence in this matter have also been thoroughly discussed in a working paper produced by the Centre for the Study of European Contract Law.[8] The authors conclude that Article 352 TFEU (formerly Article 308 TEC) would be the most likely legal basis but that, under this measure, the content of the new instrument would have to be restricted to subjects that are most pertinent to the internal market. This implies that an entire instrument of European contract law would be difficult to justify on any presently available grounds.

Article 345 TFEU (formerly Article 295 TEC) also prohibits interference with the system of property ownership within Member States. As there are grey areas between contract and property issues

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6 See the analysis of William Blair QC and Richard Brent in their article *A Single European Law of Contract*, EBL Rev 2004, 15(1), 5-21 at page 14.

7 The Tobacco Directive case (joined cases C-376/98 and C-74/99 *Germany v European Parliament and Council*), at paragraph 84.

8 Hesselink, Martijn W., Rutgers, Jacobien W. and De Booys, Timothy Q., The Legal Basis for an Optional Instrument on European Contract Law (October 31, 2007). Centre for the Study of European Contract Law Working Paper No. 2007/04. Available at SSRN: http://ssrn.com/abstract=1091119.

which vary from Member State to Member State, this may be an obstacle to adoption of a sensible code. For example, a change on the rules on the passing of title on the sale of goods would be an interference in the system of property ownership for goods in the affected Member States. This is of particular concern as any new instrument is likely to cover the sale of goods.

The second area of uncertainty is that which is inherent in a completely new legal system that lacks any established and consistent jurisprudence to enable parties to structure their transactions or draft contracts with any confidence. Researching the different sources of law within the EU, negotiating which to select where different systems take different approaches and ensuring that the new instrument is drafted as clearly as possible pose significant challenges and costs. The Dutch Civil Code "Burgerlijk Wetboek" took 45 years to complete, from 1947, when the Dutch government instructed Eduard Meijers with the task of completely revising the code, to 1992 when the new Code was finally introduced. Moreover, a uniform code applied across 27 or more member states is likely to be considerably more challenging than a code applicable at a national level only.

Even with reference to existing cases from the jurisdictions contributing towards the new system, linguistic differences as well as differing decisions and approaches between various Member States would leave debatable issues as well as established and accepted points of law open to challenge for many decades until some form of reliable jurisprudence could be formed. Different approaches to interpretation between Member States would make it difficult to ensure consistency of interpretation or application and would further delay the development of any coherent jurisprudence. The suggested database of decisions across the EU would not have the legal effect of decisions by senior courts or the ECJ. There would be no means of knowing which one of conflicting interpretations was the correct one. It would also involve a large and costly bureaucracy in establishing and maintaining the database and translating the decisions.

The third area of substantive uncertainty relates to the provisions of the Draft Common Frame of Reference (**"DCFR"**), which is likely to provide a basis for formulating a new instrument. The CLLS considers the DCFR to contain significant flaws. A group of European academics have indicated that:

> "*The text suffers from a great number of serious shortcomings*" which "*include unresolved or unconvincing policy decisions as much as ill-adjusted and inconsistent sets of rules*"[9]

Professor Simon Whittaker has expressed the opinion that:

> "*From a pan-European perspective, it possesses too many difficulties of scope and structure, suffering from complexity and a good deal of interpretative uncertainty. From the point of view of its substance, both in terms of EC law and especially of English law, its provisions affecting commercial contracts…qualify too broadly and far too uncertainly the central principles of freedom of contract and the binding force of contracts.*"[10]

Businesses would need to study the new instrument and be advised on it by their lawyers in order to know whether or not they wish to agree to use it and to work out the consequences of doing so, including the implications for their usual terms of business and internal procedures. They may need to have parallel systems in place depending on the law chosen (this is why in many organisations and markets businesses often have a policy to use one legal system as the market standard for the relevant market). Given the lack of jurisprudence and the substantive uncertainty of the DCFR, businesses would be well advised to draft their contracts with more detail and background included. This would be necessary either for it to be clear what is intended and to make it less likely that a provision would be held to be unreasonable or to override some of the rules and presumptions in the DCFR. This would result in contracts being longer and more detailed, imposing further costs on businesses.

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[9] Ibid., at page 706.

[10] *The "Draft Common Frame of Reference", An Assessment* by Simon Whittaker, commissioned by the Ministry of Justice, at page 11

There is likely to be more litigation than under national law because of parties' lack of familiarity with a new instrument, resulting in many more, longer cases and more appeals. The appeals would often be referred to the European Courts, creating lengthy delays and, for parties who are not prepared to wait, decisions likely to be inconsistent across the EU. This would impose greater costs on businesses as well as both national and European judicial systems. Furthermore, the ECJ is not equipped or staffed to perform the role of the final court for commercial cases. If they are required to cope with an even greater workload their budget will need to be greatly increased at a time when Member States are cutting budgets in far more critical areas. The suggested database of decisions of national courts would also be costly to establish and maintain, particularly with translation costs and differences in styles of judgments and the need to have a detailed process for reporting the cases in the first place.

In addition, an optional European law would not be one that national courts could leave to the parties to lead evidence on. They would have to be equipped to apply it, where chosen, with the same objectivity as if it were national law. Therefore the courts and each nation's lawyers would need to know the law and how it differs from their own and be prepared to refer uncertain areas to the European Courts.

Further costs would be created as national systems of tort/delict and property law would apply alongside the new law. While the effect of the Rome II Regulation is that a choice of national law or the application of national law rules in the absence of choice will lead to the application of one national system of law to overlapping issues in contract and tort/delict (for example negligence claims which may be framed in contract or tort), where the new contract law was chosen, two legal systems would inevitably become involved, taking away the benefits of Rome II. In addition, the choice of law or court by parties can often eliminate the operation of different legal systems at the interface of property and contract law. For example a contract relating to real property will be governed by the law of the place where the property is, even when it is not itself an instrument creating an interest in land which needs to be recognised under the relevant legal system. For goods the law chosen for the contract will cover the passing of title and will often be the place of manufacture or delivery of the goods. While some intellectual property rights are created under EU law, their enforcement once created is governed by national law, and others remain unharmonised by EU law (even though most Member States may have adhered to relevant international treaties). In short a choice of the new law would be a choice of multiple laws with added complications, not a simplification for the parties. Even in the field of intellectual property the move to an EU wide law has been approached very cautiously and an EU contract law, capable of affecting everyday transactions, should not be contemplated in the short term.

Given the costs and uncertainties involved, parties in business to business contracts would be unlikely to select the new instrument as opposed to better established existing systems. The 2010 International Arbitration Survey (the **"Survey"**) has found that familiarity and experience is one of the most important factors taken into account by companies when selecting the law that will govern their disputes.[11] This makes a new instrument highly unlikely to be selected in business to business transactions, especially since many companies never use trans-national laws or rules to govern their disputes.[12] Furthermore, those businesses that are willing to trade across EU borders are not necessarily deterred from doing so by the difference in local legal systems and those that are unwilling to do so tend to take other factors, such as language and culture, into account rather than the governing law in other Member States.[13]

In business to consumer cases a major issue would be to whom the choice should be given whether or not to opt into a new instrument. If the choice were to be assigned to the business the optional instrument would be unlikely to be selected for the reasons considered above. It would

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11 2010 International Arbitration Survey, Chart 8.

12 Most relevantly, 58 per cent. of companies surveyed never used general principles of law, commercial practices or fairness and equity, only 16 per cent. used them often; 53 per cent. never used international treaties or conventions, only 6 per cent. used them often; and 39 per cent. never used commercial law rules contained in codifications while only 14 per cent. used them often (2010 International Arbitration Survey, Chart 12).

13 See references to Eurobarometer surveys discussed in response to Question 1.

be more likely for the choice to be given to consumers, in order to protect their position. There is no evidence that consumers would consider a new instrument, untested and unfamiliar, in preference to the law of their home Member State (as presently available under the Brussels Regulation 44/2001). If consumers do select the optional instrument, this would essentially impose a two-tier system on SMEs and other businesses. The result would be to further increase costs to businesses, which would have to comply with the new instrument in addition to other legal systems that would otherwise be selected by other consumers or traders with whom they deal.

Options 5, 6 and 7

The CLLS very strongly opposes these options, all of which effectively result in the abolition of national contract laws and impose very significant costs and uncertainties on consumers, SME's, large businesses and Member States.

The consequences of introducing a new legal system have been discussed above and are equally relevant in relation to these options. A compulsory instrument would also be even less justifiable, given the lack of a demonstrable impact on trade of divergent national laws and the lack of evidence that these measures would reduce any such deterrence of trade. A compulsory instrument, given the uncertainties and costs involved in understanding and applying a new instrument and resolving any disputes that may arise, would create a strong deterrent to international trade.

A compulsory instrument will not only fail to promote trade with or within the EU, it will also undermine the positive effects of English law and other well-resourced national legal systems in attracting worldwide trade to the EU. The selection of English law as the governing law by global parties makes a significant contribution to national and European exports not only from the legal profession, but also related services such as banking, accountancy and insurance. The abolition of English contract law will result in a loss of revenue that will be detrimental to England and the EU as a whole, given that many companies use England as a gateway to trading with the whole of the EU. A globally popular legal system should not, therefore, be sacrificed by the imposition of a compulsory instrument that is not internationally accepted and weakens the attraction of the EU as a global trading partner. There would be a similar effect for other national systems, where uncertainty about the new law would be likely to push those preferring a civil law framework to Swiss law. As choice of jurisdiction often follows choice of law, this would also damage EU centres of dispute resolution, including London, Paris and Stockholm.

The findings of the 2010 International Arbitration Survey suggest that, rather than encouraging businesses to adopt a compulsory instrument of European contract law, the replacement of English law may push them towards using New York or Swiss law (Swiss law being the Civil law system most commonly chosen in international contracts, having the advantage of a developed and well understood jurisprudence and good dispute resolution services, both in courts and arbitration).[14] The Survey quotes references to familiarity, foreseeability, certainty and predictability; a "well developed jurisprudence" and "international acceptance" as influencing the choice of law. These were particularly relevant to the popularity of English law, in combination with the prevalence of the English language and its acceptance throughout the world, making it more appropriate to cross-border trade. By contrast, any European instrument would suffer from the difficulties of uniform application using different languages and legal backgrounds. Thus, replacing English law with a new compulsory instrument would frustrate the desires of mercantile parties throughout the world and would be unpopular amongst those upon whom it is imposed as well as non-EU parties.

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[14] 44 per cent. of companies surveyed most frequently choose the law of their home jurisdiction when they are free to do so. 25 per cent. select English law, 9 per cent. choose Swiss law and 6 per cent prefer the law of New York. The next most popular European jurisdiction is French law, with only 3 per cent. of companies surveyed choosing their disputes to be governed by this (2010 International Arbitration Survey, Chart 9).

QUESTION 3

Should any future work/response cover business to business contracts/business to consumer contracts/on-line transactions or all of the above? Should it regulate domestic as well as cross-border contracts?

The CLLS believe that domestic contracts and business to business contracts (regardless of the size of the business) should be excluded from the scope of any future work. Efforts should be devoted to the Consumer Rights Directive, which is the proper forum for consumer and perhaps online transactions, rather than the excessively broad options suggested in the Green Paper.

Businesses are generally more familiar with the legal systems of the Member States in which they operate than consumers would be, reducing the need for any measures affecting business to business transactions. The forum for standardising the rights of consumers, where appropriate, should be the Consumer Rights Directive (and on-line contracts with consumers should be dealt with as part of the review of consumer law), not through the introduction of a whole new contract law. It is possible to superimpose the consumer protection aspects onto national contract law as has been done in the past. This would achieve the desired political and economic outcomes without incurring the disadvantages of the legal uncertainties mentioned in response to Question 2 and at less cost both for the public and private sector.

Much is made of the importance of extending consumer protection laws to SMEs. SMEs also need certainty of meaning and enforceability in relation to their contracts with other businesses. While larger businesses are better placed to deal with the significant additional costs of understanding any new optional or compulsory instruments, the cost in time and money for SMEs will be disproportionately high. The experience of the Netherlands in relation to the implementation of their new civil code in 1992 was that this resulted in increased costs to businesses and impacted disproportionately on SMEs.

The Green Paper suggests that on-line transactions are particularly affected by having multiple contract laws within the EU, however the underlying problems (i.e. that parties may be unfamiliar with foreign laws, may have to incur the cost of hiring lawyers expert in those foreign laws, and may be unhappy about using foreign laws but may be prevailed upon to do so by the other party to the transaction) are the same for on-line transactions as for other transactions. The Green Paper does not appear to have suggested any particular ground to formulate special rules for on-line transactions. Rather than suggesting measures with potentially significant consequences, evidence should be gathered regarding whether trade is in fact deterred by the divergence of applicable laws in on-line transactions, or whether more proportionate and less costly or extensive options can be formulated, for example, clarifying *which* legal system should apply.

Furthermore, the problems highlighted by the Green Paper in relation to trade do not arise in relation to purely domestic transactions. A contract between two parties in one state with no cross border element will be governed by the local law of that state (unless, unusually, the parties were to agree otherwise). There is no confusion nor any additional transaction costs resulting from a choice of laws. Thus there is no justification for any EU measures that will extend into a purely domestic context, although creating a separate regime for cross-border transactions would also be unlikely to further the stated aim of the Green Paper. If the motive for such measures is consumer protection, then they should not be created in such a way as to affect the entire sphere of contract law.

In contracts concerning the financial markets, in determining the capital requirements of financial institutions, the ability to net transactions and set-off matching assets and liabilities is crucial. In the absence of legal opinions that this can be done, institutions would have to account for their positions on the basis of their gross positions and not their net positions. If the meaning and/or enforceability of their contracts was unpredictable (for example because of the lack of jurisprudence or the discretions given to courts by an optional instrument based on the content of the DCFR), we understand that the opinions would not be able to be given with sufficient certainty to satisfy the requirements of the institutions' regulators. Accounting for gross positions could

have severe consequences and even destroy the global financial system in its current form. Great care therefore has to be taken to ensure that in pursuing the objectives of increased cross-border trade (in particular in regard to consumers, SMEs and e-commerce), the financial system is not unintentionally adversely affected. If EU institutions such as the European Investment Bank were to insist on the optional instrument being used, it could introduce systemic risks into the financial system both in relation to capital requirements (and therefore costs) and in the legal basis risk as there would be no certainty that hedging operations would result in uniform interpretation of contracts.

QUESTION 4

What should the preferred "material scope" of any instrument be?

Ideally, there should not be any new instrument, so it should not have any material scope at all.

QUESTION 5

Are there any other matters not covered in the Commission's Green Paper or the Call For Evidence which should be addressed in this exercise?

The key matter that has not been addressed is the need for a full and complete cost-benefit analysis of this project, in order to properly assess the impact of the proposals set out in the Green Paper. The CLLS do not believe that in times of austerity scarce resource should be devoted to this issue until a proper study has been made that supports the argument that the economic advantages of implementing any of the proposed options outweighs the economic costs of implementation.

Professor Hesselink's approach of formulating a set of questions, considering the form a European Contract Law should take and the policy questions that will have to be dealt with while doing so may be helpful. Member States could then indicate what sort of contract law they are prepared to accept and whether there is any possibility of consensus (preferably only acting in areas agreed upon by all Member States). This would be appropriate, given the gravity of the action contemplated and the importance of contract law to trade and to the fabric of society, before the EU spends any more time and money looking into contract law harmonisation.

If further consideration is to be given to the issues referred to in the Green Paper, it is imperative that in addition to academic lawyers, practising lawyers with extensive international contract experience be involved. In addition, to date there has been relatively little involvement of lawyers from a common law background. Given that the potential proposals will have a greater impact on common law jurisdictions than civil law jurisdictions, it is imperative that this imbalance be addressed. Finally, it is important that economists and business organisations be involved in any further consideration of the issues referred to in the Green Paper.