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# FINANCIAL MARKETS LAW COMMITTEE

# ISSUE 121 – EUROPEAN COMMISSION FINAL PROPOSAL FOR A REGULATION ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS ("ROME I")

**Legal assessment of the conversion of the Rome Convention to a Community instrument and the provisions of the proposed Rome I Regulations**


c/o Bank of England
Threadneedle Street
London EC2R 8AH
www.fmlc.org

## FINANCIAL MARKETS LAW COMMITTEE

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# PART A – General Comments

## 1 Introduction and executive summary

### a) Introduction

1.1 The role of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 In January 2006 the Department for Constitutional Affairs ("DCA") sought the views of the FMLC on the European Commission's Final Proposal for a Regulation on the law applicable to contractual obligations (known as the "Rome I" Regulation)[1] and its impact on the wholesale financial markets. This paper responds to that request and sets out the FMLC's analysis of the issues, providing a legal assessment of the provisions of the proposed Regulation.

1.3 In summary, the conclusion of the FMLC is that the Regulation, as presently drafted, would be likely to undermine the ability of English law to offer legal certainty in this area to contracting parties. The Committee believes that further study and analysis is essential and that significant redrafting may be required.

1.4 The key points in the reasoning of the FMLC are summarised below.

### b) Executive summary

1.5 The FMLC has concerns about a number of aspects of the text of the proposed Regulation. In particular, the Committee considers that the proposed Article 8(3), which contemplates the discretionary application of certain foreign rules, is harmful because it would create major uncertainty. It requires the courts of the forum to determine whether or not they should give effect to the "mandatory rules" of countries that are deemed to have "a close connection" with the matter, in addition to the law chosen by the parties. 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 mandatory rules might undermine the enforceability of their contracts, and also to predict how the discretion will be exercised.

1.6 Article 4, which deals with applicable law in the absence of choice, does not adequately contemplate financial contracts. It is likely to produce anomalies and conflicts in complex financial transactions where the likely result is that, if the parties have not made an express choice of law, a related series of contracts may be governed by different laws.

1.7 The new provisions in Article 7 which govern choice of law in agency situations raise significant difficulties for the financial markets. Article 7(2) appears to subject the relationship between principal and third party to the law

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[1] COM (2005) 650 final

of the country in which the agent had his habitual residence when he acted. This would place the burden on a third party, when entering into a contract with someone known to be acting for another as principal, of investigating where the agent resides, and the law of that country.

1.8 Article 13(3) introduces a rule which may not be in the interests of the financial markets. It provides that the question of whether an assignment may be relied on against third parties is to be governed by the law of the country in which the assignor has its habitual residence at the relevant time. The FMLC does not consider that this is the correct approach. This is an issue of considerable significance to the financial markets since many financial transactions involve intangible claims of this nature.

1.9 A further area for concern is the treatment of consumer contracts. Article 5 of the proposed Regulation would impose the law of the Member State in which the consumer has his or her place of habitual residence as the governing law of the contract as a whole. In practice, this is likely to increase uncertainty and costs for business as a party's contract with a consumer will become subject as a whole to the local law of the consumer's place of residence, rather than just being subject to those rules in that country which are mandatory.

1.10 In addition, there are a number of substantive drafting problems with the proposed Directive and the Committee also finds difficulty with its apparent retrospective effect. Finally, there are doubts as to the Regulation's conformity with its stated Treaty basis which itself causes uncertainty.

1.11 Overall, the Committee believes that the present situation under the regime contained in the Rome Convention is largely satisfactory. There appears no pressing reason for reform of the Rome Convention regime nor its conversion into a Community instrument.[2]

## 2 The conversion of the Rome Convention to a Community instrument – General Comments

### a) Introduction

2.1 The European Commission's proposal for a Rome I Regulation is made on the basis of articles contained within Title IV of the Treaty Establishing the European Community (TEC).[3]

2.2 It is the FMLC's position that the decision as to whether or not to participate in the conversion to a Regulation is a political matter. That said, in the Committee's view, careful consideration should be given to the question

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2 Although see discussion at paragraph 4 on Article 3(4) of the Regulation (which is almost identical to Article 3(3) of the Rome Convention) and the discussion at paragraph 7.4 on Article 5(2) of the Rome Convention.

3 It should be noted that measures adopted pursuant to that Title do not apply to the United Kingdom unless it expressly exercises its right to opt-in to them in accordance with the relevant Protocol (No. 4, 1997).

whether there is any demonstrable advantage from the change which outweighs the inherent costs and uncertainty therein.

**b) Certainty of existing regime**

2.3 Since its signature in 1980, the Rome Convention has become an essential element of the legal structure under which international businesses choose to determine and regulate their contractual relations. The rules it establishes are well known and well established, and the overwhelming majority of professionally drafted commercial contracts with an international element contain a choice of law clause relying on the principle of party autonomy, as enshrined in Article 3 of the Convention. Although not without its flaws the Convention has brought a significant degree of certainty and harmonisation to the question of applicable law for contracts, which is one of the most important constituents of legal certainty in international transactions.

2.4 The Rome Convention has performed its intended function more than adequately in most contexts. It is to be doubted whether its conversion to a Community instrument is necessary for it to be able to continue to fulfil its function effectively. Whilst the FMLC is not convinced that the European Commission has made out the case for the "necessity" of transformation of the Rome Convention into a Regulation (see below), if it were possible to take account of the various problems with the proposed text outlined below, that would go some way towards ameliorating the FMLC's concerns.

2.5 The Treaty basis proposed for the Regulation by the Commission, Article 65(b) TEC, is in itself a cause of uncertainty. In order to legislate on this basis, the measure in question must be "*necessary for the proper functioning of the internal market*". This necessity is not readily apparent from the grounds for conversion put forward in the Green Paper:

a. it would lead to greater consistency in Community legislation on private international law;

b. it would confer on the European Court of Justice the jurisdiction to interpret the rules in the best conditions;

c. it would facilitate the application of standardised conflict rules in the new Member States.

2.6 The principal contention of the Commission in relation to greater consistency in Community legislation appears to be that it would be neater to have all of the Community's private international law instruments in the same format. In the view of the FMLC, that is not a "necessity" for the proper functioning of Community law. The only other argument suggested by the Commission appears to be that there would need to be reconsideration of the derogations permitted by Articles 22, 23 and 24 of the Convention, but this is a matter independent of the form of instrument within which those rules are contained and not a ground supporting conversion to a Regulation.

2.7 The second ground proposed by the Commission, that of empowering the ECJ to interpret the rules, has fallen away since the Green Paper, as the Protocols to the Convention have now come into force conferring that jurisdiction on the European Court. The Commission also set out a subsidiary point of the advantage of the ECJ having "*identical jurisdiction over all Community private international law instruments,* [in order to] *ensure that legal concepts common to the Rome Convention and the Brussels I Regulation are interpreted in the same manner*". There is no immediately apparent reason that the source of the ECJ's jurisdiction should have any effect on its ability to interpret common legal concepts in the same manner. It may be felt that the test of necessity is once more not met.

2.8 At paragraph 2.4 of the Green Paper, the Commission argued that the adoption of a Community instrument "*would prevent the entry into force of the uniform conflict rules from being delayed by ratification procedures in the application countries.*" This may well be the strongest argument proposed by the Commission. It may be noted, however, that the ten Member States who joined the EC in 2004 have agreed to accede to the Rome Convention, and four of them have already ratified the Accession Convention.

2.9 Finally, the proposed Regulation appears to go further than is necessary for the proper functioning of the internal market, in so far as it is not limited to contracts having a connection to the European Union.

2.10 The FMLC considers, in view of the material that follows in this paper, that a proper and thorough-going impact assessment of the Regulation is urgently required. The lack of such an assessment to date is difficult to square with the European Commission's well-publicised commitment to "better regulation". Moreover, the Commission's view that the proposal has a "limited impact" is not clearly supported and is difficult to reconcile with the argument that the proposed Regulation is necessary.

## PART B – Specific Substantive Comments

### 3 Article 8(3) – Third country mandatory rules

3.1 Article 8(3) provides:

> Effect may be given to the mandatory rules of the law of another country with which the situation has a close connection. In considering whether to give effect to these mandatory rules, courts shall have regard to their nature and purpose in accordance with the definition in paragraph 1 and to the consequences of their application or non-application for the objective pursued by the relevant mandatory rules and for the parties.

In effect, this concerns the potential application of the "mandatory rules"[4] of a country other than that whose law applies to the contract or the law of the forum. In this respect, if not in its precise wording (see paragraph 3.4(f) below), it mirrors Article 7(1) of the Rome Convention.

3.2 The UK, in common with Germany, Luxembourg, Ireland and Portugal, a group now joined by Latvia and Slovenia upon their recent accessions, elected by reservation not to apply the provisions of Article 7(1) of the Convention. In so doing, these States took advantage of the express derogation in Article 22(1) of the Convention.

3.3 The official commentary on the Convention, prepared by Professors Giuliano and Lagarde, explains that this derogation was included because of "the novelty of [Article 7(1)], and the fear of the uncertainty to which it could give rise".[5]

3.4 The FMLC considers that Article 8(3) has the same potential to give rise to uncertainty as did Article 7(1). In particular:

a. In the FMLC's view, Article 8(3) is likely to cause confusion and uncertainty among contracting parties[6], as a result of (i) its discretionary nature, (ii) the uncertainty of the criteria which it employs, and (iii) its potential breadth.

b. As to (i), the existence of a discretionary element in the application of any rule appears contrary to the principle of legal certainty. The contrast with the attitude of the Court of Justice to discretionary rules of jurisdiction in its recent case law is striking.[7]

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4 As defined in Art. 8(1), inspired by the decision of the ECJ in the *Arblade* decision (Cases C-396/96 and C-374/96).

5 Giuliano-Lagarde Report [OJ C282, 31.10.80, p. 27]

6 In particular, parties to financial markets transactions, for which legal certainty is a paramount consideration.

7 See *Owusu v. Jackson* (Case C-281/02) [2005] QB 801, paragraph 41 ("Application of the *forum non conveniens* doctrine, which allows the court seised a wide discretion as regards the

c. As to (ii), the concept of a "situation with which the close connection" and the absence of any indication as to the weight to be given to the various factors referred to in the second sentence seem likely to give rise to differing interpretations of Article 8(3) between (or within) the Member States.

d. As to (iii), the words "effect may be given" and "another country" are plainly wider than would be necessary, for example, to address any conflict between the performance required by the contract under its applicable law and the overriding rules of the country of performance.[8] Thus, for example, rules capping rates of interest (or excluding the payment of interest entirely) of a country in which the borrower has his principal place of business may be argued to be directly applicable under Article 8(3),[9] even if the contract is governed by a different law and all payment flows take place outside that country.

e. Further, in the FMLC's view, the breadth of Article 8(3), and the absence of any clear territorial restriction or guidance as to the exercise of the discretion, are likely to increase materially the costs of cross-border financing transactions[10], both in terms of legal expenses and the pricing of transactions to reflect uncertainty and increased legal risk.[11] The uncertain criteria employed in Article 8(3) may also encourage speculative attempts to avoid contractual obligations, leading to increased cost and delay at the stage of attempting to settle and litigating disputes.

f. The proposed changes to the wording of Article 7(1) of the Rome Convention have not, in the FMLC's view, materially improved the position. Indeed, the task of contracting parties and courts would (if anything) appear to have been made more difficult by the more complex definition of mandatory rules, derived from ECJ case law on the free

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question whether a foreign court would be a more appropriate forum for the trial of an action, is liable to undermine the predictability of the rules of jurisdiction laid down by the Brussels Convention, in particular that of article 2, and consequently to undermine the principle of legal certainty, which is the basis of the Convention.").

8 This situation has been suggested as the reason why Art. 8.3 is "indispensable" (see response of the Max Planck Institute to the Commission's Green Paper, paragraph 75). It may be questioned whether even that assessment is correct. That performance is prohibited under the law of the place where the contract is to be performed may be a relevant consideration in applying the rules of the applicable contract law (see, e.g., *Ralli v. Compania Naviera Sota y Aznar* [1920] 1 KB 287) or the forum's public policy (see, e.g., *Foster v. Driscoll* [1929] 1 KB 470), without the need for an independent applicable law rule (let alone one as widely formulated as Art. 8.3) to support that conclusion.

9 See Giuliano-Lagarde Report [OJ C282, 31.10.80, p. 27].

10 The parties to a transaction will be required to consider the mandatory rules of all countries with which the contract, or its performance, may be said to have a close connection. Additional legal opinions would almost certainly be required from jurisdictions whose rules might be argued to apply under Article 8.3.

11 The FMLC understands that rating agencies already take account of the possible effect of Art. 7.1 of the Rome Convention in rating transactions centred in a Member State which applies that rule.

movement of persons and goods, now contained in Article 8(1) of the proposal.

3.5 In summary, Article 8(3) lies at the heart of the FMLC's concerns about the proposed Rome I Regulation. Overall, it seems likely to cause significantly more difficulties than it may resolve. It appears to constitute an unwarranted interference with the principle of party autonomy and wholly contrary to the requirement of legal certainty. If adopted within the framework of a Regulation, the FMLC is concerned that Article 8(3) would greatly undermine contractual stability. It should, therefore, be deleted.

## 4 Article 3(4) – Fraudulent evasions of mandatory rules

4.1 Article 3(4) of the Regulation is almost identical to Article 3(3) of the Rome Convention (the only amendment being the phrase "in accordance with paragraph 1 or 2" added after "the fact that the parties have chosen a foreign law"). This rule constitutes a limitation of the effect of a choice of law by the parties. The basic condition for the application of this rule is that all the other relevant elements (other than the choice of law) are connected with one country only, and that this connection introduces the applicability of the mandatory rules of that one country.

4.2 This limitation of the freedom of the parties may give rise to uncertainty and increase in the costs of litigation. Although the EU Member States may have an interest in assuring full applicability of their mandatory rules, the interest of the market, in particular in the presence of a clear choice of law, is to achieve certainty and not to limit parties' freedom. Article 3(4) of the Regulation should therefore be deleted.

4.3 In the event that Article 3(4) is included in the Regulation, the relationship between this provision and Article 8(3) is unclear. On one view, Article 3(4) is unnecessary since Article 8(3) currently provides that effect may be given to the mandatory rules of the law of another country with which "the situation has a close connection". Article 8(3) appears, therefore, to encompass the application of the mandatory rules of a country with which the contract is solely connected, as provided for by Article 3(4).[12] In these circumstances, the chief distinguishing characteristic of Article 3(4) is that it is binding on the court, whereas Article 8(3) confers a discretion. A further aspect of this same distinction is that Article 8(3) requires the court to take into account the rules' nature and purpose, together with the consequences of their application, in considering whether to give effect to them, whereas Article 3(4) does not.

4.4 To give more effective meaning to Article 3(4), it may be thought preferable to limit the scope of Article 8(3) by clear drafting to situations where the

[12] The same degree of overlap does not occur in the case of the equivalent provisions of the Rome Convention – Articles 3(3) and 7(1) – because, as discussed above, the provisions of Article 7(1) of the Convention do not apply in all Member States, as would the provisions of Article 8(3) of the Regulation.

applicable law is determined in the absence of choice (Article 4 does not provide for any rule along the lines of Article 3(4)).[13]

4.5 It is to be noted that the restrictive definition of mandatory rules contained in Article 8(1) does not apply to Article 3(4), which simply refers to rules of law "which cannot be derogated" from by contract. This distinction (between rules which are expressed, without more, to be mandatory in the domestic context for which they were drafted – as in Article 3(4) – and rules which are deliberately and additionally expressed to apply irrespective of a contrary governing law – as in Article 8(1)) was also observed by the Rome Convention in respect of the equivalent provisions (that is, Article 7 and Article 3(3)). However, it may now be thought preferable to subsume Article 3(4) within Article 8 for the purposes of clarifying the relationship between the two. If this were to be done there is a good argument for applying the restrictive definition set out in Article 8(1) (albeit with improved drafting) to both situations, since under the broader approach taken in Article 3(4) there is a residual risk that the courts of the forum will regard themselves as bound by a foreign law which was not intended by the lawmaker to override a contrary governing law and which would not have applied to the same situation in the jurisdiction within which it was drafted.

## 5 Article 3(5) – Community mandatory rules

5.1 Article 3(5) seeks to ensure the potential overriding effect of Community legislation. However, it is unclear why it is necessary given that Article 8.2 already requires the application of the overriding mandatory rules of the forum, which would include rules derived from Community law. Article 3(5) is, therefore, unnecessary and the FMLC considers that it should be deleted because of the uncertainty it may cause.

5.2 If a provision of this kind is to be included, it is important that it should make clear that it does not (of itself) have the effect of giving overriding status to all Community rules which affect contractual obligations, making them automatically applicable to a given situation irrespective of the absence of a substantial territorial connection to the Community. For example, there is a risk that this article could result in a Member State court applying Community law rules to a contract regulating a transaction taking place wholly outside the EU, even though those rules would otherwise not apply to that situation.

## 6 Article 4(2) – Applicable law in the absence of choice

6.1 A significant number of cases where there is no express choice of law will fall within Article 4, rather than Article 3.[14]

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13 However, this was not the approach taken to Article 7(1) of the Rome Convention.

14 Article 4(2) concerns the applicable law in the absence of a choice of law. This is different from the concept of implied choice pursuant to Article 3(1). The Explanatory Memorandum to the Proposal for a Regulation on Rome I encapsulates the difference by asserting that the changes to Article 3(1) "require the courts to ascertain the true tacit will of the parties rather a pure hypothetical will ...". The "true tacit will" is a deliberately narrow concept, concerned with those relatively rare cases in which the parties intend a particular law to govern, although

6.2 The rule concerning the selection of the applicable law in the absence of choice is very narrow and does not cover all relevant case-scenarios. It attempts to encompass all types of contracts in a few fixed categories, without taking into account that because of its general application, a more flexible rule is needed. The result is an oversimplification of the various situations which could occur in the absence of choice.

6.3 The new rule prescribes how the applicable law is to be identified in eight situations. The courts have no discretion and cannot identify a different law that may have a closer connection to the contract. The contracts not "specified" in Article 4(1) are governed by the law of the habitual residence of the provider of the characteristic service performed, and if the service cannot be identified, the law of the country with which it is most closely connected.

6.4 Article 4 should not prescribe a set of rules intended to be applicable to almost all types of contracts without clarifying the principle behind those rules. Otherwise, Article 4 would allow the applicability of a system of laws distant from the situation, which would be at odds with parties' expectations.

6.5 Article 4 should leave a margin of discretion to the national courts as to whether a set of circumstances exists in a particular case that would justify the non-application of the fixed rules. In some situations, the facts of the case would show the contract to be manifestly more closely connected to laws different from those that would be selected pursuant to the eight cases in Article 4(1).

6.6 Such discretion would serve the interests of certainty, by allowing a court to locate a contract in its social and economic context, and so reflect the expectations of the parties, and of any relevant market. The proposal as drafted seeks certainty in adjudication, but in doing so undermines certainty in commercial relations.

6.7 In the cases contemplated by Article 4, the parties have decided, either consciously or not, not to elect the substantive law governing the contract. In this event, the substantive law should meet or attempt to meet the parties' reasonable expectation, which is the law mostly connected with them and the contract, and not an artificial system of rules, possibly with no relevance to the contractual relationship.

6.8 Article 4 should regulate how to localise the substantive law on the basis of objective considerations connecting the contract to a particular country and giving precedence to the residence of the party performing the characteristic obligation, unless the totality of the circumstances demonstrates a manifestly closer connection to another country.

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they have not indicated their choice by an express governing law clause. It does not allow a court to draw inferences from market practice. It is also unlikely that there can be implied choice under Article 3 where the parties have deleted a governing law clause from a standard-form contract, as may legitimately happen in contractual negotiations (Samcrete S.a.e. v. Land Rover Exports Ltd. [2001] EWCA 2019).

6.9 The overall rule is intended to apply across a wide range of types of contract, but it is essential to leave a measure of discretion to the courts, which takes into account the nature and the circumstances of the particular contract in question. This would avoid attributing relevance to the presumption of characteristic performance in the event that it has no real significance as a connecting factor.

6.10 The FMLC considers that Article 4 should therefore be reformulated as follows:

a. It should contain an initial paragraph stating that the contract shall be governed by the laws of the country with which it is most closely connected.

b. Secondly, it should contain the general presumption based on the concept of characteristic performance, which requires identification of the country with which the contract is most closely connected, and it should list by way of example several types of contracts and how to determine the applicable law.

c. Thirdly, the presumption based on the concept of characteristic performance should be disregarded where it appears that the contract is manifestly more closely connected with another country. The Regulation could give an indication of how the general presumption might be rebutted and the connecting factors that may be taken into account by the courts (e.g. place of performance) (compare Article 5.3 of the proposed "Rome II" Regulation[15]).

6.11 Alternatively, but not optimally, Article 4 should be reformulated by inserting within Article 4(1) a flexible exception similar to that currently in Article 4(2).

6.12 Either reformulation would give the necessary flexibility in identifying the applicable law in connected contracts (allowing the so called "accessory" determination of the applicable law) and in all other contracts, including the ones falling in the categories listed in Article 4(1), where the criteria listed in Article 4(1) would not identify the law with connecting factors.

6.13 Furthermore, the current drafting of Article 4 poses several potential problems:

a. Article 4.1(a) – the seller may be domiciled in a tax haven or in a country with no connecting factors with the sale.

b. Article 4.1(b) – the provider of the service is the same provider of a service indicated in Article 4.2. In the first case, the applicable law is the law of the country in which the service provider has his habitual residence, while in the second case the applicable law is the law of the country in which the service provider of the characteristic performance has his habitual residence.

c. Article 4.1(f) assumes that a contract relating to intellectual or industrial property rights has to provide only a transfer or assignment of rights.

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d. The default rule is applicable only to contracts where the service cannot be identified.

6.14 Financial contracts are not expressly contemplated by Article 4. Assimilating financial contracts to contracts for the provision of services would trigger the presumption contained in Article 4.1(b), which would lead to the applicability of the law of the country in which the principal place of business of the bank is located (or to a relevant branch under Article 18). This approach would result in lack of clarity in the case, for instance, of international letters of credit. It is not market practice to include governing law clauses in letters of credit. This allows credit to be extended promptly, using standard documentation, without addressing the identity of the applicable law. But the expectation of the market is that the law applicable at the place of presentation and payment will govern the separate contracts between the beneficiary and, respectively, the confirming and issuing banks. As presently drafted, however, the unqualified application of Article 4(1) might subject each contract to a different law, a result avoided by the English courts in cases under the Rome Convention by using the flexible exception provided by Article 4(5) of the Convention.[16]

6.15 If separate provision is not to be made for complex financial transactions in Article 4, this further argues for the more flexible approach suggested above in paragraph 6.10.

6.16 Finally, it should be noted that, in respect of contracts other than financial contracts, the monetary obligation is not deemed as being "characteristic". However, in certain cases it should be considered as an additional connecting factor.

## 7 Article 5(1) – Consumer Contracts

7.1 The focus of the FMLC is on the wholesale financial markets and it is in this context that it expresses concern about the impact of the Rome I Regulation. The following sections on consumer contracts have been developed, in particular, because of the significant degree to which consumer receivables are securitised. To the extent that the points below touch on non-financial consumer contracts, they have been raised by way of analogy with financial contracts and/or for the sake of completeness.

### a) Introduction

7.2 Article 5(1) of the Regulation sets out a new rule for consumer contracts, under which these contracts are to be governed by the law of the Member State in which the consumer has his habitual residence.

7.3 The approach in Article 5(1) is a departure from the present rule in Article 5(2) of the Convention, which provides that, in certain specified circumstances, a choice of law made by the parties shall not deprive the consumer of the

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16 See *inter alia* Bank of Baroda v Vysya Bank [1994] 2 Lloyd's Rep. 87 and PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd [2005] EWCA Civ 442.

protection afforded to him by the mandatory rules of the law of the country in which he has his habitual residence.

**b) Deficiencies in Article 5(2) of the Rome Convention**

7.4 It is widely recognised that, in an otherwise functioning and relatively efficient instrument, the approach to the law applicable to consumer contracts in the Rome Convention is awkward and uncertain.[17] In particular, the approach gives rise to a lack of transparency, as the law specified in the contract concluded with the consumer is not necessarily definitive. Instead, an additional set of rules, where they are mandatory under the law of the consumer's country of habitual residence, are overlaid on top of the rules of the legal system specified in the contract. The result is a complicated, overlapping regime, with a hybrid legal framework drawing on two legal systems being applicable to the contract.

7.5 The problem with the approach in the Rome Convention is exacerbated by the provisions of Article 3(3) and Article 7(1) of the Rome Convention (where the latter applies). These Articles provide that:

a. notwithstanding that the parties have chosen a foreign law, where all the other elements relevant to the situation at the time of the choice are connected with one country only, the rules of the law of that country which cannot be derogated from by contract still apply (Article 3(3)); and

b. when applying the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract (Article 7(1)).[18]

7.6 Therefore, the effect of Article 3(3) and Article 7(1) of the Rome Convention is to further overlay additional systems of law, such that it is possible for there to be four different legal systems providing rules applicable to the contract.

**c) Issues with new approach in Article 5(1) of the Rome I Regulation Proposal**

7.7 The FMLC does not consider that the new approach proposed in Article 5(1) is a solution to the deficiencies in the corresponding provisions of the Rome Convention approach to consumer contracts. Although Article 5(1) removes some of the possibility of hybrid applicable laws, it raises its own issues that mean that, in the FMLC's view, the proposed Article 5(1) will not be a provision that will contribute to legal certainty and is likely to increase costs.

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17 This issue is also referred to in the Explanatory Memorandum (page 6) accompanying the Commission's Rome I Regulation Proposal.

18 As discussed above, this Article does not have the force of law in the United Kingdom: see section 2(2) of the Contracts (Applicable Law) Act 1990. However, this opt out, allowed by Article 22(1)(a) of the Rome Convention, is not available under the Rome I Regulation Proposal.

7.8 The effect of Article 5(1) is that a contract with a consumer is subject to the entire corpus of contract law of the Member State in which the consumer has his habitual residence. The application of all the rules of contract of the Member State may thus profoundly affect the nature of the contract and its effect on the parties, as rules on areas such as contractual construction, mistake, misrepresentation, undue influence, illegality and consideration from that Member State's law are applied to the contract. Clearly, these rules are much wider in scope than mandatory rules and therefore the impact of Article 5(1), which undermines party autonomy, is much greater than the corresponding rule in the Rome Convention. It is also possible that the application of the local law of the consumer brings in registration and establishment requirements that could lead to the contract being illegal.

7.9 The particular issue that arises for those concluding cross-border contracts with consumers where Article 5(1) applies is that the due diligence necessary to be able to conclude a contract with a consumer is exceedingly large, so as to become intolerable. Without a full understanding of the legal system and the contract law in the Member State where the consumer has his habitual residence, the party concluding the contract with the consumer cannot know the full impact the contract will have and will not be certain all the requirements for the contract to be enforceable have been met. For parties operating in several Member States, this exercise is likely to be particularly costly and may inhibit cross-border commerce.

7.10 The FMLC recognises that there are arguments both for and against the approach taken in Article 5(1) from a policy perspective. On the one hand, consumers are entitled to the benefit of the legal regime with which they are most familiar. On the other, imposing the legal system of the Member State the consumer habitually resides in is a barrier to firms concluding cross border contracts with consumers and therefore should be limited as far as possible, for example by only imposing those requirements that are mandatory for the purposes of consumer protection.

7.11 However, it is currently not possible to properly assess the issues raised by Article 5(1), as no comprehensive regulatory assessment has been carried out to consider the impact of such a significant change to the rules determining the applicable law for consumer contracts. In this regard, the Commission has failed to carry out its better regulation responsibilities. The justification for the change set out in the Explanatory Memorandum to the Commission's proposal provides only very limited analysis of the issue, asserting that where the parties are drafting clauses not covered by mandatory provisions of law in the country of the consumer, it matters little whether they are governed by the law of one party or the other. For the reasons set out above, the FMLC does not consider that this is the case. The law governing the contract is a matter of great significance, which can have a substantial impact on the nature of the contractual relationship between the parties.

7.12 One particular issue that the FMLC believes should be considered in order to properly assess the impact of the proposal relating to consumer contracts is how the provision would impact on the single market. The application of the law of the Member State where the consumer has his habitual residence is likely to be

a significant barrier to trade across borders. The challenge that this presents to businesses is likely to be too great for all but the most sophisticated, and even these organisations will be confronted by a very large burden to ensure that their contracts are drafted appropriately.

7.13 Therefore, the FMLC considers that the positive and negative impacts of the proposal must be assessed and balanced through a proper consultation and impact assessment. The areas that should be considered in such an impact assessment are likely to include:

a. the likely effect on intra-Community trade;

b. the likely uncertainty and additional cost to business; and

c. the likely reaction of business and consumers to the new regime.

**d) Consumer contracting outside the Member State of his habitual residence**

7.14 The FMLC considers that there is a further issue in relation to the proposal in Article 5(1) to which it does not appear the Commission has fully turned its mind. This issue concerns the situation where a consumer seeks out a contract in a Member State other than where he has his habitual residence.

7.15 When a consumer is travelling outside the Member State where he has his habitual residence and buys goods or services, the question arises what is the applicable law of that contract. If Article 5(1) applies, it will be the law of the Member State where the consumer has his habitual residence, notwithstanding that the nature of the transaction may be such that it would be fairer and more appropriate for the law of the professional's establishment to be applicable to the contract, since the consumer has sought out the professional in that country.

7.16 The provisions of paragraph 2 and subparagraph 3(a) of Article 5 attempt to address this issue. However, these provisions do not go far enough to cover all the possible situations where the applicable law of the contract should be determined by the professional's residence and not the consumer's.

7.17 Article 5(2) provides that paragraph 1 of Article 5 applies on the condition that the contract was concluded with a professional who pursues his profession in the Member State in which the consumer has his habitual residence or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities. This provision will operate so that, where, for example, a shopkeeper established in only one country sells goods to a consumer from another Member State, Article 5(1) will not apply.

7.18 However, where a store sells goods to a consumer and that store is located in another country to that in which the consumer has his habitual residence, an issue arises where that store is part of a chain of stores that are established in a number of Member States, including the Member State where the consumer has his habitual residence. In this set of circumstances, the fact that the chain of stores includes an establishment in the Member State in which the consumer

has his habitual residence could cause the law of that Member State to be applicable to the contract, notwithstanding that the transaction in question was initiated by the consumer and took place outside of that Member State.

7.19 It is not clear how Article 5(2) is intended to operate in this situation. It appears that Article 5(2) has been drafted to cover two situations:

a. where a contract has been concluded with a person who pursues a trade or profession in the Member State in which the consumer has his habitual residence; and

b. where a contract has been concluded with a person who pursues a trade or profession by any means and directs such activities to the Member State in which the consumer has his habitual residence or to several States including that Member State, and the contract "falls within" the scope of such activities.

7.20 If this analysis is correct, the first limb of Article 5(2) simply requires the professional to be active in the consumer's country of habitual residence. There is no requirement for the contract in question to be concluded as part of the activities in that Member State and therefore a contract concluded as part of the professional's activities outside the consumer's home country would still be caught by Article 5(1) if the professional's activities were conducted in both countries. A similar issue arises in relation to the second limb of Article 5(2), which requires the professional to direct his activities to the Member State in which the consumer has his habitual residence, there being no clear requirement for the contract to be concluded through the activities in that Member State as opposed to through the activities in another State.

7.21 Article 5(3)(a) provides that paragraph 1 of Article 5 shall not apply to a contract for the supply of services where the services are to be supplied to the consumer exclusively in a country other than that in which he has his habitual residence.[19] Although this provision would again appear to offer some relief from the situation outlined above, the fact that Article 5(3)(a) only refers to services and not goods would suggest that those selling goods to a consumer outside the consumer's country of habitual residence would not be outside Article 5(1) if they fulfilled the criteria in Article 5(2).

7.22 There is clearly potential for great unfairness to a professional dealing with a consumer who has sought out the professional's services outside his country of habitual residence. We assume that it is not the Commission's intention to catch those contracts where the consumer has sought out the professional in a State other than that in which he has his habitual residence. The FMLC considers that this should be addressed more clearly in the provisions of Article 5, so that there is more certainty on the point. If, therefore, the solution proposed by Article 5 is to be adopted it will require substantial revision.

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[19] This provision reproduces Article 5(4)(b) of the Rome Convention.

## 8 Article 7 - The new rules on contracts with agents

8.1 The proposed Article 7 is entirely new, there being no equivalent in the Rome Convention. The FMLC is unclear why the addition of an article dealing specifically with agents was considered to be necessary (there being no reference to this in the Commission's Green Paper), but more significantly the FMLC sees three areas of difficulty with the text currently proposed, the second of which is the most important.

8.2 The first point is that it is not clear who would be included in the definition of "agent" in the Article. Would this include, in particular, every employee of a company who commits a company to a contract? English law, for example, distinguishes in certain contexts between agents and employees. It is important to make quite clear what is included within agency in this context, not least because of the need to be clear, as explained below, as to whether a third party should be required to investigate the agent's country of habitual residence and the law of that country.

8.3 This leads to the second point, which relates to the proposed Article 7(2). This appears to subject the relationship between principal and third party to the law of the country in which the agent had his habitual residence when he acted. The paragraph might have been directed to the law applicable to the question as to whether the agent had authority to bind the principal, but that is not what it says. The relationship between the principal and the third party will usually be the contract entered into between them, of which the agent was simply the instrument bringing it into existence. It is hard to see the justification for rendering the contract between principal and third party subject to the law of the agent's residence, both as a matter of principle and by reference to the practical difficulties which this causes to the third party.

8.4 As for principle, it is hard to see why the agent's residence should assume such importance. In many cases, the contract between principal and third party, once made, no longer concerns the agent, and his role in the making of the consensus embodied in the contract may in any event be minimal.[20] In any case, the rule undermines party autonomy, without obvious justification.[21]

8.5 As for practicality, it seems onerous for the third party, when conducting a contract with someone known to be acting for another as principal, to have to investigate where the agent resides, and the law of that country. As the text of the proposed 7(2) shows, this may differ from the place where the agent is

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[20] Note, however, that in the case of: (i) the sale of structured products to consumers through "retail aggregators" (i.e. where products developed by one firm are sold through another firm to the second firm's retail clients); and (ii) the sale of mutual funds managed by one firm through other firms to the second firm's retail clients, the agent's role is initially and continues to be very important, and by both contract and regulation the agent will have ongoing responsibility and liability for its actions both towards the principal and towards its retail clients.

[21] The suggested rule would differ fundamentally from the existing common law rule under English law, which looks to the governing law of the contract between principal and third party (Dicey and Morris, The Conflict of Laws (13th ed., London: Sweet & Maxwell, 2000) Rule 197).

acting at the time when he commits the principal to the contract. If the question is not "the relationship between the principal and third parties", as stated in the proposed paragraph, but the authority of the agent to contract, the new rule would be more understandable. We do not have any difficulty with the proposed Article 7(1), which in general (and subject to party choice) subjects the relationship between principal and agent to the law of the habitual residence of the agent.

8.6 The third point concerns the curious language in the proposed Article 7(3), which seems designed to allow parties to stipulate a governing law, but is cast in very narrow terms. It is limited to a designation in writing by principal or agent, as distinct from designation by the third party, although the acceptance of the third party is required. Clearly this provision should be equally available to all parties, provided there is agreement between them. The FMLC suspects that this was the intention of the proposed paragraph, but greater clarity is required.

## 9 Article 13 – Voluntary assignment and contractual subrogation

### a) General

9.1 Article 13 of the draft Rome I Regulation corresponds to Article 12 of the Rome Convention. Certain drafting changes have been made to paragraphs 1 and 2 and an additional paragraph 3 has been added. The title of Article 13 has also been amended to reflect the addition of a reference to contractual subrogation in paragraph 1 (see "Part C – Specific Drafting Comments" below).

### b) Article 13(3)

9.2 Paragraph 3 of Article 13, as noted above, is wholly new. The addition of this provision appears to be intended to address the question which has troubled many commentators and some courts in relation to Article 12 of the Rome Convention, namely, whether it is limited to the contractual aspects of assignment or also covers proprietary aspects.[22] This would be relevant, for example, in a situation in which the assignor has become insolvent after making the assignment.

9.3 It is not clear, however, that the correct rule has been chosen. The Explanatory Memorandum says that this solution "is the one recommended by the great majority of respondents" to the original Green Paper consultation on this proposal and refers to this rule having been adopted in the 2001 UNCITRAL Convention on the assignment of receivables in international trade. Apart from the fact that the UNCITRAL Convention is not yet in force (and has been signed only by four jurisdictions, only one of which has actually ratified or

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22 A reasonably detailed discussion of the different views expressed by different commentators, including Professor Lagarde in an article published in 1991, and in the Dutch and English courts, see R Plender and M Wilderspin, *The European Contracts Convention – The Rome Convention on the Choice of Law for Contracts* (2nd ed., London: Sweet & Maxwell, 2001) 223-229.

acceded to the Convention),[23] the UNCITRAL Convention contains numerous exceptions to its rule, most notably in relation to financial contracts.

9.4 There are strong arguments for an alternative rule, namely, that the law governing the contract to be assigned should govern not only its assignability but also whether the assignment is effective against third parties. This would appear to be more consistent with the principle of party autonomy. In other words, there is a strong argument that the parties who between them have created a contractual right should determine what law will govern these issues. The rule proposed in the draft Rome I Regulation would have the law of the assignor's habitual residence override this basic freedom. It appears that this rule could therefore lead to uncertainty and inconsistencies. For example, a debtor could be obliged under the law governing the contract to pay an assignee while under the law of the assignor's habitual residence the debtor would not be so obliged. Whatever solution is preferred, the precise scope of the rule in Article 13(3) must be limited so as not to affect the debtor's obligations under the law applicable to the underlying contract.

9.5 Considerably more study is necessary to determine whether the rule proposed in Article 13(3) to govern the effectiveness against third parties of an assignment of a contractual right should be preferred to the apparently more logical rule, at least in the context of financial market contracts, that the law governing the contract itself should govern this question.

## 10 Article 22(a): Incorporation by reference of the insurance rules

10.1 The FMLC has considered the insurance contract aspects of the Rome I Regulation Proposal in a separate paper.[24] The Rome I Regulation Proposal maintains the dual approach to the conflict of laws that currently exists under EU law in relation to insurance contracts, where risks located in the EU are covered by conflicts rules in the Life and Non-Life Insurance Directives[25] and risks located outside the EU are governed by the conflicts rules in the Rome Convention.

10.2 In summary, the paper concluded that it would be beneficial in terms of transparency for the conflicts rules relating to insurance contracts to be brought into the Rome I Regulation Proposal, therefore making the rules more accessible and contributing to certainty. However, the FMLC understood that the regime under the Life and Non-Life Insurance Directives did not appear to present any significant problems for the insurance markets and therefore there

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23 Liberia has acceded to the UNCITRAL Convention. Luxembourg, Madagascar and the United States have signed but not yet ratified or acceded to the UNCITRAL Convention. In addition, Luxembourg has entered a reservation against the relevant provisions.

24 FMLC Issue 113 – Insurance Contracts, Rome I (February 2006), "Draft Rome I Regulation – Position re Applicable Law of Insurance Contracts" available at .

25 Specifically, the Second Non-Life Directive of June 1988 (88/357/EEC, see Article 7); the Third Non-Life Directive of June 1992 (92/49/EEC) (and related Motor Insurance Directives); as well as the three Life Insurance Directives consolidated and revised by the Life Insurance Directive of November 2002 (2002/83/EC, see Article 32).

was no overriding objection to the substantive approach adopted in the proposal for the regulation.

10.3 The paper also noted that the revised Article 5 included in the Rome I Regulation Proposal no longer led to the danger of hybrid legal regimes. This is the case under the Rome Convention, where the choice of law is not to have the result of depriving the consumer of protection afforded to him by the mandatory rules of the law of the country where he has his habitual residence.[26]

10.4 The main issue considered by the paper was that surrounding the position of EU risks covered by non-EU established insurers, where it is understood that Member States do not adopt a uniform approach. As the ambit of the Life and Non-Life Insurance Directives is uncertain in relation to this point, the scope of the Rome I Regulation Proposal, which cross refers to the Life and Non-Life Insurance Directives (see Article 22 and Annex 1), is also uncertain.

10.5 The paper proposed that the scope of the Life and Non-Life Insurance Directives be clarified. It would be preferable for this clarification to follow a narrow approach, whereby the Life and Non-Life Insurance Directives do not apply to EU risks covered by non-EU insurers. Such an approach would limit the use of special rules for ascertaining the law applicable to insurance contracts.

## 11 Article 24 - Temporal application of the proposed Regulation

11.1 Retrospective measures are, in general, contrary to rule of law and the principle of legal certainty established in the case law of the ECJ. Accordingly, a measure which purports to have retrospective effect must give clear reasons for departing from that principle.

11.2 The recitals to the proposed Regulation do not even suggest that it is intended to have retrospective effect. Under Article 24, however, it is proposed that the Regulation would apply to contractual obligations arising before its entry into force in circumstances where they make the same law applicable to the contract as would have applied under the Rome Convention. On this basis, provisions of the Regulation other than those whose purpose is to identify the applicable law would appear to be given retrospective effect. Notably, those provisions would arguably include Articles 3(5) and 8(3) of the proposal. In view of the FMLC's concerns as to the terms and possible effects of these articles (see paragraphs 3 and 4 above), the prospect of their application to existing contracts is a matter of serious concern.

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[26] It was recognised the revised Article 5 might raise other issues in a wider context – consideration of those issues was outside the scope of the paper.

## PART C – Specific Drafting Comments

### 12 Article 3(1)

12.1 The drafting of the first sentence of Article 3(1) paragraph 2 is problematic in three respects.

12.2 First, the draftsman appears to have departed from the use of words equivalent to "may" in the French and German versions, to adopt the word "must" in the first sentence. It would be more consistent with the other language versions of the proposed Regulation to use permissive language ("The choice may...") but for reasons of clarity the word "either" should then be inserted to make it clear that the possible alternatives are contained within the rule ("The choice may be *either* expressed *or* demonstrated with reasonable certainty ..."). It seems that the role of the presumption in the next sentence is to override the basic alternatives, (since it cannot be said that the presence of a jurisdiction clause will always demonstrate a choice with reasonable certainty). However, this could be made clearer by introducing the provision appropriately with the words "provided that..." (see below paragraph 12.8).

12.3 Second, a comma has been omitted between the words "contract" and "behaviour". As a result, the sentence does not make sense and is inconsistent with the meaning and punctuation of the French and German versions: "des dispositions du contrat, du comportement des parties ou des circonstances de la cause" and "aus den Bestimmungen des Vertrages, dem Verhalten der Parteien oder aus den Umständen des Falles". The omission is clearly an error.

12.4 Third, despite a clear steer from the Commission in paragraph 3.2.4 of the Green Paper, backed up by the majority of replies received by the Commission (see page 3 of its Discussion Paper of 27 January 2004), the draftsman has failed to align the various language versions of "with reasonable certainty". The French version in particular reads quite differently ("de façon certaine"). This is presumably not an oversight, but a recognition of differing views as to what a single, uniform wording should say.[27]

12.5 Regarding the second sentence of Article 3(1) paragraph 2, the FMLC welcomes a presumption in favour of the law of the country in which the chosen court is situated. It is certainly reasonable to assume, all other things being equal, that parties who choose to litigate their contractual disputes in the courts of one country also intend the substantive law of that country to apply to the terms of the contract. This was indeed the position in England, broadly speaking, at common law. However, the wording proposed by the Commission goes further than this. It appears to say, in effect, that where a choice of law clause sits side by side with a choice of court clause in a written contract, the former is entirely worthless unless backed up by further evidence as to the parties' intentions. This is absurd.

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[27] In the circumstances the FMLC supports the UK's default position, as expressed in its response to the Green Paper, that the European Court of Justice should be left to resolve this problem in its own way.

12.6 A further problem with this sentence is that no distinction is made between exclusive and non-exclusive jurisdiction agreements, and there appears to be an assumption that the courts of only one Member State will be cited. In our view this may lead to confusion and/or to the presumption operating in a way which is not reasonable.

12.7 If both these problems are dealt with, the FMLC believes the scope of the presumption may be extended to the law of countries outside the EU.

12.8 The Committee suggests that Article 3(1) subparagraph 2 be amended as follows:

> The choice ~~must~~ may be either expressed or demonstrated with reasonable certainty by the terms of the contract, behaviour of the parties or the circumstances of the case~~.~~; provided that ~~I~~if the parties have not agreed in writing the governing law of the contract, but have agreed in writing to confer jurisdiction exclusively on one or more courts or tribunals of ~~a Member State~~ one (and only one) other state to hear and determine disputes that have arisen or may arise out of the contract, they shall also be presumed to have chosen the law of that ~~Member State~~ state. (*Deleted wording crossed out, new wording underlined.*)

**13 Article 3(2)**

13.1 Although the position was not entirely clear, it was generally accepted that Article 3(1) of the Rome Convention only permitted the choice of a national law. The revised Article 3(2) permits the choice of "the principles and rules of the substantive law of contract recognised internationally or in the Community" as the applicable law.

13.2 While the Committee believes that permitting the parties to a contract to choose non-national principles and rules as the substantive law of a contract gives effect to the principle of party autonomy, the definition proposed is likely to lead to confusion and uncertainty. There is no consensus as to what principles and rules of the substantive law of contract are in fact recognised internationally or in the Community. The adoption of this wording is therefore likely to lead to preliminary disputes as to whether the principles or rules chosen are within this definition.

13.3 Such problems may be avoided by adopting a broader definition of principles and rules. One solution may be to permit the parties to chose "rules of law" without any further qualification. The choice of such "rules of law" is commonly permitted in arbitration laws and rules and does not in practice appear to have created undue difficulties.

13.4 Nonetheless the Committee is conscious that a great majority of financial contracts are governed by a national law and accordingly this issue is likely to be of limited relevance in this field.[28]

13.5 The FMLC has no comments on the second paragraph of the proposed Article 3(2), setting out the default option should the principles or rules chosen be insufficient to provide a resolution to an issue that may arise, which appears to be a sensible provision in the circumstances.

13.6 The FMLC is aware of differing views as to whether parties should be permitted to choose non-national rules. However, if more than lip-service is to be paid to the principle of the freedom of the parties to contract, then such parties should be permitted to choose non-national rules, as indeed already happens in the case of arbitration.

13.7 Nonetheless, the present wording seems almost to invite litigation as to what exactly constitutes "principles or rules ... recognised internationally or in the Community". The Commentary by the Commission expresses the view that while this wording would authorise the choice of the UNIDROIT principles, the Principles of European Contract Law (the latter having no formal status internationally or in the EC) or possible future optional Community instruments but would not encompass the *lex mercatoria* which, it is said, is not precise enough (although precision forms no part of the Article 3(2) test). Certainly there is a substantial body of academic opinion which favours the view that the lex mercatoria is sufficiently developed to constitute a workable law of contract. This seems to illustrate the kind of problem that will ensue if the present wording is adopted.

## 14 Article 5

14.1 Article 5(1) of the draft Rome 1 Convention as it currently stands provides that the law applicable to a consumer contract shall be the law of the place of habitual residence of the consumer. This choice displaces any express choice of law in the contract itself.

14.2 This arrangement clearly creates considerable difficulties for cross-border consumer contracts generally, since it is not always easy to determine the place of habitual residence of a consumer. For itinerant workers within the EU (a class which may include bankers and engineers as well as manual labourers) the establishment of place of habitual residence may be difficult or impossible. This is particularly true where the contract is a contract of loan.

14.3 The development of cross-border lending in some consumer contexts is, however, a policy priority for the EU. In the relatively recent past the Commission, the ECB and other bodies have all committed themselves to the development of a border-free retail financial market as part of the development of the single European economy. This has been particularly prominent in the

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[28] It is unclear whether a reference to Shari'a Law would qualify as a choice of "the substantive law of contract recognised internationally or in the Community", see *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain, EC* [2004] EWCA Civ 19.

case of cross-border mortgage lending, the development of which has been described as necessary in order fully to realise the benefits of the single European currency.

14.4 These consequences of the application of Article 5(1) to a contract - an indeterminate (and possibly indeterminable) governing law – are particularly unattractive where the contract is a mortgage contract. The law relating to interests in land generally differs significantly from country to country. The legal uncertainties resulting from a contract under the laws of one country being used to deal with land in another would generally be expected to be substantial.

14.5 Article 5(3) is probably an attempt to resolve this problem. It provides that that the Article 5(1) law of habitual residence rule does not apply where the contract relates to "a right in rem or a right of user in immovable property…". Thus, where a contract relates to a right in rem in land in (say) Spain, the choice of Spanish law in that contract will be valid under the convention even if the contract is a consumer contract concluded with a consumer resident outside Spain. Thus, to take a simple example, where a UK resident buys a holiday home in Spain, he will be subject to the laws of Spain in respect of that contract.

14.6 Leaving aside issues relating to the overall desirability of Article 5(1), the principal behind Article 5(3) is clearly sound. The problem comes with the somewhat odd choice of wording of the terms "right in rem" and "right of user". It is likely that what the draftsman was seeking to achieve here was to catch any contract which either (a) transferred ownership of or a right of ownership in land, or (b) created any right to use land. Again, this in principle is unobjectionable. However, the problem is that there are a number of important contracts which relate to land which are neither transfers of ownership nor grants of rights of use. The most important class of these is the class of grants of security over land – that is, mortgages. The structure of mortgages varies significantly between EU countries, and many jurisdictions have several ways of creating mortgages. Perhaps more importantly, such mortgages may be construed differently by other legal systems – for example, the question of whether a particular type of English mortgage grants the lender a right in rem in the secured property might be determined differently by a court in whose jurisdiction a similar contract created no such right. Finally, it should be noted that at English law the terms real and personal property are not completely interchangeable with the terms moveable and immoveable property.

14.7 The correct approach here would be to recast the article so that it excluded from Article 5(1) "any interest in or right in relation to immoveable property or any grant of security over such property…"

## 15 Article 13

### a) Introduction

15.1 The Commission's Explanatory Memorandum says that the addition of contractual subrogation reflects the fact that it performs a "similar economic

function" to voluntary assignment and therefore should be included. This does not appear to be controversial. This does, however, lead to some drafting inconsistencies in the Article. There is a reference at the end of paragraph 1 to "the contract between the assignor and the assignee". There is no corresponding reference to the contract between the subrogor and the subrogee. It may have been felt that the terms "assignor" and "assignee" are sufficiently broad to cover contractual subrogation as well as voluntary assignment. In that case, however, the words "or the author of the subrogation" are not necessary in paragraph 3 of Article 13 and should be removed.

**b) Article 13(2)**

15.2 Article 13(2) corresponds to Article 12(2) of the Rome Convention. There are three drafting changes, one of which is substantive. The non-substantive changes are (1) the replacement of the words "the right to which the assignment relates" with the words "the original contract" and (2) the deletion of the words "any question" before the words "whether the debtor's obligations have been discharged". These changes do not appear to be problematic.

15.3 The substantive change is the replacement of the words "its assignability" with the words "the effectiveness of contractual limitations on assignment as between the assignee and the debtor". This appears to narrow significantly the scope of paragraph 2. The effectiveness of a contractual limitation on assignment is only one aspect of the question of whether a claim is of a type that may be assigned (see, for example, the rules of English law concerning maintenance and champerty). As paragraph 3 does not address this question, we believe that the implications of this narrowing need to be studied in considerably more detail before it may be concluded with safety that the revised drafting of paragraph 2 should be preferred to the present position under the Rome Convention.

15.4 It may be that those who drafted the Rome I Regulation were of the view that the aspects of "assignability" not encompassed by the words "the effectiveness of contractual limitations on assignment as between the assignee and the debtor" are covered by the words (which also appear in the Rome Convention) "the conditions under which the assignment can be invoked". The Giuliano-Lagarde Report appears to provide some support for this view. But the Committee believes that this potential uncertainty in the text should be studied and clarified and that any change must be carefully justified.

## 16 Titles of Articles 14 and 16

16.1 The FMLC notes that the title of Article 14 refers to "statutory subrogation". Similarly, the title of Article 16 refers to "statutory offsetting". The FMLC believes that the use of the word "statutory" in both these contexts may be a mistaken translation (cf. the French text). Under English law, both subrogation and offsetting can arise from legal sources other than statute (for example under the common law). Therefore, we suggest that a more appropriate reference in the title of these two articles would be to legal subrogation and legal offsetting.

16.2 In the case of Article 16, this amendment would also need to be made in the body of the article, which also refers to statutory offsetting.

## PART D – Conclusions

### 17 Conclusions

17.1 The FMLC considers that if the Regulation were adopted in its current form it would cause significant uncertainty in the financial markets, in particular as a result of Article 8(3). This compares to the present, largely satisfactory, position under the Rome Convention.

17.2 The difficulties with the proposed Regulation are not confined to Article 8(3), although this provision generates the greatest concern. Articles 3(4) and 3(5) constitute a limitation of the effect of a choice of law by the parties. This limitation of the freedom of the parties may give rise to uncertainty. The provisions in Article 7 regarding agency raise particular difficulties and the rule in 13(3) is not the correct rule to address the issue it raises. Other areas of concern include the rules that apply in the absence of choice and the treatment of consumer contracts.

17.3 There is also doubt as to the validity of the Regulation because of the doubts as to its conformity with the stated Treaty basis, which could create further significant uncertainty. Finally, the FMLC has identified a number of substantive drafting problems with the proposed Directive and it takes issue with its retrospective effect.

17.4 The FMLC believes that there is a very wide range of issues that need to be addressed in relation to the Regulation, some of which require considerable further study.

# FINANCIAL MARKETS LAW COMMITTEE MEMBERS

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