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LEGAL IMPLICATIONS OF THE SINGLE CURRENCY

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GENERAL QUESTIONS

A.1 ONE MARKET, ONE CURRENCY, ONE LAW

1) General introduction. Need for unifying basic aspects of the regulation of contractual relations

The current objective of the European Union is to create a single internal market, a unified economic area extending throughout the entire territory of its member States. The pursuit of this objective justifies the monetary union project, in the understanding that use of a single currency will stimulate an increase in trade and thus facilitate dissolution of national markets, by means of their progressive integration into the projected single European market.

The existence of one market, regardless of the breadth of its contours, presupposes the presence of a set of rules whose enforcement guarantees the market effectively serves its intended purpose: the best or most appropriate allocation of available economic resources. Even in the simplest market model, achievement of this aim demands that economic agents be subject to common rules regarding both the ***conditions for participating in the market*** and the ***subject matter of the economic intercourse*** carried on in that market, so as, on the one hand, to assure all economic operators have access on equal terms and, on the other, to make it possible for the different offers and demands to refer to relatively homogeneous items that market players are able to recognise and evaluate.

In a broad complex market, such as the one the European Union is now attempting to establish, regulatory efforts cannot be confined to facilitating identification of the ***material aspect*** of the subject matter of intercourse (goods and services, one the one hand; monetary prices, on the other), but must necessarily also affect the ***regulatory facet*** of that subject matter, that is, the discipline governing the relations established in the market. The various types of regulation applicable to trade relations determines the differentiation between the items exchanged and serves to condition, more than do the substantive characteristics of the goods and services, the actual valuation of the objects transferred and acquired in the market.

The regulation of trade relations includes *legal rules* (universal norms with an organisational social value) and *contractual clauses or covenants* (provisions of a narrower scope that define the commitments assumed by the parties in each particular case). The former include two main groups of legal prescriptions: the fundamental rules of economic organisation (the principles and directives that compose public economic policy) and those laying down the essential rules of contracts (conditions of consent, requirements of subject matter and consideration, rules on the form of contracts, rules on nullity). In turn, the rules arising from the autonomous private realm mainly involve regulation of the specific terms of each contract, although it must be borne in mind that the said contractual terms are also affected by provisions of legal origin, born from customary business practices and derived from the principle of good faith (art. 1258 of the Spanish Civil Code, along these same lines and to cite but two examples in European legal systems, paragraph 242 of the German Civil Code and art. 1175 of the Italian Civil Code).

Market unity does not demand uniformity of the entire framework of rules that regulate economic intercourse. But it does require, as a prerequisite or indispensable minimum condition, the ***oneness of the rules that configure or structure the market***, rendering the commitments assumed by economic agents recognisable and assuring legal protection of their expectations. These rules include the ones that establish the ideal model of economic intercourse (rules on essential requirements of contracts, rules imposing formal requirements, rules establishing the procedure for making contracts), the ones that sanction deviations from the model (rules on the nullity of contracts), those establishing protective mechanisms in case of non-performance or defective performance (rules on termination of contracts) and, in general, those defining the scope of contractual freedom (for example,

rules that in a certain type of relations, those established between consumers, prohibit as abusive contract clauses that produce a *major imbalance* between the rights and obligations of the parties; see art. 3.1 of Directive 93/13/EEC). Such provisions may be imperative (such as those regarding the capacity or liberty of persons who give their contractual consent, or those referring to the consideration received for financial compensation) or merely non-mandatory (those relating to a seller's warranty). But even in this last case, they represent an objective model of regulation of the contractual relation, an abstract order of justice applied irrespective of the will of the parties and which the same are not absolutely free to ignore (grounds for nullity due to extraordinary and unjustified deviation from a -mandatory legal right).

All of these fundamental rules of private property law contribute to defining, together with the specific covenants reached by the parties, the regulatory aspect of the contract subject matter, of the subject matter of the economic intercourse. Within the scope of the same market (European internal market), the oneness of the said rules therefore constitutes a necessary prerequisite for the recognition and valuation of the objects exchanged in the market. In the absence of unique regulation (that is, where there coexist several national legal system that adopt different solutions in relation to the basic aspects of contractual obligations), and taking into account the costs incurred by market agents to acquire and maintain a thorough knowledge of national laws, competition can only develop inside the limits of each national market, thereby thwarting the possibility of attaining the economic benefits that accompany the establishment of a single market.

A single market cannot exist if that market does not provide the conditions that allow effective competition to take place. One of the basic conditions for competition is the capacity of economic operators to make a correct valuation of the objects of trade. But in order for the different goods, services and prices to be knowable and assessable, it is not enough that there be attained a high degree of homogeneity in relation to the materials aspects of the objects traded in the market (economic goods and money). It is not enough for market agents to be able to weigh the substantive characteristics of the goods and services and the value of the money which must be paid as consideration for the same. One further step is necessary, having regard to the regulatory aspect of the trade subject matter, so that the participants in the market can also predict the legal effects of the relations in which they engage. When a variety of national legal systems persists, this ability to forecast can only be attained by the assuming very high transaction costs (information, negotiation and control), which hinders, renders more expensive and to a large extent makes non-viable the establishment of relations between sellers and buyers from different countries. In the face of the diversity of national laws applicable to contractual relations, persons interested in economic intercourse will prefer to establish those ties within a known legal framework, the one for their own domestic market, without heed to the rest of the conditions (quality, price) of the contract subject matter. The efforts waged by the European Community to ensure homogeneity in the material aspects of that subject matter (identification of goods and services, simplification of payments by means of the single currency) will therefore be ineffective, thwarting the basic goal of establishing a single European market into which the various national markets are dissolved or integrated.

The basic regulatory framework for trade relations (general theory of contract) thus has the effect of configuring or determining the market. In each one of the national markets, the rules constituting that disciplinary framework emanate, by virtue of the principle of market unity, from a single regulatory level. In the same way, a unified regulatory framework must also apply at the European level, recognisable by all parties interested in trade so as to permit the intended supra-national market to be constructed and maintained. The introduction of the euro, inasmuch as it culminates a process pursued by European Community authorities to facilitate recognition of the content of the commerce conducted in the market, makes it all the more obvious that the said process must be completed by means of actions aimed at allowing economic agents to be in a position to predict the legal consequences of their relations.

2) Initiatives toward self-regulation. Recourse to *lex mercatoria*. Requirements of the regulatory system of sources of law in States governed by the rule of law.

The elaboration in different sectoral markets (banking, capital, insurance, etc.) of codes of conduct, uniform practices based on standard contracts, operating practices, unified contractual terms and all other kinds of common rules and conventions is indicative of the need to submit international commercial relations to a unified normative regime that makes possible effective engagement between entrepreneurs from different countries. But the recourse to private mechanisms for self-regulation cannot constitute the only means of satisfying that need. This is so for three main reasons:

1. Because the various manifestations of modern *lex mercatoria* constitute the expression of the specific interests of businessmen and therefore do not cater in a balanced manner to the interests and expectations of the rest of the protagonists in trade relations. If the market is conceived not only as a meeting ground but also as an area for the conciliation of opposing interest, then regulation of the market must obviously embrace, along with the aforementioned forms of self-protection of the interests of professional operators (soft law), legal rules founded in statutes (hard law), that is, mechanisms for hetero-protection of the interests of the consumers of goods and services. Submission to the so-called "law of the market", recourse to privately produced law aimed at achieving maximum entrepreneurial efficiency cannot on its own satisfy all social requirements linked to the existence of the market.
2. Because, as a consequence of the above, modern States governed by the rule of law do not renounce intervention in market relations by means of legal rules regulating the private autonomous sphere which aspire to establish a value system of material justice based on the general interest. The applicability or enforceability of purely private regulatory orders prepared by national or international trade groups is conditional on express delegation of the regulatory powers of the State.
3. Because the autonomous law of business activity (*lex mercatoria*) can only be a fragmentary conventional order

that will always need to be completed and integrated by invoking the rules and principles of State legal systems.

3) Sectoral regulatory unification. Difficulties

The intervention of a single regulatory level in the European market determines the configuration of different single markets in each sector or segment of the economy (single market for bank services, single transport market, single securities market). But Community action in the various sectors of the economy runs further than the regulation of the legal institutions or relations corresponding to each sector; inevitably, it involves common aspects relating to the discipline of trade relations. This effect is explained by the essentially systematic nature of juridical systems. Any legal norm, albeit one aimed at regulating a very specific aspect of a given type of commercial relation, can have implications on other relations, modifying institutions which the lawmaker has not expressly contemplated and eventually altering the general provisions of the legal system of which it forms part.

Analysing European Community initiatives directly aimed at regulating relations or institutions of private law (legal persons, liability for defective products, consumer credit, direct home selling, insurance contracts, travel contracts, circulation of securities, copyright, contract conditions, multi-property, amongst others), it may be observed that the rules and principles that make up each of these particular disciplines possess a notable expansive capacity, spreading to other relations or institutions, such as to bring under their influence the basic elements of the system of private law (conditions for validity of legal transactions, nullity). There is frequently seen a sharp contrast between the content of EC prescriptions regarding a given sector of relations or institutions and the general rules on obligations in force in the various national legal systems. This contrast or discordance can compromise the effectiveness of EC rules and thus constitutes a serious obstacle to achieving the goal of dissolving national markets into a single European market.

Community sectoral unification thus entails important dysfunctions in national legal systems, underscoring the need at the Community level for unified regulation of the basic discipline of obligations. It is precisely due to the absence of such regulation that the case-law of the European Court of Justice has had to elaborate interpretative criteria which, in case of conflict with the internal law, assure the prevalence of the Community rules. Of particular interest in this connection is the doctrine established in the *Marleasing* decision (13 November 1990 judgement of the ECJ in case C-106/1989), which argues the duty of Spanish courts to construe the general rules on nullity contained in the Civil Code in accordance with the text and aim of the provisions contained in Council Directive 68/151/EEC of 9 March 1968 on Company Law, which means the exclusion in company law of a specific grounds for nullity contained in Spanish law (absence of consideration for the transaction due to absolute simulation; art. 1275 of the Civil Code). This ***principle of interpretation in conformity*** with the requirements of Community law (expressly formulated as from the *Von Colson* judgment, ECJ judgement of 10 April 1984, case 14/83, and which also applies where EC rules have not yet been incorporated or transposed into the internal law) represents a general formula for liaison or coordination between the sectoral Community rules that may have some relation to the rules and principles of the law of obligations and the corresponding national legal system. But this formula has a limited scope, as it only applies to cases where the internal law may be subjected to different interpretations. In addition, deciding whether this margin of interpretation exists is discretionary with the national judge, with the Community court lacking power to decide on the possibility or content of such interpretation (the constant case-law of the ECJ: *Kolpinghuls Nijmegen* judgement of 8 October 1987, case 80/86; *Wagner Miret* judgement of 16 December 1993, case 334/92; *Faccini Dori* judgement of 14 July 1994, case C-91/92; *Luigi Spano* judgement of 7 December 1995, case C-472-/93; *El Corte Inglés* judgement of 7 March 1996m case C-192/94; *Lucianoa Arcaro* judgement of 26 September 1996, case C-168/95; the *Marleasing* judgement cited above, which constitutes an exception to ECJ case-law in that it decides on the existence of a margin of interpretation in the internal juridical system, also imposing on the national court a certain interpretative option that entails disapplication of the national rule).

The limitations of the principle of conforming interpretation, insofar as they lead to maintenance of non-uniform internal rules, without even guaranteeing that national judges will adopt the interpretation of national law that best aligns with Community provisions, reveal the difficulties which must necessarily be faced in the systematic insertion of Community sectoral law into each national legal system. Nor can these difficulties be overcome simply by going further along the lines marked by the *Marleasing* judgement or by upholding the indirect enforceability of the directives in relations between private parties, given that, in all events, the scale and complexity of the interactions between Community law (ostensibly sectoral in origin, but with an expansive inclination) and internal legal systems (which take different approaches to the regulation of the basic aspects of economic exchange) will provoke the adoption of disparate interpretative solutions by courts of different countries, perpetuating the climate of legal uncertainty that currently cloaks relations that reach beyond the limits of each national market. The only means of assuring effective uniform application of Community law thus consists in undertaking, together with the partial or sectoral regulation of certain economic relations, the task of unifying the basic rules and principles of private property law which in each national system can condition or mediate the practicability of the rules dictated by European lawmakers.

A.2 HISTORICAL EXAMPLES

1) Market unity and unification of law

Historical experience demonstrates that the unification of the internal economic arena in the various States requires that economic activity be regulated by means of a single body of law applicable throughout the entire State territory. Without unified regulation,

the free movement of persons, goods and capital is not possible and, hence, supply and demand cannot be optimally matched at any given point in the internal economic area.

In federal states, this correlation between market unity and normative unity is not as clear, as it must confront the obstacle represented by the subsistence of the regulatory powers of the states integrated in the federation. Despite the maintenance of those particular state powers, all federal processes have sought to uniformise the basic rules governing the discipline of economic activities. This objective has been achieved by recourse to diverse mechanisms ranging from the establishment of general clause attributing powers to the higher State entity (the "interstate commerce clause" of the United States Constitution) to the specific assignment of regulatory powers in each of the key economic areas (German Fundamental Law, Constitution of the Swiss Confederation of 1874, after its successive reforms).

It bears emphasis that, as also taught by the experience of federal States, economic unification processes place a premium, first of all, on measures aimed at suppressing the material barriers to the free movement of production factors, then take up the task of establishing rules that allow the adoption of unified economic policy, and later on, at the end of the process, take on the establishment of uniform regulation for economic relations applicable throughout the territory.

This explains why in Germany the free movement of goods was achieved at a much earlier date (1833, Treaty constituting the *Zollverein*) than the date on which, with the political unity of the German states having been definitively established (Constitution of 1871), economic and political policy came under the control of the Reich, and that only then did codification begin (1896-1900). In Switzerland, the elimination of physical barriers to the movement of goods (abolition of internal customs) came about in 1848, the assumption by the Confederation of management of economic policy in 1874, and the Code of Obligations was promulgated in 1881. In the United States, the Constitution of the 1787 guarantees the free movement of goods, with the Union thenceforth also assuming powers of economic intervention in all matters of general interest or affecting more than one state, as well as monetary policy-making powers (confirmed after the Supreme Court decisions in the cases *McCulloch vs. Maryland* in 1819 and *Gibbons vs. Odgen* in 1824).

2) The case of Spain. Market unity and unification of the regulation of economic activities in the Spanish Constitution of 1978

The present Spanish Constitution recognises the lawmaking powers of the regional self-governing communities within the scope of their respective Statutes of Devolution. Spain’s configuration as a composite State came about at a time when the unity of the domestic market had been fully consolidated. This circumstance raises the need to preserve that unity, avoiding the splintering which could be provoked by the intervention of the self-governing communities in the regulation of the various aspects of economic activity. If we examine the various mechanisms wielded by the Spanish Constitution itself (and later developed in the case-law of the Constitutional Court) to ensure unity of the national market, while at the same time guaranteeing the regulatory powers for economic affairs that may be assumed by the self-governing communities, we can establish criteria of general value (extrapolatable to other situations in which, in the context of coexistence of legal systems, the objective of market unity is pursued) for determining the minimum content of the lawmaking powers that must necessarily rest with the central regulatory authority (the State), without encroaching on the purview of the remaining regulatory authorities (the self-governing communities).

The case-law of the Spanish Constitutional Court has established a direct correlation between unity of the national market and unity of economic regulation (Constitutional Court judgements 1/1982, 88/1986, 615/1986, 64/1990, 225/1993), holding that the assurance of market unity stems, amongst other constitutional precepts, from those that define the distribution of powers between the State and the self-governing communities. Maintaining market unity is thus the foundation for assignment to the State of exclusive powers to dictate the norms of business law (art. 149.1-5 of the Spanish Constitution) and the rules regarding the basis of contractual obligations (art. 149.1-8 Spanish Constitution), such that "only through its central bodies can the State determine the proper scope of the activity of the business enterprise, and only legislation emanating from those central bodies can regulate the way in which the rights and obligations arising from that activity are born and extinguished and the necessary content of the said rights and obligations" (Constitutional Court judgements 37/1981, 615/1986 and 264/1993). In particular, by means of the empowering title referring to the basis of contractual obligations, the lawmaker attempts to avoid a situation in which the regional rules of the self-governing communities produce a "*novum* in the contractual content", that is, that they "introduce rights and obligations in the framework of private contractual relations" (Constitutional Court judgements 71/1982 and 615/1984, as that would imply an alteration in the territory covered by the regional rule of the conditions applicable to the pursuit of economic activity, thereby provoking fragmentation of the national market. For the same reasons, the Constitutional Court has understood that the "rules for perfection and enforceability of contracts belongs within the purview of the State" (Constitutional Court judgement 284/1993) and that there also rests with the State the regulation of the types of contracts (Constitutional Court judgements 225/1993 and 264/1993).

The safeguarding of market unity therefore justifies assignment to a single regulatory level (the central bodies of the State) of the power to establish the fundamental rules that regulate economic activity throughout the national territory. This unitary normative nucleus, excluded from the jurisdiction of the self-governing communities, includes the rules relating to the "basis of contractual relations", that is, the norms defining the legal instruments of intercourse that are traditionally grouped under the heading "general theory of contract".

A.3 THE POWER OF THE EUROPEAN COMMUNITY TO HARMONISE PRIVATE LAW

The construction (in federal States) or the maintenance (in the singular Spanish experience of a composite State) of a unitary economic area immune to the danger of fragmentation consequent upon the coexistence of a plurality of lawmaking powers requires that the market be configured or delimited by means of a unified regulation of the essential aspects of private property law. In the same manner, the fundamental aim of the European Union and the European Community ("creation of an area without internal frontiers", art. 2 of the Treaty on European Union; "establishing a common market and an economic and monetary union", art. 2 of the Treaty establishing the European Community) cannot be definitively achieved without having a uniform regulation of the fundamental core of the (legal-private) relations of exchange.

Positing this need as a necessary precondition begs the question as to the appropriate procedure for eliminating the diversity of laws now prevailing in the different member States. It appears beyond question that, as is the case in the national markets that allow coexistence of different regulatory levels, the leading roles in the unifying task must be assumed by a central or supranational political authority, that is, by the European Community.

The objection is usually raised, however, that the Treaties do not appear to contemplate unification of private law as one of the objectives pursued by the Community. Along these lines it is argued that according to the express terms of the Treaties, the creation of a unitary market does not require such unification and that, consequently, the Community lacks the requisite legitimacy for stepping forth as the single regulatory authority for the legal-private rules regulating the economic intercourse that takes place in the European market.

This argument must be rejected for two basic reasons. First, because in the technique employed in the Treaties, regulatory harmonisation is never an objective in its own right, but merely a means for achieving the Community purposes. Second, because given the lack of precision of the text of the Treaties, the Community may have direct powers of action without the need for an explicit assignment in such respect. Thus, as regards the regulation of the basic aspects of the private law of contractual relations, the legitimacy of Community actions emanates directly from the knowledge that establishing a common market with a high degree of competitiveness (that is, to achieve the merger of national markets into a single market that functions as a genuine internal market) requires an intense approximation between the currently divergent national laws (art. 3.1-h of the TEC). It must also be taken into account that the Treaty establishing the European Community (TEC) contains a general clause that allows Community powers to be extended to areas not provided for in the Treaty, provided such power are necessary "to attain, in the course of the operation of the common market, one of the objectives of the Community" (art. 308 TEC, ex art. 235). In addition, Community actions aimed at harmonising national laws regarding the basic regulation of contractual obligations do not exceed the limits imposed by the principles of subsidiarity and proportionality (art. 5 TEC), as this is an area, like all regulatory harmonisation considered necessary for the operation of the common market, included in the competence of the Community, for which there has not been provided the alternative route of inter-State collaboration or cooperation (art. 293 TEC, ex art. 220), and in which the action to be taken by the Community authorities does not go beyond what is necessary for attaining one of the objectives established in the founding Treaty.

The Treaty of Amsterdam’s emphasis on the principles of subsidiarity and proportionality do not constitute an obstacle to the harmonisation of the law of obligations. According to the clarifications contained in Protocol no. 30, which the said Treaty annexed to the Treaty establishing the European Community, the principle of subsidiarity only affects "areas for which the Community does not have exclusive competence". It must also be borne in mind that according to the provisions of the Protocol, the Community rule is considered to respect the principle of subsidiarity when "the objectives of the proposed action cannot be sufficiently achieved by Member States' action in the framework of their national constitutional system and can therefore be better achieved by action on the part of the Community", adding that such condition should be understood to be complied with if "the issue under consideration has transnational aspects which cannot be satisfactorily regulated by action by Member States" or if "action at Community level would produce clear benefits by reason of its scale or effects compared with action at the level of the Member States".

As for exclusion of the negotiated harmonisation provided for in art. 293 TEC, the question could be raised as to the whether the unification of basic aspects of contract law is considered included within the possibility of Member States entering into Conventions regarding "the protection of persons and the enjoyment and protection of rights". Despite the existence of an isolated opinion advocating use of this singular mechanisms for harmonisation, the very text of the Treaty implies a rejection of this avenue.

With respect to the appropriate legal technique for achieving legal harmonisation in this area, we should take as starting point the precept laid down in art. 94 TEC (ex art. 100), which allows Directives to be adopted for the approximation of the legal provisions of Member States that directly affect the establishment or functioning of the common market. But we must also bear in mind that art. 95 TEC (ex art. 100, introduced by the European Union Act) broadens the possibilities of Community actions by providing that for purposes of achieving the establishment and function of the internal market "The Council shall, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States", without excluding, therefore, that the appropriate measure consists in approval of Community Regulations. Along these lines, it must also be recalled that (as recognised by the ECJ in its judgment of 12 July 1973 in the *Marleasing* case), the rule laid down in art. 308 TEC (ex art. 235) justifies the adoption of Regulations even where the Treaty has provided that Community action be taken in the form of the approval of Directives.

A.4 LEGAL AREAS REQUIRING HARMONISATION AS A CONSEQUENCE OF THE NEW DIMENSION OF THE MARKET ARISING FROM THE INTRODUCTION OF THE SINGLE CURRENCY

Regulatory intervention by the European Community had as its initial aim the destruction of the technical and legal barriers that hinder or impede the physical movement of goods, persons and capital, as well as to combat anti-competitive arrangements. In a second phase, which began with the approval of the European Union Act (1986), the objective of Community actions was to build or structure a single market. This task goes beyond the legislative technique of negative integration (principle of the equivalence of the technical regulatory systems contained in the different countries) and requires the elaboration of common rules applicable throughout the territory of the Community. Such rules have predominantly referred to the material subject matter of economic intercourse, attempting to render transparent the qualitative differences between the economic goods offered in the market and achieving, in addition, by means of imposing minimum safety and quality levels, uniformity in the production costs of entrepreneurs who compete in the European market. This has significantly increased the scope of the information available to economic operators, information which constitutes an essential element for the functioning of any market. Along these same lines, the introduction of the single currency will facilitate the availability of the information given by the market dynamics in the form of prices, that is, information on the matching of supply and demand.

Assuming knowledge by economic operators of the quality characteristics and price of the various products and services, full effectiveness of the single European market has required intervention by Community authorities aimed at correcting informational lagoons regarding the quality of contracts for the purpose of also rendering recognisable the legal rules that govern their stipulation and determine their validity. In this area, Community rules have focused on *contractual relations between professional operators and the end acquirers of the products and services*, attempting to assure consumers and users the indispensable information for making rational economic decisions. Toward this end, the Community has deployed different legal techniques: the imposition of informational obligations by increasing the formalisation of contracts (neoformalism), the adaptation of voluntary informational activity to the criteria of competition and liability (prohibition of misleading content in advertising messages, protection of the expectations generated by advertising), submission of negotiated rules and conventions to the imperatives of good faith (exclusion of abusive clauses).

Definitive establishment of the single European market, propitiated by the pursuit of Community actions (prominently included amongst them the implementation of the euro), will require application of the aforesaid jural techniques to *contractual relations between entrepreneurs*, given that this sphere displays informational asymmetries that produce severe imbalances in the parties' appreciation of the contractual content (contract quality) and ultimately hinder the functioning of the economic intercourse pursued in those contracts. In addition, an intensification is needed in the lawmaking work of the European Community in all areas in which the divergence between internal legal systems continues generating competitive inequalities (which occurs, for example, in relation to the regulations on the terms of performance of contractual obligations and with respect to the mechanisms for court protection of creditor claims). Harmonisation of Member States' laws must therefore aim, in the immediate future, for definitive elimination of the contractual imbalances arising from information defects in specific legal transactions (both in the end markets, between entrepreneurs and consumers, and in intermediate markets, between entrepreneurs who unilaterally impose the contract conditions on other entrepreneurs with less economic powers, in line with the task already initiated by Directive 86/653/EEC on agency contracts), while also affecting the general legal provisions applicable to contracts of all types (general theory or general part of the contract, actions for court protection) and aimed at structuring the single European market.

LAW OF OBLIGATIONS. LAW OF CONTRACT

B.1 The European Commission, in its Resolution of 6 May 1994 (pursuant to the previous Resolution of 26 May 1989 in which the European Parliament invited the Commission to make efforts aimed at harmonising the civil and commercial law provisions of Member States), has decided to open a new track for the construction of European private law as a complement to the avenue of uniformising the discipline of certain areas or sectors of private law relations through directives or regulations. The new method is to carry out the indispensable preparatory work for the elaboration of a *Common European Code of Private Law*, conceived as an organised compilation of the principles common to the various national legal system. The said principles are to be defined according to the methods of historical analysis and comparison.

Work had already begun in 1982 in this direction by the so-called ***Lando Commission,*** originally a private initiative now supported institutionally and financially by the European Commission and which has published the first and second parts of what it terms "Principles of European Contract Law". According to the terms of the aforesaid 1994 Resolution, the jurists in the Lando Commission may also issue their opinion on the sectors of private law whose unification is to be given priority. Ultimately, their efforts are to be aimed at the objective of total unification or assimilation of European private laws. With a similar orientation, but completely unrelated to Community institutions, another group of scholars has been working, at the initiative of Prof. Giuseppe Gandolfi, in the ***Academy of European private jurists***. The immediate objective pursued by this second group is not a simple organised compilation of common legal principles, but the elaboration of a detailed organic system of legal rules, that is, a genuine European code of contracts modelled on the Italian Civil Code, a normative body synthesising the French and German legal traditions and considered especially close to the orientations of common law. More recently, other study groups have been formed, such as the one coordinated by the Italian jurists Mattei, Bussani and Graziadei, known as the ***Trent Project***, whose objective consists in identifying the "common core of Private Law in Europe". There are also a large number of European jurists working individually on the definition of the principles of private law common to the legal systems of the European Community Member States. These legal thinkers have promoted the foundation of three specialised journals: the German *Zeitschrift für Europäisches Privatrecht* (published since 1993), the Dutch *European Review of Private Law* (which also began to be published in 1993), and the Italian *Europa e Diritto Privato* (created in 1999).

The immediate objective of this classification of common basic rules or principles would be to make available to the agents engaged in economic intercourse in the single European market a uniform regulatory framework that can be adopted by them as the agreed rules for their contractual relations. The *Code* or *Compilation* of rules of European private law would thus pursue a similar logic to that which underlies the various manifestations of *lex mercatoria*, in that, without seeking to impose its precepts as objective rules, it seeks to regulate contracts by constituting a faithful reflection of the particular interests of the contracting parties. Later, as an indirect or more distant objective, it is also hoped that these rules or principles can contribute to a doctrinal redefinition or rediscovery of "European common law" (heir to the old *jus commune*), creating a favourable context for the *Europisation* of jural science and literature, to serve as a model or guide for the national lawmakers of the different Member States in relation to the reform of their respective private law systems to eliminate the legal divergences which distort competition and thus compromise the efficacy of the single European market.

The opening of this new route to legal harmonisation, which has led to the preparation of doctrinal models of regulation of private relations of exchange, represents the acknowledgement by Community authorities of the difficulties that will be encountered in the initial goal of endowing the single market with unified legal regulation of contractual relations. Paradoxically, the elaboration of these private codes or compilations is serving to slow the construction of European private law, because these efforts to some extent push aside the direct harmonisation method consisting in giving statutory law (that is, the Community lawmaker) exclusive control of this process. It no longer appears to be a matter of aspiring to produce rules of positive law applicable throughout the entire European Community, but to formulate a sort of "virtual law" (the expression used by KÖTZ, *Europäisches Vertragsrecht*, Tübingen, 1996, page VI), which does not have a real existence and whose legitimacy is founded only in the intellectual authority of the jurists involved in the private groups that pursue study and comparative research of European legal systems.

An important reasons for this change of direction is the belief that respect for the singularities of the legal systems Member States (which express the essential elements of the respective national legal identity) requires that the construction of European private law can only be the result of a slow, gradual process, with limited objectives, in which the final elimination of the peculiar institutions of the various national law only takes place in the very distant future after a gradual "Europisation" of legal science and practice has modified the cultural substratum reflected by those institutions. In the meantime, construction of the single market is considered compatible with a certain degree of legal diversity, that is, with the conservation of the fundamental aspects of the private law of the Member States.

Partial abandonment of the direct route of legislative unification is also the result of a general awareness of the costs entailed by such unification. The following costs of unification may be identified: 1) the investments needed in order for the Member States to be able to agree on a common law; 2) the risk of error in the choice of the most appropriate legal solution by the Community lawmaker, in the understanding that this risk is quite high in the absence of any guarantee that officials responsible for drafting Community laws will be able to resist the influence of business pressure groups and adopt rules inspired in the general interest; 3) legislative petrifaction as a result of Community lawmakers' hesitance to reinitiate, insofar as required by the changed circumstances of economic intercourse, the complex process of preparing laws agreed by all Member States; 4) arbitrariness in the choice of areas of law which should be submitted to unitary regulation; 5) the effect of accentuating the complexity of the applicable law, given that legislative unification does not on its own assure regulatory simplification, as can be seen in the differences in the integration and interpretation of uniform legislation in the national jurisdictions. In addition to these costs, there is also the conviction that achieving the regulatory framework best suited to the needs of the participants in economic intercourse rests on the possibility of choosing between the offerings of the different "law producers" (regulatory arbitrage, competition between legislative systems), which presupposes the maintenance of the current legal diversity.

The consideration of all these objections should not compromise or slow the purpose of achieving legislative unification of the law of obligations and contract applicable in the single European market. The conservation of the legal systems of the Member States and of the consequent legal divergences impedes the achievements of the economic purposes sought in the single market, and does not appear to be justified by the requirement of due respect for the respective national legal identities. Actually, despite the exaggerations of legal nationalism (now reactivated by the various currents of "post-modern" thought), the physiognomy of the institutions of contract law in each of the Member States' legal systems is not the historical expression of the values that make up a particular cultural substratum (of a purported "spirit of the people" or "national spirit"). Strictly speaking, these institution have never been spontaneous popular creations, but merely solutions of a technical nature elaborated by the jurists of each period, and they can therefore be replaced without impairing the national identity in any way as far as necessary to satisfy the changing aspirations of the parties to economic relations. At present, these aspirations are linked to the effectiveness of the single European market, which requires that those economic relations be submitted to a common legal discipline. In addition, the oft-stated doctrinal denunciation of the costs of the process of European legislative unification implies a radical mistrust of the very capacity of law to tend to the regulation of private law relations. On careful examination, the objections raised to the unifying mission of the Community lawmaker (risk of error in choosing legislative solutions, legislative petrifaction, arbitrariness) could be extended to the mechanisms for production of private law in each national legal system. National lawmakers, too, are subject to the risk of error, resistant to legislative change and incur in arbitrariness. Similarly, for the sake of adding more reasons to buttress the opposition to unification, it could be argued that national lawmakers act are swayed by pressure from the most powerful business groups, relinquish the task that is rightfully theirs to specialists whose democratic legitimacy is not endorsed by the polls, and betray the objective of legal certainty and security by giving rise to a proliferation of confusing and disconnected laws that make the process of determining the applicable regulation needlessly complex. But a denunciation of all of these defects should not lead, either at the level of national law or at the Community level, to a supplanting of the lawmaker as the lead protagonist in the regulation of the relations of economic intercourse, attributing his functions to the decisions of the equitable judgement of the courts or entrusting them to the fruits of a spontaneous social adjustment (reflected in the various manifestations of *lex mercatoria*, or in the legal precipitate resulting from the competitive confrontation between the laws of the different States). By virtue of the demands of the democratic principle (of which only the law is direct expression), pursuant to the

necessary objectivity of law, for the sake of guaranteeing individual liberty, closely tied to the values of legal security and certainty, legal norms must continue to be the primary source for regulation of the relations between persons interested in partaking in the exchange of economic goods, insofar as such regulation has the value of serving to constitute or configure the market in which such relations are pursued (of each national market, for so long as they exist, and also of the desired single European market).

Despite the limited ambition of the initiatives aimed at determining the common legal principles of European private law, their results could constitute the necessary doctrinal foundation so that the Community lawmaker can in the immediate future undertake, with the requisite democratic legitimacy and according to the procedures established in the Treaties, the unavoidable construction of the common discipline that allows conformation and functioning of the European market.

B.2 The definitive dissolution of the current national markets into a European market depends on the corresponding relations of economic exchange being submitted to a single legal regulation. Such regulation must include, as the essential core of its content, the general discipline of contractual obligations, that is, the set of legal norms and principles that determine an objective regulatory model applicable to all classes and kinds of contracts. It can therefore come as no surprise that efforts of groups of jurists determined to elaborate the aforementioned "Codes" or "Compilations" of European private law have been focused on the various aspects of the general theory of contract. This does not mean that European integration does not also require legislative initiatives in the specific domain of contract law. Assuming the existence of the single market, such initiatives become necessary for achieving the aims associated with the establishment of that market or of others which the Treaties assign to the European Union. In particular, a common regulation of some categories or singular types of contracts may be considered necessary for guaranteeing the abolition of obstacles to the free movement of goods, persons, services and capital (art. 3.1-c TEC). It is in this sense that we must understand harmonising actions relating to distribution contracts (goods), works and advertising contracts (services), and financing contracts (banks and capital). The same occurs with respect to the regulation of contractual relations between entrepreneurs (or professionals) and consumers, in which regulatory unification appears justified as a means of achieving "contribution to the strengthening of consumer protection (art. 3.1-t TEC), thereby promoting "economic and social cohesion" between Member States (art. 2 TEC), and also of impeding legal divergences between national legal systems in relation to consumer protection from compromising the free movement of goods (common rules for sales made outside the commercial premises), of persons (travel contracts), of services (insurance contracts), or of capital (consumer credit contracts).

On the basis of the above ideas, no objection can be found to having the aforementioned groups of jurists also work on preparing doctrinal models for regulation of certain types of contracts. The attention of these legal thinkers should be trained, first of all, on the basic types of contracting (sale-purchase; in particular, the rules on rescission for hidden defects), because certain aspects of the regulations governing the same are generally applied, as supplemental law, to the other types of contracts. With respect to other types of contracts, it would be advisable to have a formulation of uniform rules in relation to the regulatory aspects most directly related to the objective of structuring the single market (the recognisable legal quality of the contract as instruments for assuring the contracting parties complete information on the legal implications of their relations, actions for enforcement of contractual commitments), with safeguards for consumer interests (transparency of contract clauses, formation of consent, right of abandonment), or, in general, of those persons who, even though they have status as professional operators, are in a disadvantaged situation as regards their power to negotiate the contract terms (intermediaries).

B.3 As has been repeated throughout this essay, the unification of the basic rules of European contract law is a necessary precondition for the construction and full operability of the single market. The essential mission of those rules is to make the competitive struggle between economic agents a reality by correcting the market flaws, which predominantly consist in informational flaws. Informational asymmetries disarticulate the market, making it generally inefficient as a mechanism for allocating the available resources. But that inefficiency, that opacity in economic relations, also gives rise, along with obvious detriment to the parties affected by the information deficit, to an increase in the profits attained by a portion of the economic agents. This circumstance makes it impossible for the elaboration of the uniform rules applicable to contractual relations in European to come at the initiative of the parties involved in those relations ("bottom-up approach"), that is, from a spontaneous adjustment by market forces, because there is no reason to trust that as a result of such adjustment the parties who previously enjoyed the advantages deriving from the informational imbalances would surrender those profits. The correction of market flaws, conciliation of the contraposed interests of economic agents, the permanent guarantee of freedom of contract and of the transparency of economic transactions require the active involvement of State (or supra-State) authorities in the determination of European contract law ("up-down approach").

B.4 The activity pursued by international institutions responsible for elaborating model laws or recommending harmonisation in private legal relations also embraces the substratum needed to proceed to the unification of European contract law. This claim may seem surprising if one observes that these are international institutions with aspirations of universality and, consequently, that the projection of their initiatives goes beyond the European Union Member States. The substantial uniformity of the technical solutions required by contractual transactions in the markets of all continents justifies, however, that European jurists (and, ultimately, Community lawmakers) can take advantage of the trove of principles and norms that belong to (what could be termed) universal contract law. In reality, in the regulation of obligations and contracts there is no opposition between the legal tradition of European countries and that of other areas or regions of the world. The key differences in legislative solutions are instead seen between the legal systems (European or non-European) belonging to the "common law" tradition and those which may be classified as forming part of the "civil law" system. Overcoming these differences (as a necessary condition for elaborating common European regulation) constitutes the prime objective of the unifying tasks pursued by the aforementioned international institutions.

One noteworthy result of these harmonising efforts is the formulation by the International Institution for Unification of Private Law (UNIDROIT) of the *Principles on international commercial contracts*, published in Rome in 1994. The so-called *UNIDROIT principles* attempt to synthesise the traditional legislative solutions common to the legal systems of different States (general principles of law), conciliating them with the rules that have arisen from international commercial practices *(lex mercatoria)*. Their scope of application is confined to contractual relations connected with more than one legal system (international) and, within this category, to those undertaken between entrepreneurs (commercial), to the exclusion of the relations pursued in the end markets in which consumers and users participate. For now (successive expansions of their content is planned) the *Principles* include the regulation of a restricted array of aspects of contract law (formation, validity, interpretation, performance, remedies for breach). This regulation is strongly characterised by the intensification of the requirements deriving from the principle of good faith, whose effectiveness is not confined (as in the "common law" legal systems) to the performance phase of the contract, but also applies to the precontract phase. The outlook adopted by the provisions contained (in the form of articles) in these *Principles* are not essentially differ from those reflected in the Lando Commission's *Principles of European contract law*. This substantive agreement, taken together with the acknowledged solidity of their systematic structure, and the singular clarity and technical quality of their drafting, place the *UNIDROIT Principles* at the top of the *virtual law* formulations that should be taken into account by European lawmakers in elaborating a contract law effectively applicable to economic intercourse in the single market.

LAW OF CORPORATE STRUCTURE. COMPANY LAW

C.1 DIRECTIVES ON COMPANIES

The process of Community harmonisation of company law, which led to the approval of nine important Directives (to which we must added, in relation to listed companies, the rules contained in the Directives regarding securities markets), has been on hold since the end of the 1980s. The reason for this paralysis is not that the proposed objectives of the European Community have been fulfilled or that the needs which spawned the process have disappeared. Actually, there remain matters on which it has not been possible to attain the necessary regulatory consensus (groups of companies, governing bodies of limited partnerships, worker involvement, public tender offers) and the goal of equipping European companies with a common legal framework that allows them to be more efficient and competitive is still considered indispensable. The reasons for the halt (or, at the least, slowdown) in the company law harmonisation process are related to a change of course in the legislative policy of the European Community, now inspired in the ideas of deregulation and legal simplification and respect for the particularities of the different national systems. The development of this new policy implies, on the one hand, a minimisation of the initiatives of Community lawmakers, which are now conditioned by the need to overcome the general limits imposed by the subsidiarity and proportionality principles, and, on the other, by belief that harmonisation can be achieved through an alternative to the action of Community institutions, as the natural result of competition between the company laws of the Member States (the negative harmonisation path).

Competition between legislative systems, assuming free choice of the applicable law, can indeed give rise to spontaneous evolution of national legal systems toward the production of laws that are more effective and better suited to the needs of the citizens. Such evolution is unevenly paced: some national lawmakers will run ahead of their "competitors" to immediately offer the rules demanded by economic operators; others, however, will lag behind, and maintain rules that doe not meet the expectations of those operators. At the end of this competitive process there would take place full unification of company law, as the national lawmakers would be obliged to modify their own systems to offer a single regulatory model, the one that has successfully won the operators' preference. But the line of argument employed by advocates of negative harmonisation displays serious insufficiencies. First, it appears to forget that company law always consists of an effort to conciliate contraposed interests. Therefore, an examination of the "effectiveness" of its provisions cannot lead to unequivocal results: the rule imposing duties of transparency, to correct a situation of informational imbalance, also lead to an increase in a company's costs; a rule that lightens such duties and expands the operating capacity of a company implies impairment to the protection of the company's creditors to whom such costs will be imputed. Even if we agree to minimise the scope of this first objection (admitting that competition between regulatory systems is not incompatible with specific interventions by the Community lawmaker intended to impede the "externalisation" of company costs), the negative harmonisation thesis has another important weakness: the competitive struggles between the legislation of different States can never ultimately lead to stable or definitive unification. The reason for this conclusion is found in the radical dynamism of the process by which company law is adapted to the needs of economic activity. This is a permanent process which must by its essence remain unfinished. Thus (even though true that each national legislature has sufficient incentives for assuming by means of proper legislation the regulatory model offered by the most advanced or effective lawmakers, and even though it is considered possible for such assumption or integration of the best regulatory solutions to take place in a not overly long time period), at no time will there occur the awaited alignment of the prevailing rules of the legal systems of the different State systems (unification), because long before all lawmakers have reached such a consensus and adopted the same legal solution, one or more of them will have restarted the process, formulating modifications that are even more effective or completing the previous regulation with new provisions that address previously unknown needs.

In particular, the negative harmonisation alternative does not allow a response to those situations in which satisfying the need of economic relations requires, immediately, a stable common legal framework whose territorial scope coincides with the dimensions of the European market, surpassing the territorial limitations of national laws. In such cases, it is no longer a matter of achieving approximation of the regulatory solutions contained in the laws of the different States, but of establishing a genuinely European system of law that offers legal cover for transnational or pan-European economic relations. This is what occurs in relation to the adaptation by companies incorporated in the various European Union Member States of their size and scope of activity to the competitiveness and efficiency needs arising from the creation of a European economic area without internal frontiers. In order to facilitate this adaptation the Community lawmaker must establish the legal framework for organisation and

functioning of the corporate structures (companies) that aspire to pursue their activities in this new economic area (single market). European regulation will make it possible to simplify the relevant processes of corporate cooperation, concentration and specialisation by providing for regulation of transactions that go beyond the jurisdiction of the State laws. Mergers between companies from different States, the formation of pan-European corporate groups, the creation of common subsidiaries, cross-border relocation of corporate headquarters, the transformation of national companies into companies with European projection, are all necessary operations for companies to adapt to the new dimension of the markets that require legislative intervention by Community authorities.

C.2 THE EUROPEAN COMPANY

The above ideas constitute the foundation for the work aimed at elaborating the "statute of a company under European law". After the initial proposals of the Commission made in 1970 and 1975, this work was abandoned until 1988, when, according to the conclusions of the European Council held in Brussels in June of the previous year, there was published a *Memorandum of the Commission to the Parliament, to the Council and to social agents regarding "Internal market and industrial cooperation. Statute of the European public limited company"*. The preamble to the document states that "the achievement of the internal market imposes specific structures for enterprises", that "these structures must be based on law independent of the various national laws in order to avoid a closing of internal markets inside the Community", and that "the appropriate instrument to achieve this, based on European law, is the European public limited company". According to this orientation, in 1989 the Commission issued a *Proposal for a Council Regulation* establishing the European Company Statute and a *Proposal for a Council Directive* complementing the European Company Statute in relation to the position of the employees, and later on, in 1991, *Modified Proposals* of both texts, without thus far having achieved their final approval.

The failure of initiatives to regulate the European company has been mainly due to differences between Member States regarding some aspects of the proposed regulation, specifically in relation to the company bodies, workers' participation and corporate groups. For this reason, the most recent versions of the proposed texts elude the controversial questions and focus on regulation of cross-border transactions involving the corporate cooperation and concentration which the new dimension of the European market requires be facilitated. Despite this correction, the approval of the European Company Statute still needs to overcome two important obstacles: the risk of corporate "de-localisation" associated with the possibility of the standard "European company" being adopted by companies without a genuine "European dimension" with the sole aim of skirting the mandatory provisions of a given national company law; the absolute preference of the European Company Statue for the legal regime governing public limited companies at a time when experience shows that the corporate restructuring processes brought about by the adaptation to the single market are also resorting to the formation of closed corporations, with a limited number of members (all with an interest in the company management) and using finance instruments other than public appeals to investors.

This last difficulty, which resembles the regulatory issues raised by limited partnerships, is the reason for the proposal to draw up as a complement or alternative to the two legislative texts mentioned above a Statute for a "European closed corporation". According to the preliminary studies (the "Propositions pour une sociéte fermée européenne" made by the "Centre de recherche sur le Droit des Affaires" and published by the European Commission in December 1997, and the "Projet de règelment relatif au statut de la société privée européenne: une société fermée", a joint project of the Chamber of Commerce and Industry of Paris and of the National Council of French Employers published in September 1998), the purpose would be to equip European enterprises with a legal instrument suited to the specific organisational needs of small and medium enterprises, insofar as they participate in the aforesaid processes of cooperation and concentration to adapt to the dimensions of the single market. The new legal standard would be a closed stock corporation for which the incorporation procedures would be liberalised, recourse to financial markets would be prohibited and a minimum of imperative provisions for protection of members and third parties would be maintained, with the regulation of a large part of the organisational and corporate control matters being left to the articles of association of the corporation.

The efforts to devise rules for the "European closed corporation" are presented as a complement to those undertaken by the European Community nearly thirty years ago to construct a regulatory framework for the "European company", in the understanding that this legal regime only envisaged public or listed companies. There are also those who believe that approval of the European Company Statute is no longer feasible, not just because the breadth of the questions regulated therein leads to friction with the main principles of the public limited company rules prevailing in the various national company laws, but also because it focused on a type of company, the public limited company, that is no longer used to articulate the corporate restructuring processes prompted by the single market. European regulation of closed corporations would thus constitute an adequate alternative for responding to the needs of the new economic reality, facilitating the execution of cross-border corporate deals and allowing the stalemate in the preparatory work for the European Company Statute to be overcome.

Whichever options is chosen (simultaneous regulation of the European Company Statute and of the European Closed Corporation Statute, or replacement of the former by the latter), and even if policymakers eventually abandon the goal of elaborating a specific model of a company with Community-wide dimension independent of the national systems of laws of the Member States, undoubtedly Community lawmakers must offer as soon as possible the legal instruments needed for adapting European corporate structures to the demands of the single market, for otherwise the intended dissolution of the different national markets cannot become a reality. In this sense, Community authorities bear the burden of culminating as quickly as possible the work for definitive approval of the Proposal for a Tenth Directive on cross-border mergers, of the Proposal for a Thirteenth Directive on public tender offers, and the Proposal for a Fourteenth Directive on cross-border relocations of company headquarters.

C.3 INSOLVENCY

The increase in commercial and financial relations between entrepreneurs from different European countries brought about by full development of the European market intensifies the risk of bankruptcies with transnational effects. In such situations, creditors must suffer the consequences of the simultaneous or successive application of very diverse legal systems that affect the very determination of the existence or the amount of their rights. In order to avoid the problems caused by the involvement in insolvency proceedings of enterprises from different countries, it is necessary, first of all, for the principle of territoriality prevailing in the insolvency laws of Member States to be overcome and replaced by the principles of unity and universality of the bankruptcy. Second, there is needed a progressive uniformisation of the regulatory solutions for situations of insolvency. Without such unification it is not possible to assure competition on equal terms between the economic agents operating in the single market.

The achievements of the European Union in the legal regulation of insolvency situations are rather few. In terms of legislation in force, there is only Directive 80/987/EEC of 20 October 1980 relating to the protection of employees in the event of insolvency of their employer. Pursuant to the inter-State negotiation procedure referred to by art. 293 TEC, there followed other efforts (Draft EEC Convention on bankruptcies, windings-up, arrangements, compositions and similar proceedings of 1982, Draft Convention on insolvency proceedings of 1991), which led to the Brussels Convention of 23 November 1995.

LAW OF FINANCIAL MARKETS

Introduction

In Spanish law, the Act on Regulation and Control of Credit Institutions *(Ley de Disciplina e Intervención de las Entidades de Crédito)* and the Stock Market Act *(Ley del Mercado de Valores)*, both promulgated in July 1988, and the regulations implementing the two Acts compose a modern, coherent system of regulation of banks and securities markets, if by coherent and modern we understand a system that fixes the principles guiding its application (transparency and protection of savers), offers a structure (distinguishing between prudential rules and rules of conduct), determines the subject matter (financial instruments), endows the system with administrative authorities (the Bank of Spain and the National Stock Market Commission), organises the various financial markets (primary and secondary markets) and formulates the professional statute of intermediaries (in protection of solvency, following the bank model).

In the coherence achieved by the banking and securities law, two aspects bear emphasis: on the one hand, the integration of regulation in a broader field, the law of financial markets, two essential parts of which are banking law and securities laws, and, on the other, the integration of this regulation in a more extensive geographical area, the European Union.

This double integration endows the system with internal and external coherence. From the internal standpoint, integration with the credit market strengthens competition between credit institutions and securities institutions, clarifies administrative oversight, enshrining the principles of collaboration between the Bank of Spain and the National Stock Market Commission (or CNMV from the Spanish *Comisión Nacional del Mercado de Valores*), serves to simplify market organisation, and intensifies the degree of protection of users of financial services.

Externally, integration in the financial market of the European Union opens the Spanish system to the outside by allowing Spanish financial institutions to provide lending and investment services in the Community on equal footing with the national institutions of the host States. At the same time, it creates a "market of financial markets" in which stock exchanges and other national markets must compete to provide their trading and settlement services with the rest of the markets existing in the European Community.

These objectives have been consolidated with the adaptation of Spanish law to Community Directives, which took place by means of Act 3/1994 of 14 April 1994, which adapted Spanish legislation on credit institutions to the Second Directive on banking coordination, and Act 37/1998 of 16 November 1998, which reformed the Stock Market Act.

These important adaptations have not involved a "reordering" of the regulatory framework. There has been no overhauling of financial regulation on the scale seen in France or Italy. Those countries, with the pretext of adapting their law to Community Directives, have opted to modernise their regulation of financial markets and entirely redefine the system (by means of the *Loi de modernisation des activités financières* of 2 July 1996 and *Testo Unico delle disposizioni in materia di intermediaziones finanziaria* of 24 February 1998, respectively). In Spain, the 1998 legislation laid the foundation for modern financial regulations. It is not considered necessary to alter these regulations in order to achieve the objective of our market’s integration into the European market.

The integration of internal bank and securities laws into Community law on financial markets mainly affects aspects of public economic policy, but it also affects private property law as we will see in the following sections. The harmonised notion of financial instruments, the rules protecting savers laid down in Community Directives and the protection of the proper functioning of financial markets by means of systems of harmonised provisions are property questions that affect contractual relations.

D.1 LEGAL CONCEPT OF "SECURITIES"

The creation and regulation of a single financial market in the European Union requires definition of the subject matter of the new market, that is, the subject matter of the provision of financial services. Of essential importance to this area, too, are actions by the Community lawmaker aimed at overcoming the diversity of concepts underlying financial market regulation in the different Member States.

No doubt, the delimitation of the financial field forms the basis for construction of the single financial market. The concept of "security" can form the foundation for building a legal system regulating the provision of financial services. The aim is thus to establish a transparent and secure market that efficiently discharges the function of allocating savings to financing needs, and for that allocation to be achieved by making it easier for European enterprises to raise funds from the public by issuing securities and other financial instruments.

Transferable securities are the main instrument for raising funds from the public. It is essential that they be defined in order to establish the scope of the new financial law of the European Union.

The need to have a fixed concept of "security", understood as an instrument for raising funds from the public, has been detected by European institutions, as reflected in Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (ISD).

In its preamble the Directive states that *"transferable securities means those classes of securities which are normally dealt in on the capital market"* and article 1.4 enumerates as "transferable securities" shares, bonds and other securities normally dealt in, except for payment instruments.

However, the central concept of this regulation is not the transferable security, as this type of security is one of the categories of instruments in relation to which investment services are provided and that are enumerated in section B of the annex, which includes, apart from transferable securities, units in collective investment undertakings, money market instruments and certain derivatives.

The European Council has recognised the difficulty of defining the instruments which form the subject matter of financial services. It strives for a flexible notion that is adaptable to the never-ending evolution of financial instruments. That is why article 2 of the ISD stipulates that the Commission will at regular intervals prepare a report on the scope of application of the Directive and, where appropriate, propose amendments to the definition of the exclusions and the services covered. All the same, it does not expressly provide for adaptation of the concept of financial instrument laid down in section B of the annex.

Spanish law does not contain a legal definition of "security", understood as a security negotiable in financial markets. Act 24/1988 of 28 July 1988 on the Stock Market, after its reform of 16 November 1998, includes a definition of the instruments covered by investment services.

The technique used is not entirely correct, as the new law contains two different references to financial instruments. One is contained in art. 2 in the definition of the scope of the Act, which includes not just transferable securities but also certain forward financial contracts, such as derivatives, and the other appears in art. 63, which establishes the subject matter of financial services, which may be provided in connection to transferable securities, forward financial contracts and, in addition, money market instruments.

The references to derivative financial instruments are completed with the stipulations contained in the tenth additional provision, part two, of Act 37/1998 of 16 November 1998, which reformed Act 24/1988 on the stock market. According to the said additional provision: *"For the purposes of this provision, the following shall be considered derivative instruments: financial swaps, forward rate agreements, options and futures, foreign exchange transactions and any combination of the above, as well as similar transactions or transactions of an analogous nature"*.

From these legal references to financial instruments we may extract an initial conclusion: Spanish law uses a broad concept of financial instrument in which a distinction is made between transferable securities, forward contracts or derivatives and money market instruments not included in transferable securities.

The notion of financial instrument in Spanish law is broader than the one set out in European Community law. Derivatives include forward contracts over a non-financial underlying asset that can be traded in second markets. These commodities derivatives are not included in the ISD’s definition of financial instruments.

The inclusion of commodities derivatives has other consequences. In Spain there is an official market for derivatives over citrus products. This market is considered official but not a regulated market for purposes of the European Union (see Order of 14 July 1995 authorising "FC&M" Sociedad Rectora del Mercado de Futuros y Opciones sobre Cítricos, Sociedad Anónima, as an official secondary market). According to the ISD, commodities derivatives markets do not enjoy mutual recognition as regulated markets. These markets are included within the scope of Spanish law and operate under the supervision of the administrative authority, the National Stock Market Commission (CNMV). But the companies that manage the market do not enjoy the benefits of a European passport. In order to provide services in other Member States they must apply for a new authorisation.

Following the model of flexibility that inspired the ISD, Spanish law recognises the need to avoid a rigid definition of the scope of the rule that defines financial instruments. The government is authorised to adapt the concept of financial instrument to the new realities seen on the market. According to paragraph five of article 63: *"The Government may amend the content of the list of investment services, complementary activities and instruments included in this article to adapt it to the amendments made in the European Union rules. The Government may also regulate the manner in which the services and complementary activities cited in this article are provided"*.

In summary, Spanish law, in its transposition of Community provisions, has incorporated a broad concept of financial instrument that includes the traditional negotiable securities. The technique used by the Spanish legislature was to enumerate the instruments in relation to which financial services can be provided. The enumeration includes traditional notions characterised by their legal status as a transferable securities that update the traditional definition of negotiable security. They are credit rights incorporated in a certificate or book entry. They are included along with other new ones, such as derivatives, which are described in the law as forward financial contracts.

This is not the most appropriate approach to creating a single financial law. It does not strive for a functional definition of financial instruments, which would be of greater utility and permanence. The definition should have addressed the function served by the financial instruments: whether they are intended to raise funds from the investing public or as a mechanism for hedging risks.

In Spanish law, there is only one article in the Act that refers to the function of transferable securities. It is article 26bis of the Stock Market Act (LMV from the Spanish *Ley del Mercado de Valores*), which reserves the right to raise funds from the public to persons who submit to the financial law, be it the law governing banks, securities or collective investment undertakings. Article 26bis of the LMV provides: *"Without prejudice to the activities reserved for credit institutions according to the provisions of art. 28 of Act 26/1988 of 29 July 1988 on the Regulation and Control of Credit Institutions, no person or entity may solicit or raise funds from the investor public in Spanish territory without submitting to this law or to the statutory and regulatory provisions on collective investment or any other special legislation authorising them to pursue the aforesaid activity"*.

It would be desirable to delve further into the functional aspects of the definition of the financial market having regard to the achievements along these lines in Anglo-Saxon legal systems. The functional concept of financial instruments has the advantage, vis-à-vis the descriptive definition, of being more stable. Financial instruments and mechanism are in constant evolution. Fixing the prevailing ones in time creates a rigid framework unsuited to the purposes pursued by financial regulation. The systems protecting users of financial services, transparency of the financial market, and the stability of intermediaries and of the system as a whole are more effective, the greater the flexibility of the defining framework. And this objective is best fulfilled by the functional notion of financial instruments.

The aim of attaining functional notions relating to financial markets should be the principle that inspires the Community rules. Thus, the ISD should include a functional definition of financial instruments, leaving the enumeration of the instruments included at any given time within that definition to the Member States. This is the solution pointed to by article two of the Amended Proposal for a Directive on distance marketing of financial services (COM (1999) 385 final, Brussels, 23/7/1999). Compared with the first draft of the said article, which enumerated financial services by reference to previous directives, the amended version simply indicates that financial service is understood to mean "any banking, insurance, investment and payment service". The definition is incomplete, as it needs to specify what is meant by "banking", "insurance", "investment" and "payment". Defining these concepts will require a harmonising effort with a functional approach.

D.2 REQUIREMENTS FOR ISSUING SECURITIES

Harmonisation of the criteria for listing securities for trading on regulated markets in the European Union has reached an acceptable level of development. In general, these efforts take as starting point mutual recognition between the authorities of Member States of their decisions regarding supervision of prospectuses. The degree of harmonisation reached allows large European issuers to obtain, without undue difficulty or cost, listed status for their securities in different markets of the European Union. The agreements for integration of regulated markets are based on such multi-exchange listing, and no difficulties have arisen to date in this connection. Harmonisation of trading and settlement rules is a different matter, as their technical and legal disparity is hindering the integration of stock exchanges and other European markets.

Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public establishes the harmonised framework to which the laws of the Member States must be adapted. The principle of mutual recognition prevails. Art. 21.1 of the Directive stipulates: *"If approved in accordance with Article 20, a prospectus must, subject to translation if required, be recognised as complying or be deemed to comply with the laws of the other Member States in which the same transferable securities are offered to the public simultaneously or within a short interval of one another, without being subject to any form of approval there and without those States being able to require that additional information be included in the prospectus"*.

However, there are special rules for offerings of securities for which stock market listing will be sought. According to art. 8.1 of the Directive: *"Where a public offer is made in one Member State and admission is sought to official listing on a stock exchange situated in another Member State, the person making the public offer shall have the possibility in the Member State in which the public offer is to be made of drawing up a prospectus the contents and procedures for scrutiny and distribution of which shall,*

subject to adaptations appropriate to the circumstances of a public offer, be determined in accordance with Directive 80/390/EEC".

For securities listed on a stock exchange, art. 24.1 of Directive 390/1980 provides that: *"Where applications for admission of the same securities to official listing on stock exchanges situated or operating within several Member States are made simultaneously, or within short intervals of one another, the competent authorities shall exchange information and use their best endeavours to achieve maximum coordination of their requirements concerning listing particulars, to avoid a multiplicity of formalities and to agree to a single text requiring at the most translation, where appropriate, and the issue of supplements as necessary to meet the individual requirements of each Member State concerned".*

The above Directives have been incorporated into Spanish law in the LMV and its implementing regulations. According to art. 26.1 of Royal Decree 291/1992, in the event of simultaneous offerings in Europe and abroad, the issuer may register the prospectus in Spain with the international format *"provided its overall content complies with the information requirements of Spanish law"*. On the basis of this principle, the Royal Decree distinguishes between Community offerings and non-Community offerings. For Community offerings, it applies the principle of recognising prospectuses of issuers that have been submitted to previous scrutiny by the competent authorities of any other Member State. Such prospectuses may be registered in Spain, provided there is added for the sake of better protection of Spanish investors *"the additional information indicated by the Ministry of Economy and Finance in relation to the tax and legal rules governing the securities, the entity or entities responsible for their distribution, and the financial service of the same, and the means of publication of information intended for Spanish investors"* (art. 26.1 of Royal Decree 291/1992, as worded subsequent to Royal Decree 259/1998).

The documents evidencing the issue and the audit report may comply with the legal provisions of the issuer's home State.

In the case of an issue with a prospectus registered by a non-Community authority, the competent Spanish authority (CNMV) may require that the audit report specify the differences between the principles used and the ones generally accepted in Spain and indicate what modification or effects such differences would imply for the financial statements in question.

It may be inferred from the above that scrutiny of prospectuses for offerings of transferable securities is a harmonised area that represents no obstacle to European stock market integration. Nevertheless, mutual recognition of the scrutiny of prospectuses is not complete. National laws may continue to demand supplementary information in the consideration that protection of investors rests to some degree with the national authorities.

Community integration could intensified by recognition of full efficacy of the prospectus' scrutiny by the competent authority of the home State of the issuer, with a modification to such effect of the Directives applicable to these questions. Power for scrutiny and registration of the prospectus could be transferred in the near future to a European supervisory authority, at least for cross-border offerings that attain certain economic thresholds. A single registry, whose operations could be decentralised, would be a useful mechanism for promoting transparency in the market for purposes of achieving better protection of investors.

D.3 LEGAL REGIME FOR SECURITIES AND FOR THE PROVISION OF FINANCIAL SERVICES

The law of the financial market is grounded in the efficiency of the credit market and securities market as mechanisms for allocating savings to investment needs. The purpose is thus to protect the proper functioning of these two parts of the financial system's regulatory framework. The model followed in Spain, and in the European Union in general, is based on the provision of financial services being reserved by law to professional intermediaries in order that these activities be submitted to administrative scrutiny. This scrutiny is organised by two types of regulations, prudential rules addressed to the intermediaries and intended to defend their financial solvency, and rules of conduct, designed to protect the users of financial services.

1) Prudential standards

The need for assuring stability in financial institutions in defence of normal functioning of the financial market manifests itself in the existence of prudential regulations of greater intensity for credit institutions. These entities play a unique and crucial role in the economy, in that they provide the means of payment. However, the existence of mixed financial groups that combine the provision of investment services with lending activities has also led to the need for securities dealers and brokers to submit to the prudential regulations.

The concept of corporate stability is common to all enterprises but takes on a special dimension in companies that provide financial services. Uncertainty and the risk of instability are higher in enterprises of this kind. It is therefore no surprise that crises can break out. Along these lines, it clear that trust is not just the foundation of the enterprise but also of its very business. A crisis of confidence in a financial company can lead to the lack of confidence spreading to other undertakings and even become a threat for the financial system as a whole. This possibility of *contagion* of the instability strengthens the need for legal regulation of financial activities in the form of rules designed to protect the solvency of intermediaries.

2) Standards of conduct

Financial institutions that provide investment services must comply with the rules of conduct laid down in the Stock Market Act and the general codes of conduct approved by the government to implement the said Act. The new article 79 enumerates the general rules of conduct that apply the provisions of the Code of Commerce to the activities of commission agents.

In Spanish financial law, the standards of conduct of intermediaries are considered provisions of public law whose violation will give rise to the levying of the relevant administrative sanction. Nevertheless, they have private law effects as well. On the one hand, they serve to integrate the diligence required of a commission agent, completing legal concepts left undefined in the Code of Commerce. For example, they serve to complete the stipulation contained in article 255 of the Code of Commerce that the commission agent "will obey the dictates of prudence" in cases where it is not possible to consult the agent's principal. Also, the rules of conduct are useful for determining when a contract clause is abusive, and in such cases they help support the application of consumer rights.

The rules of conduct applicable to the provision of investment services must be harmonised in order to promote integration of the single financial market. The provision of cross-border financial services cannot be made conditional on compliance with each and every one of the rules of conduct in force in the different national systems. It is not enough to demand in defence of the consumer publication of these rules when their source consists of self-regulating organisations; progress must be made toward their harmonisation, with greater emphasis on the aspects of contract law.

D.4 CROSS-BORDER TRADING OF SECURITIES AND RULES FOR ITS SCRUTINY

Cross-border trading of transferable securities encounters the obstacle of application of the rules of conduct for the location where the services are provided. There are as many codes of conduct as there are Member States. Their application is governed by the territorial principle. The general interest of consumer protection is considered to justify the application of the rules of conduct of the internal law.

The necessary coordination of banking and stock market supervision in the integrated market is achieved by means of the coordinated action of national authorities, acting according to the principles of mutual recognition of their respective prudential scrutiny measures, monitoring of compliance with the prudential rules by the home Member State of the entity providing the investment service (referred to as home country control), and control of the rules of conduct that govern relations between the client and the financial institution by the host State (host country control). Hence the importance of structural separation between prudential standards and standards of conduct when regulating this field in the internal law.

Responsibilities are divided up according to the purpose of the supervision: the protection of solvency rests with the home country authority and protection of market transparency with the host country authority.

It should be pointed out that this model of supervision applied by Community law is not exactly the same as the one that governs Spanish internal law. In Spain, the model for distributing supervisory powers is of a functional nature, by activities, with oversight of banking activities resting with the Bank of Spain and supervision of the provision of investment services with the CNMV, the body responsible, for example, for examining the solvency of securities dealers and brokers. The recent reform of 16 November 1998 was not used as an occasion to change this distribution of powers. Spain has not adopted the Italian model, in which the Bank of Italy now supervises the solvency of all financial institutions and the CONSOB concentrates on scrutiny of market transparency. This option facilitates cross-border scrutiny of the activity of financial institutions. In Spain such scrutiny is more complex because it requires coordination between the Bank of Spain and the CNMV. A Community credit institution operating in the Spanish securities market submits to scrutiny by three authorities: by the home country authority in relation to its solvency, by the Bank of Spain, as a credit institution, in relation to scrutiny of the rules of conduct, and by the CNMV, as regards its trading in the securities market.

There is another point which must be taken into account. The globalisation of this field and the intense technological innovation achieved have created the need for coordinated regulation and supervision of financial services. The emergence of financial conglomerates that bring together companies which provide banking, investment and insurance services requires, in order to maintain proper functioning of the market, guarantee solvency of intermediaries and protect investors, a new international order that establishes the principles which should govern the financial world. This function is being pursed on a sectoral basis by the *Basel Committee* (banking), the *International Organisation of Securities Commissions* (stock market) and the *International Association of Insurance Supervisors*, although since 1996 they have been pursuing coordinated action through the *Joint Forum on Financial Conglomerates.*

Given its central importance to the financial system, the banking sector is the one which has seen the greatest advance in international financial regulatory coordination. Since 1930 the Bank for International Settlements (BIS) has provided a forum for contacts between central banks of the most developed countries. In 1974 the Committee on Banking Supervision, also known as the *Basel Committee*, was created in the BIS (incidentally, with no Spanish presence). It should be pointed out that its work is carried on in close collaboration with the Contact Group of Banking Supervision Authorities of the European Union and inspires many of the reforms of Community bank law.

The *International Organisation of Securities Commissions* (IOSCO), whose first annual conference was held in Caracas in 1974, is an organisation that brings together practically all securities commission. It seeks to intensify cooperation amongst its members for the promotion of adequate levels of financial regulation, exchange information and establish the principles for achieving

effective supervision of international transfers of securities.

The *International Association of Insurance Supervisors* (IAIS) is a new organisation, born in 1994, in recognition that globalisation of the financial market has reached the insurance business and that a forum is needed for contact between authorities responsible for the sector in order to achieve better protection of insureds and promote stronger and more efficient insurance markets.

All of these organisation seek to enhance the coordination of supervision by national authorities of international financial activity. Their work is aimed at creating a uniform law by establishing basic principles to guide the reform of the various national systems. The agreements of the Basle Committee, IOSCO and IAIS are merely technical guidelines issued in order that they be applied by the various member countries according to their own internal law. They are not sources of law and the signatories to the agreements do not act as State representatives; nor are there plans for their ratification. It seems unnecessary to recall that central banks, securities commissions and insurance supervisors do not have authority to enter into genuine international agreements.

Cooperative initiatives between national authorities has led these bodies to publish the principles they believe should govern proper regulation and supervision of international financial activity. The vagueness of their provisions does not diminish their importance, because they are the origin of the incipient international codification of financial transactions. In April 1997 the Basel Committee published the "Core Principles for Effective Banking Supervision" in order to strengthen both national and international financial systems. The principles are developed in a "Compendium" which serves as a consolidated text setting out and systematising the agreements reached within the Basel Committee since it was founded.

The IOSCO, in turn, approved in September 1998 its "Securities regulation objectives and principles". These are 30 principles based on investor protection, guarantee of fair, efficient and transparent markets, and the reduction of risks in the system. On similar terms to the above, in September 1997 the IAIS published its "Principles of insurance supervision".

Pursuant to the above principles a full system for regulating financial supervision can be attained. One major lagoon is seen in the silence on rules for banking crises and, specifically, the lender-of-last-resort function that should be performed by financial authorities.

The work of the Basel Committee, IOSCO and IAIS supply irreplaceable material for the drawing up of Community directives regulating the financial market. Through European organisations such as the *European Forum of Securities Commissions* (FESCO), progress is being made in the preparation of rules on the provision of financial services in the European Union. It would be desirable to have a European securities commission to assure, together with the European Central Bank, an equal level of protection for all savers and investors in the European Union.

D.5 FLEXIBILITY IN THE TRANSPOSITION OF EUROPEAN COMMUNITY DIRECTIVES

The need for harmonisation of the financial systems of Member States stemmed from the deep differences existing between the various legal systems governing this area. Anglo-Saxon regulations, which emphasise self-regulation, contrast with the more heavily regulated continental systems. Financial harmonisation is being pursued with the adoption of important legislative policy decisions. We can cite the most important one in the Community endorsement of universal banks. The different legal traditions and starting points have required that harmonisation proceed gradually and with flexibility.

Part of this flexibility is reflected in the lengthy periods of adaptation stipulated in the Community directives. Even so, often, these periods have not been complied with.

In Spain, there was a significant delay in adaptation to the investment services directive, whose transposition deadlines expired on 1 July 1995, but which was not incorporated into Spanish law until the Act of 16 November 1998.

Since the harmonised framework was established in the Second Directive on banking coordination and the Investment Services Directive, fewer difficulties are being found in the adaptation to Community requirement. Thus, in relation to the most recent directives, such as the one on cross-border transfers or on the finality of settlement systems, Spain has complied with the transposition time limit. Once the new reality has been recognised, that is, the decision to establish a single financial market in the European Union, local resistance to adapting to the Community directives has diminished, thereby allowing the deadlines to be met.

Nevertheless, a prudent approach is still needed, giving ample time limits for adaptation, especially for transposition of those directives that affect the sphere of private law. For this reason, it is particularly appropriate for the proposed directive on distance marketing of financial services to stipulate an ample transposition period: until 30 June 2002. Bolstering the confidence of users of financial services in the single market requires that adaptation of the internal legal framework to Community legislative novelties be conducted smoothly.

D.6 STANDARDISATION OF THE LEGAL STRUCTURE OF SECURITIES TRADING

International financial markets require standardisation of securities trading contracts and guarantees. It has been the

intermediaries themselves who, through their international associations, have worked to achieve uniform model contract forms in what appears to be one more manifestation of *lex mercatoria*. Despite their unilateral origin, agreements of this kind do not arouse special misgivings from the standpoint of the public interest, concerned with maintaining the proper functioning of the financial market. There is a widely held belief that inter-professional agreements for standardisation of financial transactions and contracts strengthen the stability of the system as a whole. Nevertheless, such agreements are scrutinised by authorities responsible for enforcing fair trading laws. This scrutiny seeks to assure that the largest intermediaries do not impose their decisions on smaller operators and that the standardisation agreements work to the benefit of users of financial services.

Let us be clear on our initial premise. The globalisation of banking transactions requires achievement of model contracts and guarantees with a uniform content. The purpose is to homogenise the financial product negotiated in the market and its guarantees. In this specific area, we must take as starting point that self-regulation by the sector by means of uniform models serves to achieve security, certainty and effectiveness and contributes to facilitating international transactions. These standardisation agreements operate somewhere between modern *lex mercatoria* and contractual freedom. These widespread practices cannot be considered from the standpoint of the sources of law as custom. They are lacking the necessary *opinio juris*, understood as the general conviction as to their mandatory nature. They are international practices of financial institutions.

These model contracts are highly technical documents, drawn up in English, which financial intermediaries agree to use because they offer security and agility in international dealings. They only constitute applicable law if the parties to the contract freely submit to the uniform content laid down by the professional bodies.

A fundamental characteristic of these instruments is their complexity. Jurists and experts in financial engineering participate in the drafting of the master agreements. The result are model forms that use technical language difficult to comprehend for persons outside the field. They are normally written in English. For this reason, their translation into other languages requires much work and the results are not usually very encouraging. Their technical complexity and proximity to the basis of Anglo-Saxon legal systems fill performance of these contracts with difficulties and uncertainties. The difficulty of the contract’s translation is compounded by the perplexity caused by odd notions which are unknown in the continental systems.

Nevertheless, these master agreements merit favourable consideration. The standardisation of the terms used in financial contracts facilitates the transaction, allows swift perfection of the contract, clarifies the obligations arising under the contract, and fixes the terms and conditions for its performance. They have a good structure. A preamble serves as a guide for interpreting the contract and includes definitions of the terms used therein. In order to facilitate their application, they include clauses that contribute to uniform construction of the contracts.

But they are not beyond criticism. Their technicality and the Anglo-Saxon legal context that marks their origin hinders their application by continental courts. These are model contracts prepared in the sphere of common law, whose application under continental European law raises interpretative difficulties.

In order to avoid these problems the model contracts usually resort to clauses that defer to Anglo-Saxon law. The parties also give authority to interpret the contract to a third party expert in the field. The most appropriate approach is to use properly translated internal model contracts. Thus, in Spain there are model contracts drawn up in Spanish, as well as the model interest rate swap contract (SWAPCEMM) prepared by the Comisión de Estudio del Mercado Monetario (Money Market Study Committee) for the purpose of standardising financial agreements of this kind.

No less important is the master agreement for financial transactions prepared by the Asociación Española de Banca Privada (Spanish Private Banking Association or AEB), known as the "netting agreement" and recognised for the purpose of Directive 96/19/EC according to its transposition by the tenth additional provision to Act 37/1998 reforming the Stock Market Act.

This is precisely the model to be followed: incorporation into law of the uniform results attained by the international operators. Such incorporation should serve to examine from the standpoint of the public interest and consumer protection the uniform models prepared by professional organisations. In addition, the inclusion in the law of new financial concepts should be done in systematic fashion, respecting the bases of the obligations and contracts and advancing in the construction of European securities law.

D.7 ESTABLISHMENT OF COLLATERAL SECURITY

Harmonisation of the rules on collateral security in the European Union has been affected by two recent developments. One is the widespread tendency toward dematerialisation of transferable securities: the traditional paper certificates have been replaced by accounting entries. Second is the fact that loans tied to monetary policy are secured with collateral consisting of transferable securities. These two developments are interrelated. The dematerialisation of securities and their representation by means of book entries has contributed to simplifying the establishment of collateral to secure monetary policy operations.

It is stipulated that loans that form part of monetary policy operations are to be secured by means of pledging government debt securities and other liquid securities as collateral. The defence of the value of the single currency requires the existence of an interbank market that can provide liquidity to banks operating in the European Union. In this framework, the European Central Bank (ECB) must have sufficient collateral in order to help meet the liquidity needs of financial institutions. Securities loans are the main collateral used in interbank systems. For this reason the development of the European System of Central Banks (ESCB)

has required approval of a legal framework that provides security to those collateralised transactions.

Proper operation of settlement systems in the European Union, as a prerequisite for correct implementation of monetary policy measures by the ECB, requires reducing the risk derived from interbank settlements and from securities clearing and settlements services. This objective was the justification for the approval of Council Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems.

One specific aspect of these rules involves the securities pledges that serve as collateral for monetary policy operations. In order to clarify the laws that apply to this type of securities pledge, article 9.2 of Directive 98/26/EC lays down a rule for resolving jurisdictional conflicts, according to which: *"Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State".*

Thus, determination of the rights of participants in the ESCB as holders of collateral security in relation to securities is to be governed by the law of the Member State in which the collateral registry system is based.

The transposition of the above Directive led to Act 41/1999 of 12 November 1999 on payment and securities settlement systems. According to article 2-b of the Act, the scope of the law includes the collateral constituted in the framework of the ESCB and collateral provided for monetary policy transactions that take place in that system.

And the conflict resolution rule of the Directive is specifically incorporated into the law. According to art. 15.2 of the Act: *"Spanish legislation shall apply, in terms of its real legal effects, to the collateral legally recorded in a register based in Spain for the benefit of a Spanish or foreign system, of their participants or of the Bank of Spain, European Central Bank or other Central Banks of European Union Member States in relation to their monetary policy operations or transactions associated with settlements in those systems.* And it adds: *"Collateral legally constituted and registered in a register based in another Member State for the benefit of a Spanish system, of its participants or of the Bank of Spain in connection with monetary policy operations or transactions associated with settlements in those systems shall be governed by the law of that Member State, as regards their real legal effects".* The Act also establishes rules of coordination between Spanish and Community registers, derived from application of the national law of the Community register system to securities issued under Spanish law and represented by book entries. In these cases, article 15.3 of the Act provides: *"the Minister of Economy and Finance, at the proposal of the supervisory authorities of the managers of the Spanish systems, shall establish appropriate liaison and conciliation procedures that ensure proper correspondence between the entries in the said foreign registers and those in the related Spanish register for those securities and the legal enforceability of the collateral security established over the same".*

Proper functioning of collateral systems that secure monetary policy operations in the European Union requires harmonisation of the collateral registration systems, which are currently linked to the registry systems for securities represented by book entries. The European Central Securities Depositories Association (ECSDA), in which the Spanish *Servicio de Compensación y Liquidación de Valores* (Securities Clearing and Settlement Service) participates, is working to coordinate efforts to interconnect the different European central depositories. This integration of systems must be preceded by legal harmonisation of book-entry registration of securities and of the rules for registering ownership and collateral. Once again, we must emphasise the importance of proper systematic insertion of the new rules in the foundations of European property law.

But the pledge of securities not only constitutes the main guarantee for ECB monetary policy operations; it also serves to secure execution of financial transactions through clearing houses. The execution of securities trades made in organised markets takes place through clearing houses. These organisations, which require the guarantees offered by collateral security, are the ones that have forced the reform of the legal regulation of securities pledges.

Traditionally, a distinction has been made between two types of clearing houses: bank clearing houses, responsible for monetary transactions, and stock market clearing houses, dedicated to the simplification of securities transactions. The integration of financial markets has made it difficult to distinguish between the bank and securities spheres and fostered the emergence of a unified clearing house model based, for the sake of greater market security, on the finality of the orders received from their members.

This is the model followed by the European Union, which has harmonised its regulations with Directive 98/26/EC on settlement finality of payment and securities settlement systems. The Directive was transposed into internal Spanish law in the form of Act 41/1999 of 12 November 1999 on payment and securities settlement systems.

Along these lines, the single currency has implied harmonisation of the clearing houses of the Member States. The approach is based on mutual recognition of clearing houses that meet certain conditions, including mandatory participation in the system's management by a credit institution authorised in the European Union. There is excessive settlement and clearing dispersion in the European Union. The ECB, for payment systems, and the ECSDA, for securities settlement systems, are taking steps to improve interconnection between the existing systems as a preliminary step toward future integration, in line with the United States model.

Spanish law conceives of clearing houses as companies that provide clearing, settlement and registration services for financial

transactions. The Act recognises the clearing house status of the settlement service of the Bank of Spain (the former the Money Market Telephone Service), the Spanish Interbank Settlement Service (which assumes the functions of the Bank Clearing House of Madrid), the Securities Clearing and Settlement Service (SCLV), the Government Debt Securities Central Book-Entry Office, and the clearing services of the governing companies of the regional stock exchanges, of the derivatives market, and of the wholesale bond market (AIAF).

The new legal framework gives priority to collateral provided to clearing houses in the event of bankruptcy of clearing-house members or of the investors who established the collateral.

The new clearing houses enjoy important privileges. Two simple rules protect them from bankruptcy of its members. One establishes that transfer orders of members are final as from the time they are received by the clearing house; not even the bankruptcy of the ordering member can affect the finality of the order. The clearing house is therefore not affected by the retroactive effects provided for in the Code of Commerce. Second, this privilege also extends to the collateral provided by its members. In the event of bankruptcy of a member, the clearing house has the right to separate the collateral provided from the estate of the bankrupt entity.

Previously, the 16 November 1998 reform of the Stock Market Act had already injected more flexibility into the rules for providing collateral. According to the sixth additional provision of Act 37/1998, constituting collateral over securities represented by the book-entry system merely requires a unilateral declaration by the borrower-owner of the securities and this declaration may even be made using telematic channels. The collateral may be enforced by means of a private proceeding by reporting default of the borrower and the validity of the collateral to the market governing company according to the terms of articles 322 to 324 of the Code of Commerce.

The above reflects the breadth of the harmonisation of the rules regarding collateral in the financial market. In order to achieve a public interest, specifically, effective execution of monetary policy and proper functioning of note and securities clearing houses, a private contractual concept is regulated, the securities pledge, and its rules are harmonised. There thus arises a common law on collateral in the European Union, whose scope of application continues to be confined to specific activities, but which could be extended to give rise to the desired general Community law of financial guarantees. As a strategic sector for the economy, the financial market serves as a sphere in which to advance toward a unified contract law.

Another question of interest is the opportunity afforded by new technologies for establishing common legal rules. It was the dematerialisation of securities that propelled the reform of the contractual regime for collateral security. Electronic technology facilitates the establishment and cancellation of securities pledges. These possibilities are used by financial authorities to promote the coverage of financial transactions by means of pledging book-entry securities as collateral. This new framework was born already harmonised in the European Union.

THE BANKING SYSTEM

E.1 MARKET APPROACH TO BANK PRACTICES. THE CASE OF ELECTRONIC MONEY

The technical agreements between representatives of European Union banks contributes to reducing the costs of cross-border transactions and to making such transactions more transparent to users of financial services. While these efforts by the banking sector are praiseworthy, they need to be complemented by legislative initiatives. One example is found in the development of electronic money, made possible thanks to interbank coordination efforts. But there are general public interests that have not been adequately protected in this area. First, there is the general interest in monetary control by the ECB, which could be undermined by a new source of liquidity. Second, there is the interest of users of this new payment service in the search for a secure and effective instrument. The protection of these interests constitute the raison d'être for the proposal for a Directive on the activities of electronic money entities [COM(98)0461]. Bank practices and professional agreements respond to market dynamics and can give rise to situations that are contrary to the general interest or, at the least, create the risk of such situations coming about. A proper response by lawmakers allows reestablishment of the balance between free enterprise and the public interest and serves to guide the conduct of the agents involved and define their responsibilities.

It should be noted that the long changeover to the euro, during which time the common currency has no physical representation, has implied full recognition of a book currency. In this sense, in Spain the legislative Act introducing the euro recognises, as a novelty, the discharging effect of payments by means of book entries. The euro has dematerialised money. This fact is leading European institutions to promote the use of bank cards, including electronic purses, as a means for facilitating the consumer's use of the new currency. This policy strengthens the role of banks in payment systems. The euro thus paves the way for generalised use of electronic purses instead of small cash payments. Hence the ECB's reaction in proposing regulation of electronic money to consider issuance of the same as an activity reserved to credit institutions as a means of ensuring its control the ECB's control of monetary policy (see European Central Bank: *Report on Electronic Money*, August 1998).

E.2 RULES ON INTERBANK SETTLEMENTS AND THE LAW OF MONETARY AND PAYMENT OBLIGATIONS

Since its creation, the ECB has taken the initiative in improving Community payment systems. Many of its proposals stem from the public interest in strengthening consumer confidence in the financial system during the changeover to the single currency. These initiatives seek to defend consumer interests and on occasion make financial institutions bear part of the cost of the

changeover.

We must accept that the single currency creates a European monetary law that replaces the monetary law of the Member States. In this sense, the ECB has underscored the discrepancies that exist between national laws on the protection of euro notes and coins against falsification (see European Central Bank: *Report on the Legal protection of Banknotes in the European Union Member States*, November 1999).

Apart from the transition to the euro, the ECB has addressed the question of interbank settlements and transfer payments. Its initiatives form the foundation for harmonisation of Community payment systems and contribute indirectly to achieving harmonisation of European law on pecuniary obligations. Large payments respond to the needs implied by the execution of monetary policy by the ESCB. The TARGET system makes it possible for interbank payments to proceed efficiently (see European Central Bank: *Cross-border payments in TARGET: A users' survey*, November 1999).

The efficiency and security of cross-border payments, in turn, constitutes one of the principal concerns of the ECB. The exercise of Community freedoms is predicated on the proper functioning of a payment system that allows prompt, efficient execution of transfers (European Central Bank: *Improving Cross-Border Retail Payment Services. The Eurosystem's View*, September 1999). In this arena, Directive 97/5/EC of 27 January 1997 on cross-border transfers has been incorporated into Spanish law by means of Act 9/1999 of 12 April 1999, which regulates the legal rules applicable to transfers between European Union Member States. The Act seeks to protect consumers who use transfers as means of payment in the internal market. It obliges the bank to inform the client as to the conditions for making the transfer and establishes the liability of the financial institution for failure to perform the transfer.

The importance of these provisions is that they harmonise, in relation to transfer orders, the rules of responsibility of bankers in the European Union. In States such as Spain, which have no specific legal framework for bank contracts, rules of this kind have an expansive force, because they can be applied by analogy to other events in which a bank fails to execute the orders received from the client. And most importantly from the standpoint of unification of law in the European Union, it establishes the bases for contractual relations between banks and their customers.

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