

# Between Contract Law and Financial Regulation: Towards the Europeanisation of General Contract Law

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## Abstract

This paper explores the interactions between the general law of contract and the EU-derived financial regulatory duties. Starting from the analysis of the legal nature of the EU-derived conduct of business rules duties and the role played by contract law in the governance of financial markets, the paper shows that, after the global financial crisis, national courts have used the remedies based on general contract law as tools to enforce the EU-derived conduct of business rules and to ensure a high level of client protection. This paper argues that this case law provides evidence of a gradual process of Europeanisation and modernisation of the general law of contract, i.e. of transformation of traditional autonomy-driven categories of general contract law into regulatory tools to govern financial transactions and increase the protection of investors.

## 1. Introduction

Following the global financial crisis, the European Commission proposed more than 40 new legislative measures to increase the stability of the financial system, the integrity of financial markets and the protection of investors.<sup>1</sup> The cascade of rules adopted by the EU between 2009 and 2015 not only reshuffled the prudential requirements for credit and investment firms and the conduct of business rules, which apply to financial services providers, but also the architecture of financial supervision and enforcement.

However, the lack of harmonisation of contract law-related rules – including the rules on the formation, performance, breach of contract and other contractual remedies – remains a distinctive feature of EU financial regulation.<sup>2</sup> Whereas the EU regulates

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<sup>1</sup> European Commission, *Regulating Financial Services for Sustainable Growth*. Brussels, 2.6.2010 COM(2010) 301 final.

<sup>2</sup> New tortious liability regimes have been introduced by Art. 21 of Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers (AIFMD) O.J. L 174/1 (2011) and Art. 35 of Regulation (EU) No 462/2013 of the European Parliament and of the Council on Credit Rating Agencies O.J. L 146/1 (2013).

financial products, services and capital requirements heavily, it does not regulate the content of contracts between financial market participants nor it requires Member States to establish contractual remedies or private rights of action for the loss suffered by clients as a result of the firm's violation of conduct of business rules.

National private law remains, formally speaking, untouched by the provisions of the EU legislation of the new post-crisis reforms.<sup>3</sup> The lack of EU harmonisation of national private law remedies could suggest that the EU generally prefers a public law-based system of regulation and enforcement of financial regulation.<sup>4</sup> It does not rule out the possibility that EU conduct of business rules can influence, by way of judicial interpretation, or even more directly determine the nature, role and function of national contract law.

The understanding of how EU-derived regulatory standards can interfere with general private law,<sup>5</sup> is important from a practical and theoretical perspective. From a practical perspective, the lack of an express private remedy for the breach of regulatory duties derived from EU law begs the question, recurrent among courts and adjudicators after the global financial crisis: whether any remedy, based on general private law, can be granted to clients, and, if so, on what legal basis (e.g. principle of effectiveness of EU law). From a theoretical perspective, the interaction between regulatory and private law duties, requires a clarification of whether, and to what extent, the general categories of private law (e.g. freedom of contract, good faith, privity of contract) can be adapted, adjusted and modelled in order to provide redress to clients who suffered a loss as a result of the firms' breach of conduct of business rules.<sup>6</sup>

Against this background, our hypothesis is that EU financial regulation, in particular conduct of business rules, has an impact on general private law, both on the principle of freedom of contract and on the remedies for breach of contractual obligations.

First, while it does not directly limit the parties' freedom to enter into contracts or to draft contracts in a specific way, EU financial regulation indirectly leads financial services providers to draft standard contract terms in ways that do not conflict with national law transposing EU law, and in particular the Investment Service Directive<sup>7</sup>

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<sup>3</sup> See, for an exception, Art. 12(3) of the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR), O.J. L 201/1 (2012).

<sup>4</sup> Takis Tridimas, *EU Financial Regulation: Federalization, Crisis Management and Law Reform* in P Craig-G de Búrca (eds.), *The Evolution of EU Law*, 793 (Oxford, Oxford University Press 2011).

<sup>5</sup> See N Lipari, *Parte generale del contratto e norme di settore nel quadro del procedimento interpretativo* 1 *Rivista trimestrale di diritto e procedura civile* 1 (2008); Hans-W. Micklitz, *The Visible Hand of European Regulatory Private Law – The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation* 28 *Yearbook of European Law* 3 (2008).

<sup>6</sup> For the importance of 'the law' and 'the legal system' in the governance of financial markets, see Katharina Pistor, *A Legal Theory of Finance* 41 *Journal of Comparative Economics* 315 (2013).

<sup>7</sup> Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (ISD), O.J. L 141/27 (1993).

and MiFID I<sup>8</sup> – the “new constitution” in the area of investment services and secondary capital markets.<sup>9</sup>

Second, the EU conduct of business rules, as transposed by the relevant national laws, can be used by national courts and adjudicating bodies as a tool to interpret, in a purposive way (i.e. in order to achieve the client protection objective), the general contract law. The influence of EU law on freedom of contract and remedies is not, however, homogeneous. Whereas in some jurisdictions (e.g. Italy, Spain, France) there is a trend towards gradual integration of EU financial regulation and national contract law, in others (e.g. United Kingdom) national statute law and case law preserve the distinction between regulatory and contract duties.

To explore these hypotheses, this chapter is organised as follows. Section 2.2. provides a theoretical framework for understanding the problems related to the legal nature and purpose of EU conduct regulation.<sup>10</sup> Section 2.3. illustrates and explains the subsidiary role played by contract law rules in EU financial regulation by analysing EU law on retail financial contracts (e.g. consumer credit, payment services) and non-retail financial contracts (e.g. MiFID II,<sup>11</sup> EMIR). Section 2.4. describes the function of contract law in the case law of the Court of Justice of the European Union (CJEU) by looking at two important cases, *Peter Paul* and *Bankinter v. Genil*, where the CJEU had the opportunity to consider the impact of EU prudential and conduct regulation on private law. Section 2.5. gives an account of the impact of EU *statute* and *case* law on national contract law in several EU jurisdictions. This comparative analysis brings to light national divergences and convergences and shows different models of interaction between EU financial regulation and national contract law. Section 2.6. illustrates the increasing role played by alternative dispute resolution mechanisms in the resolution of disputes involving retail clients. Section 2.7 draws conclusions from the preceding research and advocates for a high degree of harmonisation of contract law rules for investment contracts in order to enhance legal certainty and legal integration between Member States.

## 2. The Legal Nature and Purpose of Financial Regulatory Duties

### 2.1. *The Legal Nature of Financial Regulatory Duties*

The legal nature of financial regulatory duties and, in particular, conduct of business rules, duties of conduct has provoked much debate in the literature. Some Authors

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<sup>8</sup> Directive 2004/39/EC on markets in financial instruments (MiFID I) O.J. L 145/1 (2004).

<sup>9</sup> Stephan Grundmann, Joannes Hollering, *EC Financial Services and Contract Law – Developments 2005-2007* 4 European Review of Contract Law 58 (2008).

<sup>10</sup> This paper does not consider the impact of EU prudential regulation on national contract law. For a recent analysis, see Christos Hadjiemmanuil, *The Banking Union and Its Implications for Private Law: A Comment* 16 European Business Organization Law Review 383 (2015)..

<sup>11</sup> Directive 2014/65/EU on markets in financial instruments (MiFID II) O.J. L 173/349 (2014). MiFID II will enter into force and repeal MiFID I with effect from 3 January 2018.

consider conduct of business rules to be regulatory rules; others see them as “contract related supervision rules”<sup>12</sup> or as hybrid duties between contract and administrative law.<sup>13</sup>

There is also intense debate over the relationship between financial regulatory duties and contract law duties (or obligations). Some authors claim that these duties should be kept separate;<sup>14</sup> others claim that the regulatory duties should produce radiating effects on contractual duties;<sup>15</sup> others argue that there is a necessary complementarity between them since they functionally integrate with each other.<sup>16</sup>

## 2.2. *The Purpose of Financial Regulatory Duties*

Seeking to further clarify the relationship between financial regulatory duties and contract law duties, some Scholars have recently focussed on the purpose of the duty (i.e. safety and soundness of individual firms, financial stability or client protection), rather than its legal nature (private or public law). From this purposive perspective, there may be convergences (especially in the field of client protection regulation) or divergences (especially in the field of micro and macro prudential regulation) between different kind of duties.<sup>17</sup> For example, the investment firm’s duty to “act honestly, fairly and professionally in accordance with the best interests of its clients” (Art. 19 of the MiFID I and Art. 24 of the MiFID II) does not differ, in its substance, from the duty to negotiate in good faith and to perform contractual obligations in good faith, both of which exist in a number of national jurisdictions and in the projects for the harmonisation of European contract law.

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<sup>12</sup> See Olga Cherednychenko, *Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law* 21 *European Law Journal* 505 (2015); Guido Ferrarini, *Contract Standards and the Markets in Financial Instruments Directive (MiFID): An Assessment of the Lamfalussy Regulatory Architecture* 1 *European Review of Contract Law* 20 (2005). Public Supervision over Private Relationships: Towards European Supervision Private Law? 22 *European Review of Private Law* 37 (2014)

<sup>13</sup> Johannes Köndgen, *Policy Responses to Credit Crises: Does the Law of Contract Provide an Answer?* in Stephan Grundmann, Yesim M Atamer (eds.), *Financial Services, Financial Crisis and General European Contract Law: Failure and Challenges of Contracting*, 40 (Alphen aan den Rijn, Kluwer Law International, 2011).

<sup>14</sup> Alastair Hudson, *Law of Finance*, 13 (London, Sweet and Maxwell, 2013) and Iris H.-Y. Chiu, *Regulatory Duties for Directors in the Financial Services Sector and Directors’ Duties in Company Law: Bifurcation and Interfaces*, 6 *Journal of Business Law* 489 (2016).

<sup>15</sup> See Brigitte Haar, *From Public Law to Private Law: Market Supervision and Contract Law Standards*, in Atamer Grundmann (eds.), *Financial Services, Financial Crisis and General European Contract Law*, 259-279 and Danny Busch, *The Private Law Effect of MiFID: The Genil Case and Beyond*, in Danny Busch and Guido Ferrarini (eds.), *Regulation of the EU Financial Markets. MiFID II and MiFIR*, 228 (Oxford, Oxford University Press: 2017).

<sup>16</sup> See Cherednychenko, *Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law*, 520; Andrea Zoppini, *Diritto privato vs diritto amministrativo (ovvero alla ricerca dei confini tra stato e mercato* 1 *Rivista diritto civile*, 523 (2013).

<sup>17</sup> See Grundmann, *The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook* 1 *European Business Organisation Law Review* 1 (2015).

However, it is much more difficult to find convergent purposes or goals between financial regulation and contractual duties in relation to micro and macro prudential regulatory rules. As is well known, after the global financial crisis, financial stability has become a key concern for international and EU regulators. Financial stability is not just conceived of as instrumental in reducing the vulnerability of individual institutions, especially in times of capital shortfalls, but also as a public good in itself, which ensures medium- and long-term growth.<sup>18</sup> The rules imposed on credit and investment firms to protect clients may be in conflict with rules, now enshrined in the CRR and CRD IV, which mandatorily require them to hold certain levels of capital and liquidity and set up efficient governance and organisational mechanisms to control financial risks. In fact, these financial regulatory rules pursue conflicting interests, which are intrinsically connected to the basic objectives of prudential regulation: on the one hand, maintaining the safety and soundness of financial institutions and the financial system as a whole; on the other hand, protecting the depositors and other creditors of financial institutions.

The difference between financial conduct of business and prudential rules suggests that a cautious approach should be adopted when interpreting the EU financial regulatory standards. Whilst there may be a convergence of purposes between financial regulation and contract law with regard to conduct of business regulation, divergence may still exist when it comes to prudential regulation because the protective contract law rules (e.g. good faith) may conflict with the prudential objectives pursued by financial regulation.

### 3. The Role of Contract Law in the Regulation of Financial Transactions

Having examined the most prominent views in European academia on the legal nature and purpose of EU financial regulatory duties, it is necessary to analyse in more detail the role played by the law of contract in EU financial regulation. The law of contract – including the default and mandatory rules governing the formation, performance, and breach of contract – has traditionally played a subsidiary role in EU financial regulation. Ever since the adoption of the ISD in 1993, the EU legislator has focussed on the regulation of conduct of business rules, i.e. by regulated financial instruments and services,<sup>19</sup> without interfering in the regulation of the contract between investment firms and clients. In fact, similar to other sectors of the internal market, the liberalisation of financial services has gradually required more regulation, supported by administrative agencies, in order to increase competition and to protect weaker parties. As a result, liberalisation has paradoxically produced its opposite, namely regulation.<sup>20</sup>

This re-regulation of the EU financial markets, however, has not directly changed nor has it harmonised the national law of contract. This is for the following reasons.

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<sup>18</sup> See Mads Andenas, Iris H-Y Chiu, *Financial Stability and Legal Integration in Financial Regulation* 3 *European Law Review* 335 (2013).

<sup>19</sup> See Andenas, *Rules of Conduct and the Principle of Subsidiarity* 15 *Company Lawyer* 60 (1994).

<sup>20</sup> See Sabino Cassese, *Quattro paradossi sui rapporti tra poteri pubblici ed autonomie private* 2 *Rivista trimestrale di diritto pubblico* 389 (2000).

First of all, given that the EU does not enjoy express competence in the field of private law, it is easier to harmonise administrative sanctions than contract law duties and civil law remedies.<sup>21</sup> Second, there is a wide belief in the financial industry and among scholars that the harmonisation of civil law remedies could give rise to opportunistic litigation by professional clients and endanger the efficiency of financial markets.<sup>22</sup> The resistance of the industry, coupled with the disagreement among Member States, is one of the reasons why the 2010 Commission proposal, put forward in the context of the MiFID I review, to introduce a principle of civil liability for financial firms who caused losses to clients was eventually dropped.<sup>23</sup> Third, from a more theoretical perspective, the EU has traditionally been much more concerned to regulate the economic activity of market participants than the legal acts that enable such activity, not only in the field of financial services but also in telecommunications, transport and energy.<sup>24</sup>

This regulatory approach has resulted in the establishment of sectoral or silo-type regimes which govern the technicalities and specificities of different economic activities for the overriding purpose of increasing the functioning of the internal market.<sup>25</sup> In fact, the Directives and the Regulations adopted on the basis of the 1999 Commission's Financial Services Action Plan (FSAP), and those adopted after the global financial crisis, between 2009 and 2015, have all relied on Art. 95 TEC (now Art. 114 TFEU), which is the classical legal basis for measures aimed at strengthening the functioning of the internal market. The rationale for this legislative choice rests on the assumption that the greater the harmonisation of national laws, the higher the level of market integration.<sup>26</sup>

A remarkable novelty is that after the global financial crisis, this provision was also used as an 'institution-building tool' to set up new EU bodies entrusted with micro- and macro-prudential financial supervision, such the European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational

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<sup>21</sup> Tridimas, *EU Financial Regulation: Federalization, Crisis Management and Law Reform*, 794.

<sup>22</sup> Ian MacNeil, *Enforcement and Sanctioning*, in Ellis Ferran, Niamh Moloney, Jennifer Payne (eds.), *Oxford Handbook on Financial Regulation*, 293 (Oxford, Oxford University Press, 2015).

<sup>23</sup> See Moloney, *Liability of Asset Managers: A Comment* 7 *Capital Markets Law Journal* 421 (2012).

<sup>24</sup> Antonio Jannarelli, *La disciplina dell'atto e dell'attività: i contratti tra imprese e tra imprese e consumatori* in Lipari (ed.), *Trattato di diritto privato europeo III*, 13 (Padova, Cedam, 2003).

<sup>25</sup> See, in particular, Micklitz, *The Visible Hand of European Regulatory Private Law – The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation*, 3 and, recently, Guido Comparato, Hans-W Micklitz and Yane Svetiev, *The Regulatory Character of European Private Law*, in Christian Twigg-Flesner (ed.), *Research Handbook on EU Consumer and Contract Law*, 35 (Edward Elgar Publishing, 2016).

<sup>26</sup> In more detail, on the relationship between harmonisation of laws and financial integration, see Moloney, *EU Securities and Financial Markets Regulation*, 27 (3 ed., Oxford, Oxford University Press, 2014) and Emiliós Avgouleas, Douglas W Arner, *The Eurozone Debt Crisis and the European Banking Union: "Hard Choices," "Intolerable Dilemmas," and the Question of Sovereignty* 50 *The International Lawyer* 32 (2017).

Pensions Authority (EIOPA) – and the European Systemic Risk Board (ESRB) which together compose the new European System of Financial Supervision (ESFS).<sup>27</sup> In the landmark case C-270/12, *UK v. Parliament and Council*, the Court of Justice of the European Union (CJEU) held that Art. 114 TFEU was an appropriate legal basis for the adoption of Art. 28 of Regulation No 236/2012 on short-selling<sup>28</sup> as this provision improves the conditions for the establishment and functioning of the internal market in the financial field.<sup>29</sup>

More critically, in 2014, the Single Resolution Board (SRB) and the Single Resolution Fund (SRF), as part of the new Single Resolution Mechanism (SRM), were set up on the basis of Art. 114 TFEU. In fact, in order to accommodate the concerns of some Member States about the appropriateness of this legal basis, it was agreed that the complex arrangements concerning the transfer to and the mutualisation of contributions to the SRF would be included in an intergovernmental agreement signed by the participating Member States.

However, whereas this “internal market-driven” substantive and institutional legislation has led to an increase in the level of harmonisation of both retail and wholesale segments of the market, it has not introduced harmonised rules on contracts between market participants. As a result of the lack of EU harmonisation of national contract law, three different levels of rules govern financial transactions:<sup>30</sup> the rules that the parties design themselves (self-regulation); EU legislative (directives, regulations, decisions) and non legislative rules (ESMA’s decisions, guidelines, recommendations); and national rules (e.g. in contract, tort and property law), whether they transpose EU rules or not.

This classification is not only illustrative of the complexity which characterises the regulation of financial transactions but also of the need for lawyers to adopt a flexible approach when interpreting financial contract clauses and regulation. In fact, in this field the boundaries between contract and administrative law have become particularly blurred. For a contract lawyer, an interest rate swap is a contract, but for an administrative lawyer, it is a financial instrument. Can the regulatory duties imposed on a swap dealer be more intense than those laid down by general contract law? Should national courts and adjudicating bodies interpret the general law of contract

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<sup>27</sup> For the analysis of the impact of the acts adopted by the ESAs and national competent authorities on general contract law see Federico Della Negra, *The Effects of the ESMA’s Powers on Domestic Contract Law*, in Mads Andenas, Gudula Deipenbrock (eds.), *Regulating and Supervising European Financial Markets: More Risks than Achievements*, 155 (Springer, 2016) pp 139 ss.; Yane Svetiev, Annetje Ottow, *Financial Supervision in the Interstices Between Private and Public Law* 4 European Review of Contract Law 496 (2014); Cherednychenko, *Public Supervision over Private Relationships: Towards European Supervision Private Law?* 1 European Review of Private Law 37 (2014).

<sup>28</sup> Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps O.J. L 86/1 (2012).

<sup>29</sup> CJEU, case C-270/12, *UK v. Parliament and Council*, EU:C:2014:18.

<sup>30</sup> For the notion of transaction see, in particular, Oliver E Williamson, *Transaction-cost Economics: the Governance of Contractual Relations* 22 Journal of Law and Economics 235 (1979); Florian Moslein, Karl Riesenhuber, *Contract Governance – A Draft Research Agenda* 5 European Review of Contract Law 248 (2009).

in light of EU financial regulation even if there is no express EU rule regulating such contracts? As we will see below, national courts have given very different answers to these questions.

Another important distinction should be drawn between retail and non-retail financial transactions. The nature of the client (retail, professional, eligible counterparty), together with the type of service execution only, investment advice, portfolio management and the financial instrument (complex, non-complex), is one of the criteria used by the MiFID I and MiFID II to customize the duties of conduct.<sup>31</sup>

#### 4. Retail Financial Transactions

The notion of retail includes all clients, both natural and legal persons, that are not professional clients; that is, who do not possess the experience, knowledge and expertise to make their own investment decisions and properly assess the risks that are incurred.<sup>32</sup> It follows that the notion of retail client includes also that of consumer which, according to the relevant EU law, refers to any natural person who, acts for purposes which are outside his trade, business, craft or profession.<sup>33</sup> This means that the EU financial directives applying to retail clients also apply to consumers and that, conversely, EU consumer directives apply to retail clients in so far as they are natural persons.

Among consumer directives, the Distance Marketing of Consumer Financial Services Directive,<sup>34</sup> the Payment Services Directive,<sup>35</sup> the Consumer Credit Directive<sup>36</sup> and the Mortgage Credit Directive<sup>37</sup> are the most important for our purposes. Although these directives do not provide a comprehensive harmonised framework of contractual rights and duties, they do regulate consumer contractual rights and remedies. In particular, Art. 6 of the Distance Marketing of Consumer Financial Services Directive and Art. 14 of the Consumer Credit Directive confer on the consumer the right of withdrawal; Arts 60 and 75 of the Payment Services Directive harmonise the payment

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<sup>31</sup> See Marc Kruithof, Walter van Gerven, *A Differentiated Approach to Client Protection: The Example of MiFID*, Financial Law Institute WP 2010/07.

<sup>32</sup> See Art. 4(1)(11) of MiFID II, referring to Annex II.

<sup>33</sup> See in particular Art. 2(1) of Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council (consumer rights directive).

<sup>34</sup> Directive 2002/65/EC concerning the distance marketing of consumer financial services O.J. L 271/16 (2002).

<sup>35</sup> Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC O.J. L 319/36 (2007).

<sup>36</sup> Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC O.J. L 133/66 (2008).

<sup>37</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 O.J.L 60/34 (2014).



service provider's liability to the payer for unauthorised payment transactions and for non-execution or defective execution of the payment transaction; and Art. 14 of the Mortgage Credit Directive imposes detailed pre-contractual information duties on the creditor.<sup>38</sup>

These provisions reveal that the consumer financial directives have been drafted from the perspective of the private law relationship between a consumer and a service provider<sup>39</sup> for the main purpose of increasing the protection of the investor vis-à-vis financial service providers.

## 5. Non-Retail Financial Transactions

Unlike the EU consumer and retail financial regulation, EU non-retail financial regulation is drafted from the perspective of public enforcement via supervisory authorities of the investor protection provisions contained therein. The Prospectus Directive,<sup>40</sup> the Transparency Directive,<sup>41</sup> MiFID I<sup>42</sup> and MiFID II<sup>43</sup> require Member States to establish effective sanctions for a firm's failure to comply with specific conduct of business rules but they do not provide private law remedies to (retail and non-retail) investors who may have been affected by the firm's violation of these rules. However, these Directives do not expressly prevent Member states from introducing or preserving private law remedies or mandatory rules which ensure a high level of investor protection. The EMIR, on the other hand, specifies that an infringement of its rules shall not affect the validity of an OTC derivative contract and shall not give rise to any right to compensation from a party to an OTC derivative contract (Art. 12(3)). In such cases, a national provision establishing the nullity of an OTC derivative contract in cases where a firm infringes conduct of business rules would be in breach of EU law.

There are two reasons for this public enforcement approach to the regulation of the B2B segment of the market. First of all, it must be kept in mind that the primary aim of the above-mentioned directives is to maintain the stability of financial markets.

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<sup>38</sup> The Recital 58 of the Mortgage Credit Directive specifies that "Without prejudice to private contract law, Member States should ensure that creditors cannot terminate a credit agreement because they realised, after the signature of the credit agreement, that the assessment of creditworthiness was incorrectly conducted due to incomplete information at the time of the creditworthiness assessment".

<sup>39</sup> See Cherednychenko, *The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?* 33 *Journal of Consumer Policy* 408 (2010).

<sup>40</sup> Art. 25 of Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading O.J. L 345/64 (2003). Art. 6 requires Member States to ensure that their laws, regulations and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.

<sup>41</sup> Art. 24 of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC O.J. L 390/38. Art. 7 requires Member States to ensure that their laws, regulations and administrative provisions on liability apply to issuers.

<sup>42</sup> Art. 51 of MiFID I.

<sup>43</sup> Art. 69 of MiFID II.

Maintaining a stable financial market increases the efficiency of financial markets and therefore indirectly enhances investor protection against banking crises, mis-selling practices and fraud. Even if investor protection has attracted more attention since the global financial crisis,<sup>44</sup> it is doubtful whether the above-mentioned legislation can be interpreted in light of this exclusive objective. Rather, it seems that this objective needs to be counterbalanced with that of ensuring financial stability. This problem, as we will show below, is particularly relevant for national courts and adjudicating bodies when deciding whether the EU conduct of business rules pursue similar or divergent goals with respect to general contract law.

Second, the public enforcement approach to financial regulation seeks to overcome divergences existing at the national level as regards the legal qualification of financial contracts (e.g. mandate, sale, *sui generis* contract) and the remedies for breach of these contracts (e.g. pre-contractual liability, contractual liability, nullity). In fact, by regulating the economic activity (e.g. financial instruments, financial services) instead of the legal mechanisms used to carry out such activities (e.g. the contract), EU law ensures that regulation will apply in Member States despite the relevant divergences across national jurisdictions. This means that EU financial regulation is insensitive to national contract law, i.e. national contract law cannot set lower standards of protection than EU law. It does not mean, however, that national contract law is insensitive to EU financial regulation as the rules of conduct imposed by EU law on credit and investment firms may drive the interpretation of traditional categories of contract law.<sup>45</sup>

How can the influence of EU law on national contract law be legally conceptualised?

From the perspective of EU law, the problem arises when EU legislation (e.g. MiFID I, MiFID II) does not expressly require Member States to establish private law rights and remedies between the parties to a transaction but similarly does not prevent Member States from doing so. In these circumstances, if the Member State does not lay down a specific remedial consequence for the firm's failure to respect the national law transposing EU law, can the firm's breach give rise to a remedy based on general contract law?

Some have argued that since directives lack horizontal direct effect they cannot be used by courts in order to provide a private law remedy to an investor (e.g. compensation). In contrast, other scholars have claimed that, notwithstanding the lack of horizontal effect of directives, the national judge has a duty to interpret national law, including contract law, in light of EU law in accordance with the principle of "har-

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<sup>44</sup> See the recitals Nos. 77, 156, 177; Art. 24(6), 74(2) and 75(1) of MiFID II. See in particular Moloney, *The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?* 13 *European Business Organization Law Review* 169 (2012).

<sup>45</sup> See Della Negra, *The Transformation of the Retail Financial Transactions in the EU and the Role of Contract Law*, in Guido Comparato, Hans-W. Micklitz, Yane Svetiev (eds.), *European Regulatory Private Law – Autonomy, Competition and Regulation in European Private Law* 6 EUI Working Paper Law 117 (2016).

monious interpretation".<sup>46</sup> Notably, the duty to interpret national law in light of EU law applies even if the provision was not enacted for the specific purpose of transposing the directive, provided that it does not lead to an interpretation *contra legem* of national law and does not have the effect of determining or aggravating the liability in criminal law of persons who act in violation of the directive.<sup>47</sup> Thus, while the provisions laid down in EU directives cannot be directly applied in horizontal relationships, they may be relied upon by the investor in order to have the conformity of national law with the directive reviewed.<sup>48</sup> To support this argument it must be remembered that since the global financial crisis the level of detail and prescription of the duties imposed on financial services providers under EU law has significantly increased<sup>49</sup> despite the lack of private law remedies for the breach of these duties. The intensification of conduct of business rules is a clear sign that, even in the contractual relationship with the firm, investor protection is assuming crucial importance.

## 6. The Case Law of the Court Of Justice

### 6.1. *The Peter Paul Judgment*

The CJEU addressed the complex problem of the horizontal effect of EU financial regulation in the *Peter Paul* judgment in 2004<sup>50</sup> and the *Genil v. Bankinter* judgment in 2013.<sup>51</sup> The former concerned the interpretation of Directive 1994/19/EC on deposit guarantee schemes<sup>52</sup> and the latter, the interpretation of MiFID I.

In *Peter Paul*, the plaintiffs claimed damages from the German state for deficient prudential supervision by the supervisory authority. However, they were precluded from claiming compensation for loss resulting from defective supervision because a

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<sup>46</sup> See Moslein, *Third Parties in the European Banking Union: Regulatory and Supervisory Effects on Private Law Relationships Between Banks and their Clients or Creditors* 16 *European Business Organisation Law Review* 551 (2015).

<sup>47</sup> CJEU, case C-168/95, *Luciano Arcaro*, ECLI:EU:C:1996:363, para. 42; case C-105/03, *Pupino*, ECLI:EU:C:2005:386, para. 45.

<sup>48</sup> See also Della Negra, *The Transformation of the Retail Financial Transactions in the EU and the Role of Contract Law*, 120. In the case law, see the judgment of the Court of Appeal of Turin of 27 November 2009 available at [www.ilcaso.it](http://www.ilcaso.it) which held that the provisions of the Italian consolidated text of finance (Legislative Decree No 58/1998) must be interpreted in light of Art. 47 of the Italian Constitution and MiFID I. For a different view, see the judgment of the Scottish Court of Session in *Grant Estates Limited v. The Royal Bank of Scotland plc.* [2012] CSOH 133, of 21 August 2012 which refused to interpret the national contract law in light of the purposes of MiFID I.

<sup>49</sup> See Moloney, *Regulating the Retail Markets*, in N Moloney, E Ferran, J Payne (eds.), *The Oxford Handbook of Financial Regulation*, 739 (Oxford, Oxford University Press, 2015).

<sup>50</sup> CJEU, case C-222/02, *Peter Paul*, ECLI:EU:C:2004:606.

<sup>51</sup> CJEU, case C-604/11, *Bankinter*, ECLI:EU:C:2013:344.

<sup>52</sup> Directive 1994/19/EC on deposit guarantee schemes of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes, O.J. 1994 L 135/5, recently replaced by Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, 2014 O.J. L 173/149.

specific banking law rule provided that the functions of the competent supervisory authority were to be carried out only in the public interest. The CJEU noted, interpreting the recitals of several banking directives (Directives 77/780, 89/299 and 89/646), that “it does not necessarily follow either from the existence of such obligations or from the fact that the objectives pursued by those directives also include the protection of depositors that those directives seek to confer rights on depositors in the event that their deposits are unavailable as a result of defective supervision on the part of the competent national authorities”.<sup>53</sup> Moreover, the CJEU held that the very objective of harmonisation pursued by these directives was the mutual recognition of authorisations and of prudential supervision systems. Therefore, the CJEU concluded that a national rule which precludes individuals from claiming compensation for damage resulting from defective supervision on the part of a supervisory authority was compatible with EU law.<sup>54</sup>

This conclusion was based on a rather restrictive interpretation of the “conferring right” quality of the banking directives’ provisions. Whilst it is undisputed that these directives did not confer enforceable rights on depositors, it could be argued that they took into account their legal interests at least in the sense that prudential authorities, when exercising supervision, should balance the interest in the stability of the individual bank with the interest in the protection of its depositors.<sup>55</sup>

## 6.2. *The Bankinter Judgment*

In the *Genil v. Bankinter* case, the referring court asked the CJEU, among other things, whether the omission of the appropriateness and suitability test provided for by Art. 19(4) and (5) of MiFID I in relation to the supply of an interest rate swap to a retail investor could determine the absolute nullity of the contract between the firm and the client. The CJEU noted that, even if MiFID I lays down administrative sanctions for a firm’s breach of national provisions transposing the directive, it does not require the Member States to stipulate contractual consequences for this breach. Therefore, the CJEU held that it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with the obligations, subject to the principles of equivalence and effectiveness.<sup>56</sup> Interestingly, the CJEU did not refer to or quote the *Peter Paul* judgment in support of its argument. This shows that the *Peter Paul* judgment could be a precedent for the interpretation of the

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<sup>53</sup> CJEU, case C-604/11, case C-604/11, *Bankinter*, para. 40.

<sup>54</sup> See, for instance, about the law before the *Bankinter* judgment, M Andenas, *Misfeasance in Public Office, Governmental Liability, and European Influences* 51 *International and Comparative Law Quarterly* 757 (2002) and about other aspects, Raffaele D’Ambrosio, *The Liability of the ECB and the NCAs within the Single Supervisory Mechanism* 78 *Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d’Italia* (2015).

<sup>55</sup> See Michel Tison, *Do not Attack the Watchdog! Banking Supervisor’s Liability after Peter Paul* 42 *Common Market Law Review* 639 (2005).

<sup>56</sup> CJEU, case C-604/11, *Bankinter*, para. 57.

contractual effects of prudential regulation but not conduct regulation.<sup>57</sup> In its concise reasoning, the CJEU made two important points. First, MiFID I does not prohibit Member States from preserving or introducing contract law remedies for a firm's failure to respect national laws transposing MiFID I; second, the national contractual remedies must respect the EU principles of effectiveness and equivalence. Yet, the CJEU did not clarify one of the most problematic aspects which emerged across national jurisdictions in the wake of the financial crisis: does EU law require Member States to provide contract law remedies, alongside administrative sanctions, for a firm's breach of national laws transposing MiFID I?

The reasoning of the CJEU suggests, in our view, that the question should be answered in the affirmative, for the following reasons. First of all, the CJEU twice underlined the importance of the "investor protection" objective in MiFID, by referring to its recitals Nos 2 and 31 and by stressing that MiFID's provisions on conduct of business rules (Art. 19 seq.) should be interpreted in light of this objective.<sup>58</sup> This is even more true with regard to the new MiFID II which has included further references in its recitals to the need to improve the protection of investors and consumers of financial services.<sup>59</sup>

Second, from a more literal perspective, the judgment itself provides further support for our argument. In paragraph 57 of the judgment, the CJEU held that MiFID "does not state either that the Member States must provide for contractual consequences in the event of contracts being concluded which do not comply with the obligations under national legal provisions transposing Article 19(4) and (5) of Directive 2004/39, or what those consequences might be. In paragraph 58, however, the CJEU concluded that it was up to the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness. The different wording used in these two instances suggests that Member States may choose an appropriate contractual remedy for the firm's failure to comply with MiFID, but that they may not choose to provide *no* remedy if this would undermine the effectiveness of MiFID.<sup>60</sup>

Third, if the ruling were interpreted as leaving Member States free to decide whether or not to establish contractual remedies for a firm's breach of MiFID, this would mean that Member States could circumvent the principle of effectiveness of EU law by simply refusing to provide a contractual remedy. This result would, however, conflict with the principle of effectiveness of EU law, which requires that national law (whether public or private) should not make impossible or excessively difficult the exercise of rights conferred on the individual by EU law.<sup>61</sup> Thus, the Member

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<sup>57</sup> See in this sense Moslein, *Third Parties in the European Banking Union: Regulatory and Supervisory Effects on Private Law Relationships Between Banks and their Clients or Creditors*, 552.

<sup>58</sup> CJEU, case C-604/11, *Bankinter*, para. 39.

<sup>59</sup> See the recitals Nos. 77, 156, 177; Art. 24(6), 74(2) and 75(1) of MiFID II.

<sup>60</sup> See Grundmann, *The Bankinter Case on MiFID Regulation and Contract Law* 9 *European Review of Contract Law*, 278.

<sup>61</sup> See, in particular, Michael Dougan, *The Vicissitudes of Life at the Coalface: Remedies and Procedures for Enforcing Union Law*, in Paul Craig and Grainne de Burca (eds.), *The Evolution of EU*

State should be able to prove that despite the lack of private law remedies the protection of individual investor rights against the financial service provider are sufficiently protected by other legal remedies (e.g. administrative sanctions).

It is likely that the CJEU's restrictive answer can be explained by the narrow formulation of the question referred for a preliminary ruling by the national court.<sup>62</sup> But the restrictive approach upheld by the CJEU could also be interpreted as a paradigmatic sign of the CJEU's reluctance to encroach on the very sensitive issue of the interplay between EU law and national contract law, regulation and private autonomy.<sup>63</sup>

In conclusion, we argue that on the basis of the *Bankinter v. Genil* ruling Member States have a duty to provide investors with private law remedies for a firm's failure to respect the EU conduct of business rules unless the Member State proves that other legal remedies already ensure full compliance with the principle of effectiveness under EU law.

## 7. The Impact of EU Financial Regulation on National Private Law

### 7.1. *The Impact of EU Financial Regulation on National Legislation*

Our proposed interpretation of the *Bankinter v. Genil* judgment would increase convergence in the judicial approach to the complex relationship between EU financial regulation and national contract law across Member States.

In the absence of any express EU law provision, Member States have adopted various perspectives on the relationship between EU financial regulation and national contract law. The divergences in national legislation can be summarised in three models. Some Member States, like Spain and France, have decided not to introduce any specific contractual remedies for a firm's failure to respect its conduct of business rules; other Member States, such as Italy, have not introduced any specific contractual remedies but, nevertheless, set out certain rules regarding the form of investment contract and the burden of proof in compensation claims;<sup>64</sup> other Member States, such as the United Kingdom, have introduced an express private cause of action for a firm's failure to comply with the conduct of business rules.<sup>65</sup>

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Law, 424 (Oxford, Oxford University Press, OUP, 2011).

<sup>62</sup> Grundmann, *The Bankinter Case on MiFID Regulation and Contract Law*, 267.

<sup>63</sup> Cherednychenko, *Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law*, 505.

<sup>64</sup> See Arts 23(1) and (6) of the Italian consolidated text of finance (Legislative Decree No 58/1998).

<sup>65</sup> Section 138D of FSMA (replacing the former Section 150 of FSMA). On the interpretation of this provision see, in particular, *Titan Steel Wheels Ltd v. The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm).

## 7.2. *The Impact of EU Financial Regulation on National Case Law*

### 7.2.1. *The Challenges of Complex Financial Disputes for the National Judge*

However, beyond the “law on the books” (i.e. *statute* law), the “law in action” (i.e. *case* law) shows a much more variegated reality. In the wake of the financial crisis, national courts have had to deal with financial disputes involving complex financial instruments (e.g. interest rate swaps, collateralised debt obligations), jurisdictional clauses and bankruptcies. The recurrent issue in the litigation concerns the role and function of the traditional categories of private law (e.g. liability, debt, guarantee, promise) in view of the rapid evolution in financial instruments, market practices and societal customs.<sup>66</sup>

For example, derivative contracts have *de facto* transformed the contractual promise into a matter of risk management. The functioning of a derivative contract, such as for example a credit default swap (CDS), does not substantially differ from a traditional insurance contract regulated by national civil codes: the seller of the CDS compensates the buyer in the event of a loan default (by the debtor) or other credit event. What is remarkably different, however, when compared to traditional insurance contracts, is the systemic relevance of these contractual arrangements, as well as the fact that they are highly standardised throughout global financial markets.

About 90% of all OTC derivatives are governed by the standardised documentation published by the trade association, the International Swaps and Derivatives Association (ISDA).<sup>67</sup> The complexity of financial instruments and practices raises important new challenges for the national judge. First, whilst the contract terms are global, the assets of the parties and the adjudicating courts remain local. Second, such contracts are not individually negotiated and the parties to the contract are not the original drafters of the contract terms. This means that, in order to understand the context of the transaction, the judge should refer to the intention of the original drafters of the terms rather than that of the actual contracting parties.<sup>68</sup> Third, as we mentioned above, the regulatory architecture of such contracts is multi-layered: it comprises self-regulation (standard contract terms), general contract law and financial regulation. But whilst self-regulation and financial regulation are rapidly evolving, the latter following the former, the general law of contract remains formally enshrined in civil codes adopted in the 19th and 20th centuries or in the case law. What role should the traditional categories of private law play in the adjudication of complex financial disputes in the post-crisis era? What is the relationship between these categories and financial regulatory standards?

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<sup>66</sup> See Mortiz Renner, *Death by Complexity: The Financial Crisis and the Crisis of Law* in Poul F Kjaer, Gunther Teubner and Alberto Febbrajo (eds.), *The Financial Crisis in Constitutional Perspective. The Dark Side of Functional Differentiation*, 105 (Oxford, Hart Publishing, 2011).

<sup>67</sup> See in particular Jo Braithwaite, *Standard Form Contracts as Transnational Law: Evidence from the Derivatives Markets* 5 *Modern Law Review* 784 (2012).

<sup>68</sup> See Stephen J Choi, G Mitu Gulati, *Contract as Statute* 104 *Michigan Law Review* 1133 (2006).

The recurrent issue tackled by national courts since the financial crisis is whether, in the absence of EU law provisions, a firm's failure to comply with conduct of business rules may give rise to a remedy based on general contract law. The solutions adopted by national courts are very diverse even within the same jurisdiction.<sup>69</sup>

### 7.2.2. *The National Adjudication Techniques*

Two general approaches can be identified in the case law.

Some national courts maintain a strict separation between financial regulatory standards and private law standards and therefore refuse to enforce regulatory standards through private law remedies. In the UK, for example, national courts have refused, bar a few rare cases,<sup>70</sup> to grant remedies based on general common law to clients who suffered a loss as a result of a firm's failure to comply with the pre-MiFID<sup>71</sup> and MiFID-derived conduct of business rules.<sup>72</sup> The U.K. court approach is based on the idea that the autonomy of general common law, and consequently, the principle of private autonomy should be protected against the 'intrusions' of EU-derived regulatory standards. Separating financial regulation and contract law is instrumental in achieving greater private autonomy, which helps to foster financial innovation and strengthen commercial and legal certainty.<sup>73</sup> To achieve these objectives, UK Courts attach a crucial importance to the contractual documentation freely agreed between the parties,<sup>74</sup> i.e. by deciding that in the absence of advisory agreement no duty to advise can arise at common law<sup>75</sup> and that, in the absence of an express contractual provision, regulatory duties cannot be incorporated into the contract and cannot be actionated by way of contractual remedies.<sup>76</sup>

Other national courts (in particular, in Italy, Spain and France) have held that a firm's failure to comply with its conduct of business rules may give rise to an implied remedy based on general contract law. The underpinning rationale is that general contract law should support EU-derived regulatory standards in order to increase the protection of retail clients. To achieve this objective, national courts, rather than focussing on contractual documentation, focus on the purposive interpretation of

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<sup>69</sup> See for an overview, Danny Busch, *Why MiFID Matters to Private Law – The Example of MiFid's Impact on an Asset Manager's Civil Liability* 7 Capital Markets Law Journal 386 (2012).

<sup>70</sup> *Loosemore v. Financial Concepts* [2001] Lloyd's Rep. P.N. 235; *Seymour v. Caroline Ockwell & Co.* [2005] EWHC1137 (QB); *Shore v. Sedgwick Financial Services Ltd* [2007] EWHC 2509 (QB); *Rubenstein v. HSBC Bank plc* [2012] EWCA Civ 1184.

<sup>71</sup> See, inter alia, *JP Morgan Chase Bank v. Springwell Navigation Corporation* [2008] EWHC 1186 (Comm) 2008 WL 2148250; *Green v. Royal Bank of Scotland Plc* [2012] EWHC 3661 (QB).

<sup>72</sup> See, inter alia, *Crestsign Ltd v. National Westminster Bank plc and Royal Bank of Scotland plc* [2014] EWHC 3043 and *Thornbridge Ltd v. Barclays Bank Plc* [2015] EWHC 3430 (QB).

<sup>73</sup> See, Michael Bridge, Jo Braithwaite, *Private Law and Financial Crises 2* Journal of Corporate Law Studies 1 (2013).

<sup>74</sup> See Kern Alexander, *Bank Civil Liability for Mis-selling and Advice* in Danny Busch, Cees Van Dam (eds.), *A Bank's Duty of Care*, 253 (Oxford, Hart Publishing, 2017).

<sup>75</sup> *JP Morgan Chase Bank and Others v. Springwell Navigation* [2008] EWHC 1186 (Comm), para. 440.

<sup>76</sup> *Clarion Ltd v. National Provident Institution* [2000] 1 WLR 1888.



national private law in light of EU-derived regulatory standards (suitability and appropriateness rules).

However, the courts' approach differ with regard to the type of remedy awarded to retail investors (e.g. absolute nullity, avoidance for mistake, liability).

In Italy, between 2005 and 2007, several courts held that a firm's failure to comply with the national rules implementing the ISD (when providing financial services to retail clients in relation to Cirio, Parmalat and Republic of Argentina bonds)<sup>77</sup> provoked the absolute nullity of the contract for the breach of mandatory rules pursuant to Art. 1418(1) of the Civil code.<sup>78</sup> This judicial reasoning was based on the premise that, since the conduct of business rules are rules of public order (*ordre public*), they are tantamount to imperative contract terms and therefore their breach enables the investor to claim the nullity of the contract for breach of imperative rules.<sup>79</sup>

By contrast, other courts have held that a breach of the conduct of business rules gives rise to avoidance of the contract for mistake or fraud<sup>80</sup> or determines pre-contractual<sup>81</sup> or contractual liability<sup>82</sup> of the financial service provider.<sup>83</sup>

In 2007, the Plenary Session of the Italian Supreme Court held, in two landmark judgments,<sup>84</sup> that a breach of the conduct of business rules would not engender the absolute nullity of the contract because conduct of business rules, whilst mandatory, do not qualify as imperative rules under Art. 1418(1) of the Civil code. According to the Supreme Court, violation of these rules by the financial service provider could only give rise to pre-contractual or contractual liability; thus it falls to the plaintiff to prove the loss suffered as a result of an alleged breach of these rules. These judgments are based on a theoretical and formalistic distinction between rules of conduct, which govern the parties' behaviour before, during and after the conclusion of the contract, and rules of validity, which govern the formal and structural requirements of the contract. However, this distinction is not expressly laid down in the law and, more importantly, it risks undermining the effective protection of retail investors who may

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<sup>77</sup> See Francesco Capriglione, *Crisi di sistema ed innovazione normativa: prime riflessioni sulla nuova legge sul risparmio (l. n 262 del 2005)* 2 *Banca, borsa e titoli di credito* 125 (2006).

<sup>78</sup> See, in particular, Trib. Mantova, 18 March 2004 and Trib. Mantova, 12 November 2004. Available on [www.ilcaso.it](http://www.ilcaso.it).

<sup>79</sup> See for this thesis Michel Tison, *The Civil Law Effects of MiFID in a Comparative Law Perspective* 5 Working Paper Financial Law Institute (2010).

<sup>80</sup> See, in particular Trib. Roma, 16 May 2005, Trib. Bologna, 18 December 2006. Available on [www.ilcaso.it](http://www.ilcaso.it).

<sup>81</sup> See Cass. 29 settembre 2005, n 19024. Available on [www.ilcaso.it](http://www.ilcaso.it).

<sup>82</sup> See in particular Trib. Firenze, 18.10.2005; Trib. Genova, 19.10.2006. Available on [www.ilcaso.it](http://www.ilcaso.it).

<sup>83</sup> For an overview of the case law see Vincenzo Roppo, *La tutela del risparmiatore fra nullità, risoluzione e risarcimento, (ovvero, l'ambaradan dei rimedi contrattuali)*, 3 *Contratto e impresa* 896 (2005) and Fernando Greco, *Informazione pre-contrattuale e rimedi nella disciplina dell'intermediazione finanziaria* (Milano, Giuffrè, 2010).

<sup>84</sup> Cass. Sez. Un., 19 dicembre 2007, nn. 26724 e 26725 commented, inter alia, by Enrico Scoditti, *La violazione delle regole di comportamento dell'intermediario finanziario e le sezioni unite 1 Foro italiano* 748 (2008); Emanuele Lucchini-Guastalla, *Violazione degli obblighi di condotta e responsabilità degli intermediari finanziari? 2 Responsabilità civile e previdenza* 748 (2008); Roppo, *La nullità virtuale del contratto dopo la sentenza Rordorf* 3 *Danno e responsabilità* 536 (2008).

find it difficult to prove the firm's breach of conduct of business rules.<sup>85</sup> It must be noted, however, that in some recent judgments Italian courts have declared null and void OTC interest rate swaps (not based on ISDA model agreements) for a lack of consideration on the nature of the risks involved in the financial instrument (*causa*) pursuant to Art. 1418(2) of the Civil code.<sup>86</sup> Interestingly, in such cases the contract was not annulled for mere lack of information but because this lack of information meant that the investors could not have been aware of the imbalance of power vis-à-vis the financial firm. As a result, the likelihood of monetary risk protection was frustrated, inexistent or reduced by the contract.

In the wake of the global financial crisis, Spanish courts have faced a wave of financial litigation concerning the mis-selling of *participaciones preferentes*, interest rate swaps and Lehman Brothers' products. Similarly to Italian courts, the Spanish courts have had to seek the most appropriate contractual remedy for a firm's failure to respect MiFID's suitability and appropriateness tests.<sup>87</sup> Unlike in Italy and in the United Kingdom, the most important remedy applied by national law is the avoidance of the contract for mistake pursuant to Art. 1265 of the Civil code. In a recent string of cases, the Spanish Supreme Court, referring to the judgment of the CJEU in *Bankinter v. Genil*, held that a firm's failure to carry out the appropriateness test required by MiFID I could give rise to an error invalidating the consent of the client.<sup>88</sup> In particular, the Supreme Court has clarified that while the lack of performance of such assessment does not itself imply the existence of an error invalidating consent, it does not preclude its presumption. Thus, the error must take place in relation to the subject-matter of the contract. In swaps contracts, the error must concern the risks associated with that instrument. This means, then, that the provision of understandable and appropriate information, comprising "guidelines and warnings about the risks associated with those instruments", becomes essential for a retail client to legitimately give his consent.

In France, civil courts have consistently held that an investment firm's failure to respect MiFID's conduct of business rules, as transposed by Art. L. 533 of the *Code monétaire et financier*, leads to a breach of the investment contract pursuant to Art. 1147 of the Civil code. The Supreme Court has specified that the duty of a bank to warn its client(s) of the risks associated with a transaction only lies where the financial instrument is of a so-called "speculative nature" (*caractère spéculatif*) – i.e. instruments subject to a high level of exposure, traded on future markets – or where the client is not a sophisticated investor (*investisseur averti*) and is therefore unable

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<sup>85</sup> See Guido Alpa, *Gli obblighi informativi precontrattuali nei contratti di investimento finanziario. Per l'armonizzazione dei modelli regolatori e per l'uniformazione delle regole di diritto comune* 3 *Contratto e Impresa* 131 (2008).

<sup>86</sup> See Corte App. Milano, 18 September 2013; Corte App. Torino, 22 April 2016. Available on [www.ilcaso.it](http://www.ilcaso.it).

<sup>87</sup> See Fernando Zunzunegui, *Mis-selling of Preferred Shares to Spanish Retail Clients* 29 *Journal of International Banking Law and Regulation* 174 (2014).

<sup>88</sup> See judgments of the Supreme court 4 February 2016, 323/2016; 20 January 2014, No 840/2013, 15 September 2015, No 491/2015, / July 2014, No 384-384/2014.

to assess his/her financial exposure.<sup>89</sup> Thus, in the absence of a specific remedy provided under the “*droit spécial*” the judge must apply the remedies of the “*droit général*”.<sup>90</sup>

Similarly, the Dutch Supreme Court in *Levob v. B, De Treek v. Dexia* and *Stichting Gedupeerden Spaarconstructie v. Aegon*<sup>91</sup> held the banks responsible for breaching the duty of care. Even if the duty to know one’s client had not been included in the financial supervision legislation then in force, the Supreme Court held that private law duties of care could extend further than the public law duties of care contained in the conduct of business rules.<sup>92</sup>

A similar solution has been adopted by the German civil courts.<sup>93</sup> According to the German Supreme Court, a firm’s failure to comply with its conduct of business rules does not determine per se the avoidance of the contract but it may give rise to pre-contractual liability and breach of contract.<sup>94</sup>

### 7.2.3. *The (Regulatory) Implications of Adjudication’s Techniques*

The foregoing overview on the national case law has brought to light differences between the continental and common law approaches to dispute resolution. The continental courts promote a gradual integration between regulatory and contract law duties. The common law courts, instead, seem to separate these two sets of duties. Both approaches have regulatory implications. The continental approach attaches to courts the role of supplementing financial regulation, supervision and public enforcement, by compensating clients who suffered a loss as a result of mis-selling of financial instruments. By contrast, the common law approach is instrumental to foster financial innovation and market efficiency because it assigns primary importance to the parties’ agreement and self-responsibility.<sup>95</sup>

The difference between these two approaches, whilst reflecting historical divergences between civil and common law that cannot be investigated in this paper, should, nevertheless, not be over-emphasised because the factual context of the disputes is very different.

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<sup>89</sup> Cass. com., 5 Novembre 1991, n° 89-10005 (*Buon* case); Cass. com., 19 September 2006, n°05-15.305 (*Benefic* cases); Com., 26 February 2008, *Bull.* 2008, IV, n° 42, pourvoi n° 07-10.761 ; Com., 1 July 2008, pourvoi n° 07-16.461.

<sup>90</sup> See Denis Mazeaud, *Droit commun du contrat et droit de la consommation nouvelles frontières? – Etudes de droit de la consommation – Liber Amicorum Jean Calais-Auloy*, 703 (Paris, Dalloz, 2004).

<sup>91</sup> HR 5 June 2009, NJ 2012, 182, 183 and 184.

<sup>92</sup> Cherednychenko, *The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?*, 421.

<sup>93</sup> See on this debate Grundmann, *Commentary to §§ 31 et seq, Bankrecht VI – Wertpapierhandels-gesetz*’ in C Ebenroth, K Boujong, D Joost and L Strohn (eds.), *HGB-Kommentar*, 2 vol, BankRparaVI 229 et seq 266 (1st ed., Munich: CH Beck, 2001).

<sup>94</sup> See, in particular, BGH, 22.3.2011, XI ZR 33/10 commented by M Haas, Lindenmaier-Möhring *Kommentierte BGH-Rechtsprechung (LMK)* 2011, 318031.

<sup>95</sup> See, on the impact of courts on contractual innovation, Ronald J Gilson, Charles F Sabel, Robert E Scott, *Contract and Innovation: The Limiter Role of Generalist Courts in the Evolution of Contractual Forms* 88 *New York University Law Review* 170 (2013).

The UK courts adjudicate high level claims disputes which involve, almost always, sophisticated retail clients (i.e. firms) or non-retail clients, who are supposed to have a sufficient knowledge, experience and financial resources to understand the terms and conditions of financial agreements; by contrast, the disputes before civil law courts, especially in Italy and Spain, often involve small claim disputes concerning unsophisticated retail clients who do not have any knowledge and experience of securities markets (i.e. retired persons).<sup>96</sup>

This context-driven consideration suggests that the role of private law-making and enforcement in financial markets should be analysed taking into account, besides national courts, also other institutional mechanisms, such as out-of-court dispute resolution, which can support courts in the ‘management of conflict between firms and clients.’<sup>97</sup>

## 8. The Role of Alternative Dispute Resolution (ADR) Mechanisms

### 8.1. *The Influence of EU Law on ADR: From Convergence to Harmonisation*

Since the outbreak of the global financial crisis, ADR mechanisms have also assumed increasing importance in the adjudication of retail client disputes. At the EU level, the out-of-court resolution of financial disputes has become an essential element of retail financial market regulation, first, through the establishment of the FIN-NET network, and, second, through ‘light-touch’ harmonisation of national laws.<sup>98</sup> In 2001 the European Commission launched the FIN-NET network to facilitate cross-border retail client dispute resolution. The FIN-NET, however, is a mechanisms of coordination which does not introduce any harmonisation of the institutional rules governing ADR at the national level. An important step towards legislative harmonisation was made by the MiFID I which required Member States to establish “efficient and effective complaints and redress procedures for the out-of-court settlement of consumer disputes” (Art. 53). The MiFID II reiterated the same principle but did not introduce any specific requirement on how Member States should design ADRs and what remedies they can grant. Therefore, these ADR shall remain subject to the principles laid down by the new Directive on consumer ADR adopted in 2013 which encourages Member States to develop ADR networks, such as the financial dispute resolution

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<sup>96</sup> See Della Negra, *The Transformation of the Retail Financial Transactions in the EU and the Role of Contract Law* in G Comparato, H-W Micklitz, Y Svetiev, *European Regulatory Private Law – Autonomy, Competition and Regulation in European Private Law* 6 EUI Working Paper LAW 119 (2016).

<sup>97</sup> See Micklitz, *The Transformation of Enforcement in European Private Law: Preliminary Considerations* 4 *European Review of Private Law* 523 (2015) and Cherednychenko, *Public and Private Enforcement of European Private Law in the Financial Services Sector* 4 *European Review of Private Law* 621 (2015).

<sup>98</sup> See Della Negra, *The Private Enforcement of the Mifid Conduct of Business Rules. An Overview of the Italian and Spanish Experiences* 4 *European Review of Contract Law* 587 (2014).

network ‘FIN-NET’ in the area of financial services, and to foster the inclusion of national ADR mechanisms in this network.<sup>99</sup>

A remarkable novelty of the MiFID II is that it requires Member States to set up mechanisms “to ensure that compensation may be paid or other remedial action be taken in accordance with national law for any financial loss or damage suffered as a result of an infringement of this Directive or of Regulation (EU) No 600/2014” (Art. 69).<sup>100</sup> Although this innovative provision does not confer an express private law remedy to clients it certainly strengthens the private enforcement of MiFID II conduct of business rules, namely by ‘importing’ in EU law the UK enforcement model of the ‘consumer redress scheme’ of Section 404 of FSMA which provision empowers the Financial Conduct Authority to require financial firms to establish and operate a consumer redress scheme when there may have been a widespread or regular failure by relevant firms to comply with its conduct of business rules, consumers have suffered (or may suffer) loss or damage and it considers that it is desirable to make rules for the purpose of securing that redress is made to the consumers.

## 8.2. *The National Models of ADR*

However, the institutional nature and remedies awarded by national ADR schemes differ significantly from one country to another. Some ADR schemes are public or publicly funded (*Arbitro Bancario e Finanziario*, ABF in Italy); others are private or privately funded (*Ombudsman-giuri bancario* in Italy). Some provide mere recommendations to investment firms (*Comisionado para la Defensa del Cliente* in Spain); others adjudicate the dispute through a binding determination (ABF and Financial Ombudsman Service, FOS in the UK). It is also important to note that some “adjudicative” ADRs, like the ABF, seriously take into account statute law and case law,<sup>101</sup> whilst others, in particular the FOS, determine the complaint by reference to what is “fair and reasonable in all the circumstances of the case”.<sup>102</sup> The British courts have emphasised the importance of this ‘informal’ approach to dispute resolution by holding that the FOS is not bound by common law<sup>103</sup> and that its determinations can be set aside by means of judicial review only if “his opinion as to what is fair and reasonable in all the circumstances of the case is perverse or irrational”.<sup>104</sup> The nature of

<sup>99</sup> See Recital No 53 of Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Directive on consumer ADR).

<sup>100</sup> See, with more detail on the interpretation of this provision, Della Negra, *The Effects of the ESMA’s Powers on Domestic Contract Law*, 155.

<sup>101</sup> See Angelo Dolmetta, *Trasparenza dei prodotti bancari. Regole* (Bologna, Zanichelli, 2013).

<sup>102</sup> See Section 228 FSMA 2000. The FOS shall take into account, among other things, the relevant law and regulations (DISP 3.6.4 of FCA Handbook Dispute Resolution Complaints). See G Alpa, *Gli obblighi informativi precontrattuali nei contratti di investimento finanziario*, 910.

<sup>103</sup> See *R. (on the application of London Capital Group) v. Financial Ombudsman Service Ltd* [2013] EWHC 2425 (Admin).

<sup>104</sup> See *R. (on the application of IFG Financial Services Ltd v. Financial Ombudsman Services Ltd v. Mr and Mrs Jenkins* [2005] EWHC 1153 (Admin).

the FOS' adjudication, together with its broad competence (up to £ 150,000), gives to retail unsophisticated investors, who could not afford access to courts, an effective way to protect their rights vis-à-vis financial firms.<sup>105</sup>

## 9. Concluding Remarks

The preceding analysis has investigated the complex interactions between EU financial regulation and national contract law. The wave of mis-selling practices involving complex financial instruments, the infamous financial fraud and the various banking failures have caused significant losses to retail investors and have increased financial litigation across Europe. EU law has reacted to this serious situation by increasing the level of regulation, through the imposition of new conduct of business rules, and by harmonising the public enforcement and supervision of financial regulation. Contract law has remained in the shadow of EU post-crisis financial regulation; the regulation of contractual duties and remedies is still predominantly based on national law and varies widely across jurisdictions.

Our research, based on an analysis of the statute law and case law in several Member States, has underlined two important findings. First, in most European countries judicial enforcement of EU financial regulation has provided certain options to investors in terms of compensation and deterrence. In Italy and Spain, in particular, national courts have played a fundamental role in protecting investors against mis-selling practices, often compensating for the weaknesses of public enforcement and supervision. Although it could be argued that an excessive level of litigation may endanger market efficiency, in several countries national courts have been successful in compensating retail investors for the losses suffered as a result of widespread mis-selling practices.<sup>106</sup>

Second, the general law of contract, which is often neglected in academic studies on financial regulation, has proved to be an adaptable and flexible tool to achieve a high level of investor protection. The case law in several EU countries (e.g. Italy, Spain, France, Germany, Netherlands) shows an ongoing process of 'Europeanisation' and 'modernisation' of general contract law and its traditional categories (e.g. liability, validity) which suggests gradual convergence between financial regulatory standards and contractual standards.<sup>107</sup>

In our view, this judicial development should be normatively welcomed. The traditional categories of contract law should not represent an outdated toolbox. On the

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<sup>105</sup> See, for the impact of the FOS adjudication of payment protection insurance (PPI)-related disputes, Ferran, *Regulatory Lessons From the Payment Protection Insurance Mis-Selling Scandal in the UK* 4 *European Business Organization Law Review* 247 (2012).

<sup>106</sup> See Andrea Perrone, Stefano Valente, *Against All Odds: Investor Protection in Italy and the Role of Courts* 13 *European Business Organization Law Review* 21 (2012).

<sup>107</sup> See Della Negra, *The Private Enforcement of the MiFID Conduct of Business Rules*, 592.

contrary, they can be effectively used as flexible theoretical tools to enhance legal and commercial certainty by conceptualising a rapidly evolving reality.<sup>108</sup>

One important implication of these ongoing processes (Europeanisation and modernisation) is the growing interdependence and integration between financial regulatory standards and contractual standards. EU law has designed financial regulation as a self-sufficient body of law, which should theoretically at least steer the parties' behaviour without needing to rely on traditional contract law.<sup>109</sup> As we mentioned above, this regulatory technique aims to set limits to the economic activity of market participants by overcoming the different private law regulations existing at the national level.<sup>110</sup> However, after the global financial crisis and the widespread mis-selling scandals, fraud and bankruptcies which followed, there was a pressing need to ensure a high level of investor protection and the effectiveness of EU law. For these reasons, the remedies based on the general law of contract have become necessary tools to support and complement the financial regulatory tools (i.e. information duties) and provide a high level of investor protection.

Of course, the national judge-made modernisation of general contract law cannot overcome per se the high degree of divergence in private law-making and enforcement that has arisen across national jurisdictions. The regulatory approach of Member States and the judgments of national courts still differ significantly as regards the kinds of private law remedy that investors can rely on to recoup losses suffered as a result of a firm's failure to comply with EU conduct of business rules, as transposed in national law. In fact, whereas the modernisation of contract law is visible in continental Europe, in the UK national courts have maintained a more conservative approach when interpreting contract clauses and have refused to interpret the general common law in light of the objectives of EU financial regulation.

Although the EU is still struggling to introduce harmonised rules on the civil liability of financial service providers, there is some evidence of a new trend towards the strengthening of private enforcement of conduct regulation. The innovative provision of Art. 69 of the MiFID II, read in light of the *Bankinter* judgment, suggests that Member States should introduce mechanisms (judicial and extra-judicial) to confer on individual clients the right to enforce EU-derived regulatory standards, thus strengthening the effectiveness of EU financial regulation. It is our conviction that, the effective enforcement of EU conduct regulation is a necessary precondition to ensure the credibility of EU client protection regulation, strengthen the investors' confidence in the EU financial markets and mitigate the systemic risk arising from firms' mis-conducts.

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<sup>108</sup> See Lipari, *Categorie civilistiche e diritto di fonte comunitaria* 1 *Rivista trimestrale di diritto e procedura civile* 20 (2008).

<sup>109</sup> See Micklitz, Svetiev, *A Self-Sufficient European Private Law – A Viable Concept?* 31 *EUI Working Papers Law* 23 (2012).

<sup>110</sup> See also Louic Azoulai, *The Complex Weave of Harmonization*, in Damian Chalmers, Anthony Arnall (eds.), *The Oxford Handbook of European Union Law* (Oxford, Oxford University Press, 2015).