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PROJET DE COMMENTAIRE SUR LE PROJET DE PRINCIPES DE LA HAYE SUR LE CHOIX DE LA LOI APPLICABLE EN MATIÈRE DE CONTRATS INTERNATIONAUX

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DRAFT COMMENTARY ON THE DRAFT HAGUE PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL CONTRACTS

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The Commentary is the product of the Working Group, the composition of which is set out on the Hague Conference website (see here). Various members of the Working Group have had primary drafting responsibility for certain Articles. They are as follows:

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Article 1	Yuko Nishitani and Francisco Garcimartín
Article 2	Lauro Gama and Geneviève Saumier
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Article 4	Dieter Martiny and Jan Neels
Article 5	Jan Neels and Dieter Martiny
Article 6	Marielle Koppenol-Laforce and Thomas Kadner Graziano
Article 7	Bénédicte Fauvarque-Cosson and Ivan Zykin
Article 8	Yuko Nishitani and Dieter Martiny
Article 9	Francisco Garcimartín and Richard Frimpong Oppong
Article 10	Neil Cohen and Daniel Girsberger
Article 11	Andrew Dickinson and Geneviève Saumier
Article 12	Yuko Nishitani and Francisco Garcimartín

Introduction to the Commentary on the Hague Principles on Choice of Law in International Contracts

The Hague Principles on Choice of Law in International Contracts ("the Principles"), consisting of 12 articles on choice of law in international contracts, are a response to private international law questions arising out of contracts with a cross-border element in international commercial law. The Principles cut across the dividing line between common law and civil law, and are intended to be used in both judicial and arbitral proceedings. Developed over several years, these ground-breaking Principles are the first legal instrument on a global level to address choice of law in international contracts.

The Principles represent the outcome of many years of research, discussions and negotiations. In 2006, the Special Commission (later to become the Council) on General Affairs and Policy ("the Council"), the governing body of the Hague Conference on Private International Law ("Hague Conference"), issued a mandate to its Secretariat (the Permanent Bureau) to conduct a series of feasibility studies on the development of an instrument concerning choice of law in international contracts. These studies focussed on existing rules and practices regarding choice of law agreements in the judicial and arbitral arenas. In 2009, following the outcome of, and recommendations flowing from, the studies, a Working Group was formed to draft a non-binding international instrument for choice of law rules applicable to international contracts, which would later become the Principles. The group consisted of specialists in private international law and international arbitration law drawn from different legal systems from all corners of the globe. In the ensuing years, the Working Group met on various occasions. In 2012, a Special Commission discussed the Draft Hague Principles proposed by the Working Group, unanimously approved a revised form of the Principles, and made a number of recommendations relating to the completion of the Principles and their accompanying Commentary. In line with these recommendations, in April 2013, the Council endorsed the Draft Hague Principles. In [**to be completed],** the Council adopted the Principles, as presented in this document.

As to their form, the Principles are relatively short, comprising only 12 articles. They attempt to address those problems in the choice of law arena that warrant dedicated treatment. Furthermore, a detailed Commentary accompanies each article and serves as an explanatory and interpretative tool for a better understanding of the Principles. The Commentary also includes practical examples to further expound the black letter rules.

In substance, the Principles will bring much needed legal certainty by providing standard rules that can be universally applied. They are intended to assist legal practitioners in drafting choice of law clauses, judges and arbitrators in resolving choice of law issues, and legislators in modernising or complementing their domestic law. The Principles are addressed, in particular, to States that do not sufficiently recognise party autonomy, are a means of refining party autonomy for those that do and are a source for filling existing gaps in the laws of those States that do not have or have only a partial set of established rules on this subject. The potential, positive impact of the Principles in international commercial law is, therefore, far-reaching.

The Principles' purpose and aim – to complement and refine already existing legal instruments – fulfils the Hague Conference's 120-year old mission of gradual unification in private international law. By operating alongside existing legal instruments that have garnered particular success in this specific field, such as the 1980 *United Nations Convention on Contracts for the International Sale of Goods* ("CISG"), the 2010 *UNIDROIT Principles of International Commercial Contracts* ("UPICC") and the 1985 *UNCITRAL Model Law on International Commercial Arbitration* as revised in 2006 ("UNCITRAL Model Law"), they complement and complete already existing rules and principles by specifically addressing the issue of the choice of law in international contracts.

The Principles are also innovative in that they are the first *non-binding* legal instrument produced by the Hague Conference. Their non-binding character means that they do not constitute a body of positive law as such. The positive law to be applied by a court (or even an arbitral tribunal) may differ from the Principles. This especially applies in respect of procedural

issues classified as such by the *lex fori*. For instance, in some countries the *lex fori* may continue to apply to prescription and limitation periods notwithstanding Article 9(1)(d). The lack of consensus, mainly because of the existence of binding regional instruments such as Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations ("Rome I Regulation") and the *Inter-American Convention of 17 March 1994 on the Law Applicable to International Contracts* ("Mexico City Convention"), is the main reason for the Hague Conference's Council having mandated the development of a *non-binding* legal instrument for the first time in its extended history. Nonetheless, this novel approach offers the advantage of providing an opportunity to create a flexible legal instrument that is more likely to lead to international consensus. In addition, while the Principles neither apply to non-commercial contracts, nor to conflict of laws among different territorial units within one State, the "end-users" retain the option of applying the Principles to such matters.

The Principles are both topical and forward-thinking, taking a clear stance on private international law issues for which consensus is lacking. One of the salient features is found in Article 2(4), which allows for a choice of a law with no connection to the parties or their transaction. In certain jurisdictions, where the Principles may have particular influence, the traditional view is that the chosen law must be objectively connected to the transaction or the parties. Furthermore, the Principles allow the parties not only to choose the law of a State but also to choose "rules of law" within certain parameters set out by Article 3. This is a novel feature of the Principles because, although arbitral tribunals typically endorse the choice of rules of law, courts in many jurisdictions have not done so. The Principles also espouse the principle of *dépeçage* (Art. 2(2)) which permits parties to choose laws or rules of law to apply to different parts of the contract. It is anticipated that, if only because of these innovative features, the Principles will advance party autonomy but in a well-thought out and balanced way.

The Principles delineate their own scope of operation, namely the parties' choice of law in international contracts. Eventually, the Principles may be transformed into a binding convention covering additional choice of law issues raised by international contracts. Presently, however, there are certain areas which the Principles do not cover, such as procedural issues.

The Principles presented here are the result of years of diligent work by the Working Group with the assistance of the Permanent Bureau. The Hague Conference is confident that the Principles will accomplish their aim – the advancement of party autonomy – within the broader context of harmonising choice of law in private international law.

The Preamble

Paragraph 1
This instrument sets forth general principles concerning choice of law in international commercial contracts. They affirm the principle of party autonomy with limited exceptions.

Paragraph 2
They may be used as a model for national, regional, supranational or international instruments.

Paragraph 3
They may be used to interpret, supplement and develop rules of private international law.

Paragraph 4
They may be applied by courts and by arbitral tribunals.

P.1 The Preamble introduces the nature (para. 1), objective (para. 1) and intended purposes (paras 2-4) of the Principles as a non-binding instrument.

Preamble, paragraph 1

P.2 The provisions of the instrument are described as "general principles"; a term that reflects their character as part of a non-binding instrument (hence also the title *Principles*; *cf.* the use of the word principles in the titles of the UPICC and the 2002 Principles of European Contract Law ("PECL")). The Principles address party autonomy in choice of law in international commercial contracts, as described in Article 1(1) and (2); they do not apply to consumer or employment contracts (Art. 1(1)). The instrument may be considered as a code of current best practice with respect to choice of law in international commercial contracts, as recognised at an international level, with certain innovative provisions as appropriate.

P.3 The objective of the instrument is the affirmation of party autonomy in choice of law in the context of international commerce (also see the Basel Resolution (1991) of the *Institute de droit international*). Endorsing party autonomy meets the legitimate expectations of the parties operating in this environment and, as such, advances foreseeability and legal certainty. The Principles therefore affirm the freedom of parties to an international commercial contract (see Art. 1(1)-(2)) to choose the law applicable to it (see Arts 2-3). The Principles, however, provide limited exceptions to party autonomy, for instance in Articles 6(2) and 11.

Preamble, paragraph 2

P.4 One of the objectives of the instrument is the acceptance of its principles in existing and future private international law codes, producing a substantial degree of harmonisation of law, on a national, regional, supranational and international level, in respect of choice of law in international commercial contracts. It is envisaged that a more comprehensive, future Hague instrument on the law applicable to contractual obligations would undoubtedly draw on the instrument to a considerable degree.

Preamble, paragraph 3

P.5 The Principles may be used by courts and arbitral tribunals (see Preamble, para. 4) to interpret, supplement and / or develop rules of private international law. These rules may exist on a national (including state and provincial), regional, supranational or international level and may involve, for instance, conventions, regulations, legislation or case law. *Interpretation* here refers to the process of explaining, clarifying or construing the meaning of existing rules of private international law. *Supplementation* in this context refers to the refinement of an existing rule that does not sufficiently or appropriately provide for a particular type of

situation. Although the *development* of rules of private international law may include their constructive interpretation or supplementation, the concept in the context of this paragraph particularly refers to the addition of new rules where none existed before or effecting fundamental changes to pre-existing ones.

Preamble, paragraph 4

P.6 Both courts and arbitral tribunals are encouraged to apply the Principles in the interpretation, supplementation and development of the rules of private international law (see Preamble, para. 3), in all cases where this would not be in conflict with binding law. All articles were drafted for use by courts and arbitral tribunals. However, the last part of Article 3 ("unless the law of the forum provides otherwise") applies exclusively to courts, while Article 11 differentiates between courts and tribunals (see Preamble, paras 1-4 and para. 5, respectively).

Article 1
Scope of the Principles

Paragraph 1
These Principles apply to choice of law in international contracts where each party is acting in the exercise of its trade or profession. They do not apply to consumer or employment contracts.

Paragraph 2
For the purposes of these Principles, a contract is international unless the parties have their establishments in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State.

Paragraph 3
These Principles do not address the law governing:

a) the capacity of natural persons;
b) arbitration agreements and agreements on choice of court;
c) companies or other collective bodies and trusts;
d) insolvency;
e) the proprietary effects of contracts;
f) the issue of whether an agent is able to bind a principal to a third party.

Introduction

1.1 The Purpose of Article 1 is to determine the scope of application of the Principles. This scope is defined by three criteria: the Principles apply to choice of law agreements (i) in *contractual* matters when the contract is (ii) *international* and (iii) neither a consumer nor employment contract.

1.2 The structure of Article 1 is the following. Article 1(1) delimits the scope of application of the Principles and contains a definition of commercial contracts. Article 2(2), together with Article 12, contains a definition of international contracts. Article 2(3) contains a list of issues or matters excluded from the scope of the Principles.

Article 1(1)

Rationale

1.3 The Principles apply to choice of law agreements in international contracts where each party is acting in the exercise of its trade or profession. An explicit clarification is included confirming that the Principles do not apply to consumer or employment contracts.

1.4 The scope of application of the Principles is confined to commercial contracts in respect of which party autonomy is widely accepted. The Principles do not, however, preclude States from applying them to other types of contracts (see para. 1.11). In 2008, "[t]he Council invited the Permanent Bureau to continue its exploration of this topic concerning international *business-to-business contracts* with a view to promoting party autonomy" (Conclusions and Recommendations adopted by the Council on General Affairs and Policy of the Conference (1 to 3 April 2008), p. 1, and in 2009, "[t]he Council invited the Permanent Bureau to continue its work on promoting party autonomy in the field of international *commercial contracts*" (Conclusions and Recommendations adopted by the Council on General Affairs and Policy of the Conference (31 March to 3 April 2008), p. 2). The rationale is to enhance and establish party autonomy in international contracts, but only in those situations in which both parties act in their professional capacity, and the risks of an abuse of party autonomy are therefore

minimised. Being a non-binding instrument, however, the Principles do not preclude legislators or others from extending them to other types of contracts (see para. 1.11).

Definition of commercial contracts

1.5 That the scope of the Principles is limited to commercial contracts is stated in the first paragraph of the Preamble. The term "commercial contracts" is used, among other instruments, by the UPICC. To clarify the meaning of the term "commercial contracts", Article 1(1) contains: (i) a positive definition of such term; and (ii) an explicit exclusion of consumer and employment contracts.

1.6 While the Preamble describes the scope of the Principles as being limited to "commercial contracts", Article 1 does not use that phrase. Rather, Article 1(1) describes contracts within the scope of the Principles as those "*… where each party is acting in the exercise of its trade or profession*". This formulation is inspired by Article 6(1) of the Rome I Regulation, which defines a consumer as a natural person acting for a purpose which can be regarded as being outside his or her trade or profession. The definition of Article 1(1) is the converse, indicating cases where each party is acting in the exercise of its trade or profession. This definition is important because it introduces an autonomous concept of commercial contracts for the purpose of the Principles (Preamble, para. 1). This concept does not necessarily mirror the traditional distinction in some jurisdictions between civil and commercial transactions. In some jurisdictions, consumer contracts are characterised as commercial contracts, since one of the parties is a professional. For the Principles to be applied, both (or all) parties must be acting in the course of their trade or profession.

1.7 The definition is formulated in broad terms. The term "*party*" includes any natural or legal person: for example, independent or self-employed persons, companies, foundations, partnerships, unincorporated associations or even publicly owned entities. Parties are not required to have extensive experience or skill in their specific trade or profession. Furthermore, the use of the terms *"trade or profession"* makes it clear that the definition includes both commercial activities of merchants, manufacturers or craftsmen (trade transactions) and liberal professions such as lawyers or architects (provision of professional services). Insurance contracts and contracts of transfer or licence of intellectual property rights between professionals fall within the scope of the Principles. Agency or franchise contracts are also included.

1.8 Whether a party *"… is acting in the exercise of its trade or profession"* depends on the circumstances of the contract, not on the mere status of the parties. Hence, the same person may act as a trader or professional in relation to certain transactions and as a consumer in relation to others.

> ***Illustration 1-1****. If a lawyer enters into a legal service contract with a company, he or she is acting in the exercise of his or her profession. However, if the same lawyer rents an apartment to spend his or her vacation, he or she is acting outside the exercise of his or her profession.*

1.9 If the contract is commercial, the Principles apply irrespective of the means through which it was concluded. Therefore, they apply to e-commerce transactions and any type of contract concluded by electronic means as long as the parties are acting in the exercise of their trade or profession.

Exclusion of consumer and employment contracts

1.10 Conversely, non-commercial contracts are excluded from the scope of application of the Principles. In particular, and for the avoidance of doubt, Article 1(1) explicitly excludes consumer and employment contracts. This encompasses both individual and collective contracts of employment. As a matter of substantive law, consumer and employment contracts are usually subject to special mandatory rules, aimed at protecting the weaker party – consumer or employee – from an abuse of the freedom of contract. These are, therefore,

typical cases in private international law where party autonomy is excluded or limited. However, the exclusion of consumer and employment contracts is a mere clarification of the definition of commercial contract, not an exhaustive list. Other non-commercial contracts, such as a contract concluded between two consumers, are also outside the scope of application of the Principles.

1.11 The fact that the Principles, by their terms, apply only to commercial contracts should not be understood as an indication that non-commercial contracts are necessarily governed by different private international law rules. The Principles are neutral with regard to the private international law rules applicable to such contracts.

1.12 Article 1(1) defines "commercial contract" in general terms, in accordance with the nature of the instrument as a set of non-binding general principles. With regard, in particular, to consumer contracts, the Principles therefore do not prejudice the characterisation of the so-called "dual-purpose contracts", *i.e.*, when a person concludes a contract intended for purposes which fall partially within and partially outside his or her trade or profession (Art. (1) *a) Hague Convention of 30 June 2005 on Choice of Court Agreements* ("2005 Hague Choice of Court Convention"); *cf.* Court of Justice of the European Union Case 464/01, *Johann Gruber v. Bay Wa AG.* [2005] ECR I-439 , (the contract qualifies as commercial if the business purpose is not negligible)). Likewise, the Principles are silent with regard to the perspective from which the purpose of the contract has to be evaluated, *i.e.*, the question as to whether it is necessary for the professional to have been aware of the purpose of the contract (*cf.* Art. 2(a) CISG and Art. 6(1) Rome I Regulation which protect the non-negligent ignorance of the professional). The Principles are neutral with regard to those issues.

Article 1(2)

Rationale

1.13 To fall within the scope of the the Principles, the contract must qualify as an "international" contract. This limitation is consistent with the traditional understanding that private international law applies only to international cases. The definition of "internationality" varies considerably among national and international instruments (see para. 1.15).

1.14 For the purpose of the Principles, the notion of an international contract is defined in Article 1(2). Pursuant to this provision, the only contracts that are excluded are those in which "the parties have their establishments in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State". This negative definition excludes only purely domestic situations, aiming to confer the broadest possible scope of interpretation to the term "international". This provision is primarily inspired by Article 1(2) of the 2005 Hague Choice of Court Convention.

1.15 Article 1(2) of the Principles does not adopt a positive definition of internationality of the contract adopted in some other instruments (Art. 1 *a)-b) Hague Convention of 22 December 1986 on the Law Applicable to Contracts for the International Sale of Goods* ("1986 Hague Sales Convention"); Art. 1(2) Mexico City Convention; Art. 1(1)(a) CISG). Nor does Article 1(2) take a broader approach of referring to all cases involving a "conflict of laws", or a "choice between the laws of different States" whereby the parties' choice of law itself may constitute a relevant element (Art. 3 *Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* ("2006 Hague Securities Convention"); Art. 1(1) Rome I Regulation).

Ascertainment of internationality

1.16 The ascertainment of internationality of the contract proceeds from the following two steps.

1.17 First, Article 1(2) refers to the establishments of the parties as a relevant element. Whenever the parties' establishments are located in a different State, internationality is

affirmed and the Principles apply. This is a "checklist" that facilitates the ascertainment of internationality without having to refer to other relevant factors. If a party has more than one establishment, the relevant establishment is the one that has the closest relationship to the contract at the time of its conclusion (Art. 12).

> ***Illustration 1-2.*** *Party A (which has its main establishment in State X) signs a contract through its establishment in State Y with Party B (which has its main establishment in State X) acting through its main establishment in State X. The relevant establishment of the parties respectively has the closest relationship to the contract in the sense of Article 12. Since these establishments are located in a different State, the contract is international and governed by the Principles.*

1.18 Second, even if the first test does not apply and the parties have their relevant establishments in the same State, a contract still qualifies as international unless all other relevant elements are located in that State. The relevant elements are objective factors that link the contract to more than one State. They are, for example, the place of conclusion of the contract, the place of performance, a party's nationality, and a party's place of incorporation or a party's establishment. If a party has more than one establishment involved in the transaction, subordinate establishments that have been disregarded in the first step, pursuant to Article 12 (see para. 1.17), may still be taken into consideration.

1.19 The ascertainment of internationality may require a careful case-by-case analysis. For example, the sale of land located in State X between parties who have their establishments in State Y satisfies the requirement of internationality of the contract because of the location of the land abroad. However, this is not the case with a domestic sale of cars or computers which only contain parts produced abroad. Similarly, the fact that pre-contractual negotiations took place abroad is generally not a relevant element. Likewise, the use of a particular language or currency without more does not fulfill the requirement of internationality as such.

1.20 Unless there is no such relevant element, the contract qualifies as international and falls within the scope of the Principles. This interpretation derives from the negative definition of internationality provided in Article 1(2).

Irrelevant factors

1.21 The phrase "regardless of the chosen law" in Article 1(2) means that the parties' choice of law is not a relevant element for determining internationality. In other words, the parties cannot establish internationality of the contract solely by selecting a foreign law, even if accompanied by a foreign choice of court or arbitral tribunal, when all the relevant objective elements are centred in one State (*cf.* Art. 1 *b)* 1986 Hague Sales Convention). This definition of internationality is in clear contrast to that of the 2006 Hague Securities Convention (Art. 3) and the Rome I Regulation (Art. 1(1)).

1.22 The Principles do not address conflict of laws rules among different territorial units within one State, for example, within the United States of America, the United Kingdom, Australia or Spain. Hence, the fact that one of the relevant elements is located in a different territorial unit within one State does not constitute internationality of the contract in the sense of Article 1(2). However, the Principles do not prevent legislators or other users from extending the scope of application of the Principles to intra-State conflicts of laws.

Article 1(3)

1.23 The Principles apply to choice of law agreements for *contracts*. Following the approach of other international instruments, the Principles do not provide a definition of the term "contract". Nevertheless, in order to facilitate their practical application, Article 1(3) excludes from the scope of the Principles certain matters that could, at least potentially, otherwise be characterised as contractual for the purpose of the application of the Principles. This list includes six items: (i) capacity of natural persons; (ii) arbitration agreements and agreements on choice of court; (iii) companies or other collective bodies and trusts; (iv) insolvency;

(v) proprietary effects of contracts; and (vi) the issue of whether an agent is able to bind a principal to a third party. This list is inspired by, among others, Article 5 of the 1986 Hague Sales Convention, Article 1(2) of the Rome I Regulation and Article 5 of the Mexico City Convention.

1.24 The reasons for Article 1(3) are twofold: the legal nature of the enumerated issues, and the lack of a global consensus on whether to characterise them as contractual issues governed by party autonomy. However, the existence of a list of exclusions should not be interpreted as a policy decision against party autonomy in respect of the matters excluded. The Principles are also neutral on this point and, therefore, do not preclude legislators or other users from extending party autonomy to some or all of the excluded matters.

1.25 *First*, the Principles do not address the law governing *the capacity of natural persons.* In this context, capacity means the ability of natural persons to act and enter into contracts independently. It does not include the authority of agents or organs to represent a principal or entity (*cf.* Art. 5 *a)* 1986 Hague Sales Convention). Capacity is a matter that may appear as an incidental question to the validity of the contract, including the choice of law agreement itself. The lack of capacity entails a restriction on party autonomy because of the need to protect the person due to, for example, his or her age (a minor) or mental state. In some jurisdictions legal capacity is regarded as a matter of status and does not qualify as contractual. The determination of the law applicable to this question is excluded from the scope of the Principles. The exclusion implies that the Principles determine neither the law governing the capacity of natural persons, nor the legal or judicial mechanisms of authorisation, nor the effects of a lack of capacity on the validity of the choice of law agreement (see Explanatory Report to the 1986 Hague Sales Convention, p. 23).

1.26 *Secondly*, the Principles do not address the law governing *arbitration agreements and agreements on choice of court.* This exception mainly refers to the *material validity* of such agreements, *i.e.*, to the contractual aspects of those jurisdictional clauses, and includes questions such as fraud, mistake, misrepresentation or duress (see Explanatory Report to the 2005 Hague Choice of Court Convention, para. 125). In some jurisdictions, those questions are considered to be procedural rather than contractual and, therefore, governed by the *lex fori* or *lex arbitri.* In other jurisdictions, those questions qualify as substantive issues to be governed by the law governing the contract as a whole as per the choice of law clause. The exclusion of Article 1(3)(b) means that the Principles are neutral on this issue; they opt for neither of those two solutions.

1.27 *Thirdly,* the Principles do not address the law governing *companies or other collective bodies and trusts.* The term "collective bodies" is used in a broad sense so as to encompass both corporate and unincorporated bodies, for example, partnerships or associations.

1.28 The exclusion under Article 1(3)(c) encompasses the constitution and organisation of companies or other collective bodies and trusts. The excluded issues are, in general, the creation, membership, legal capacity, internal organisation, decision-making processes, dissolution and winding-up of companies and other collective bodies. The same exclusion applies to the issues concerning the internal administration of trusts. In many jurisdictions, these issues are subject to specific private international law rules, pointing to the law of companies (in general, the law of the place of incorporation or central administration) or the law of other collective bodies or trusts.

1.29 On the other hand, the application of the Principles to companies or other collective bodies and trusts is not excluded *per se.* Therefore, contracts which they conclude with third parties fall within the scope of application of the Principles. The Principles also apply to commercial contracts entered into between the members of a company (shareholder agreements).

1.30 *Fourthly,* the Principles do not address the law governing *insolvency*. This exclusion refers to the effects that the opening of insolvency proceedings may have on contracts. Insolvency proceedings may interfere with the general principles of contract law, for example,

insolvency law invalidating a contract pursuant to claw-back rules, staying a termination right of the party *in bonis* or giving the insolvency administrator the power to reject the performance of a pending contract or to assign it to a third party. The exclusion of insolvency in Article 1(3)(d) relates to those questions. In general, the Principles do not determine the law applicable to the question of how contracts are to be treated in insolvency; nor do they address the legal capacity of the insolvency administrator to enter new contracts on behalf of the insolvent estate. The term insolvency is used here in a broad sense, encompassing liquidation, reorganisation, restructuring or administration proceedings.

1.31 *Fifthly*, the Principles do not address the law governing *the proprietary effects of contracts.* The Principles allow the parties to choose the law governing their contractual obligations, *i.e.*, they only determine the law governing rights *in personam*, not rights *in rem*. Hence, if the contract is for the sale of an asset, movable or immovable, tangible or intangible, the Principles do not determine the law applicable to the proprietary rights over the asset; in particular, they do not apply to the question of whether the conclusion of a contract is sufficient or not to transfer the ownership of the asset or to create a security right in respect of it.

1.32 Finally, the Principles do not address the law governing the issue of *whether an agent is able to bind a principal to a third party*. This exclusion refers to the *external* aspects of the agency relationship, *i.e.*, to issues such as whether the principal is bound on the grounds of an implied authority or on the grounds of negligence, or whether and to what extent the principal can *ex post* ratify an *ultra vires* act of the agent (see Art. 11 *Hague Convention of 14 March 1978 on the Law Applicable to Agency* ("1978 Hague Agency Convention")). By contrast, the Principles apply to the internal aspects of an agency, *i.e.*, the agency or mandate relationship between the principal and the agent, if it otherwise qualifies as a commercial contract.

Article 2
Freedom of choice

Paragraph 1
A contract is governed by the law chosen by the parties.

Paragraph 2
The parties may choose (i) the law applicable to the whole contract or to only part of it and (ii) different laws for different parts of the contract.

Paragraph 3
The choice may be made or modified at any time. A choice or modification made after the contract has been concluded shall not prejudice its formal validity or the rights of third parties.

Paragraph 4
No connection is required between the law chosen and the parties or their transaction.

Introduction

2.1 Article 2 establishes the parties' freedom to choose the law governing their contract. In addition, it provides that this choice may apply to only part of the contract, it may be exercised at any time, and that no connection between the contract and the chosen law is required. This article should be read in conjunction with Article 3, which allows parties the freedom to choose rules of law to govern their contract.

Rationale

2.2 Article 2 reflects the Principles' primary and fundamental purpose of providing for party autonomy in the designation of the law governing international commercial contracts (defined in Art. 1). Of particular importance is the fact that under the Principles the freedom of parties to choose the law or rules of law governing their contract is not dependent on the method of dispute resolution involved, whether before a court or arbitral tribunal.

2.3 The Principles acknowledge that certain restrictions on party autonomy are necessary, even in the field of international commercial contracts. Thus the effect of the parties' choice of law is expressly limited by overriding mandatory rules and public policy as provided for in Article 11. The scope of party autonomy under the Principles is further defined by Articles 1(3) and 9.

2.4 Unlike most regimes of private international law, the Principles do not provide for the law applicable to an international commercial contract in the absence of a choice of law by the parties. However, the Principles do allow for a tacit choice of law by the parties, as defined in Article 4. The Principles are thus silent as to the method of determining the applicable law in the absence of an express or tacit choice of law by the parties.

Freedom of choice (Art. 2(1))

2.5 Article 2(1) provides that "[a] contract is governed by the law chosen by the parties". Under the Principles, parties are free to choose the law of any State (see para. 1.22 for different territorial units within one State). Furthermore, Article 3 specifies that parties may designate rules of law. Article 2(1) imposes no other limitations or conditions on the selection of the chosen law.

Illustration 2-1. *A contract for the sale of equipment contains a provision according to which the law of State X, where the seller has its principal place of business, shall govern all aspects related to the formation and validity of the contract, obligations of the seller and the buyer, breach of contract and damages. Where a dispute arises between the parties, the court or arbitral tribunal seised will apply the law of State X as the law governing the merits of the dispute, even if the buyer invokes the law of State Y, where it has its place of business, and according to which law the contract has not been breached.*

Partial or multiple choice of law (Art. 2(2))

2.6 The Principles permit partial or multiple choice of law, that is, subjecting separate elements of the contract to different laws (also known as *dépeçage*). Considering that such partial or multiple choice is by its very nature one of the forms of exercise of party autonomy, the Principles reserve to the parties the option to use that process. However, to avoid the risk of contradiction or inconsistency in the determination of the parties' rights and obligations, parties should not undertake this option without due consideration of its implications.

2.7 Under Article 2(2)(i), parties may choose the law applicable to only part of the contract. Where the parties make such a partial choice of law, the remainder of the contract is governed by the law otherwise applicable in the absence of choice. As noted above in paragraph 2.4, the Principles do not provide rules for identifying the applicable law in the absence of choice by the parties, and therefore a partial choice of law under Article 2(2)(i) leaves this issue to be determined by the court or arbitral tribunal under the private international law rules.

2.8 Under Article 2(2)(ii), parties may also choose the law applicable to different parts of their contract, with the effect that the contract will be governed by more than one chosen law.

2.9 In practice, such partial or multiple choices may concern, for example, the contract's currency denomination, special clauses relating to performance of certain obligations such as obtaining governmental authorisations and indemnity / liability clauses.

Illustration 2-2. *In a contract for the supply and installation of a special production line in States X, Y and Z, the parties have chosen the law of State W to govern all aspects related to the validity and formation of the agreement, leaving the remainder of the contract to be governed by law applicable in the absence of choice.*

Illustration 2-3. *In a share purchase agreement between Buyer A and Seller B, the parties have specified that, for the purpose of price determination, the financial statements of the target company must conform to the law of State X, being the place of the target company's main establishment. Furthermore, the agreement stipulates that the rights and obligations of the parties are governed by the law of State Y and that the pledge given by the buyer in favour of the seller is governed by the law of State Z, where the pledged assets are located.*

Illustration 2-4. *In an international distribution agreement, the parties have expressly agreed that the contract is to be governed by the law of State X, but the conditions under which the distributor must obtain inspection certificates will be governed by the law of the various States of final destination of the goods.*

2.10 Partial or multiple choice of law should not be confused with the modification of the applicable law (see Art. 2(3)), which consists of another process by which the law governing the contract may be altered.

Timing and modification of the choice of law (Art. 2(3))

2.11 Party autonomy justifies the parties' freedom to make or modify their choice of law at any time. It is generally accepted, therefore, that the conditions for, and the effects of, a

change in the choice of law are governed by party autonomy. A change in choice of law is limited in its effect on the formal validity of the contract and on pre-existing rights of third parties.

2.12 The Principles provide that the law chosen by the parties governs the validity of the contract (Art. 9(1)(e)). As a result, any contractual change in the law governing the contract after its conclusion could affect the formal validity of the contract. To avoid the retroactive invalidation of the contract, Article 2(3) specifies that any contractual change in the applicable law as a result of a choice or modification of a choice by the parties may not prejudice a contract that was formally valid under the previously applicable law. The formulation of the rule makes it clear that it applies whether or not the law initially governing the contract was chosen by the parties.

2.13 In addition, Article 2(3) is a reminder that the change in the law applicable to the contract affects not only the parties' rights, but could in some cases have an impact on the rights of third parties. There is a broad consensus to the effect that a modification to the choice of law should not negatively affect the rights of third parties (see Art. 3(2) Rome I Regulation). The significance of this potential consequence of party autonomy requires that it be directly addressed in the Principles rather than relying on expected equivalent protection accorded by the applicable substantive law. Accordingly, where the applicable law changes as a result of a contractual choice or modification of a choice, pre-existing rights of third parties that arise from the contract should be preserved.

2.14 The Principles do not limit the timing of the choice or of the modification of the choice of law by the parties. As noted in the Introduction, they do not generally seek to resolve what are commonly considered to be procedural issues before courts or arbitral tribunals. As a result, if the choice or modification of the choice of law occurs during dispute resolution proceedings, the effect of this choice may depend on the *lex fori* or the law governing the arbitral proceedings. Similarly, the Principles are neutral regarding the issue of proof of foreign law.

> ***Illustration 2-5.*** *An international loan contract between Bank A and Company B is governed by the law of State X, where Bank A has its main establishment. In a separate contract with Bank A, Party C undertakes to personally guarantee Company B's obligations in favour of Bank A; the contract of guarantee is stated to be governed by the law applicable to the loan contract. The law of State X allows the guarantor to avoid the personal guarantee whenever the amount of the loan is increased without his or her consent, whereas the law of State Y does not contain a similar provision. Bank A and Company B decide to change the law governing their loan contract to the law of State Y. Such a modification of the chosen law may not adversely affect the pre-existing rights of Party C, the personal guarantor.*
>
> ***Illustration 2-6.*** *A contract between Party A and Party B specifies that it is governed by the law of State X. A dispute arises and is brought before the courts of State Y. In the course of the proceedings, both parties frame their arguments in terms of the substantive contract law of State Y. While these facts may be evidence of a tacit modification of the choice of law under Article 4, the characterisation and effect of such a change in the course of proceedings may depend on the law of State Y.*

No connection required (Art. 2(4))

2.15 Under the Principles, party autonomy is not limited by any requirement of a connection, whether geographical or otherwise, between the chosen law and the contract or the parties. Accordingly, the parties may choose the law of a State with which the parties or their transaction bears no relation. This provision is in line with the increasing delocalisation of commercial transactions. Parties may choose a particular law because it is neutral as between the parties or because it is particularly well-developed in the type of transaction contemplated (*e.g.*, a State law renowned for maritime transport or international banking transactions).

2.16 It should be noted that some States in which party autonomy is accepted nevertheless require that an objective connection exist between the transaction and the law designated by the parties.

2.17 Contracts governed by rules of law, as defined in Article 3, do not raise this issue, since such rules of law are usually not connected to any national legal order.

Article 3
Rules of law

Under these Principles, the law chosen by the parties may be rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.

Introduction

3.1 Article 3 broadens the scope of the party autonomy provided for in Article 2(1) by providing that the parties' choice may designate not only State law but also rules of law. The expression "rules of law" comes from existing arbitration sources, including national arbitration legislation, model arbitration laws and private institutional arbitration rules (see Art. 28(1) UNCITRAL Model Law; Art. 21(1) International Chamber of Commerce Rules of Arbitration 2012 ("ICC Rules")). It refers to rules that are not drawn from formal State sources of law.

3.2 The criteria for rules of law provided in Article 3 afford greater certainty as to what the parties may designate as rules of law governing their contractual relationship. The criteria refer to the admissible sources and the nature of those rules of law recognised under Article 3. In addition, Article 3 admits an exception to the general principle it expresses when the law of the forum so provides.

3.3 The criteria relating to the source and nature of rules of law should be read as a whole with a view to ensuring that the parties' designation respects party autonomy and provides a workable framework within which to assess their respective rights and obligations should a dispute arise. By circumscribing the scope of the reference to rules of law, Article 3 should assist lawyers and decision-makers in identifying the content of the rules of law designated by the parties, and applying them to a dispute, whether in an arbitral or judicial context.

Generally accepted on an international, supranational or regional level

3.4 This criterion stipulates that the rules of law designated by the parties must have garnered some level of recognition beyond a national level. In other words, the rules cannot be limited to provisions in a set of rules still underdeveloped at a transborder level, or to those contained in the contract itself, or to one party's standard terms and conditions, or to a set of local industry-specific terms.

3.5 International treaties and conventions may be considered a generally accepted source of rules of law where those instruments apply solely as a result of the parties' choice of law. For example, the CISG may be designated by the parties as rules of law governing their contract in situations where the CISG would not otherwise apply according to its own terms (see Art. 1 CISG). In other words, the parties may designate the substantive rules of the CISG as a free-standing set of contract rules and not as a nationalised version of the CISG attached to the law of a State that has ratified the CISG. Following such a choice, the CISG applies as rules of law, without consideration of any State reservations that might otherwise intervene if the CISG were applied as a ratified treaty or as part of State law. Model choice of law clauses proposing such a designation of the CISG as rules of law are available (see, *e.g.*, the model clause suggested by the Chinese European Arbitration Centre (CEAC)).

3.6 Another source of rules of law that would satisfy this first criterion may come from non-binding instruments formulated by established international bodies. One example is UNIDROIT, an inter-governmental organisation responsible solely to its Member States, which operates on the basis of consensus. The UPICC are an example of rules of law that are "generally accepted on an international level". Moreover, the UPICC expressly provide that parties may designate them to govern their contract and suggest choice of law clauses to that end (see the footnote to the UPICC Preamble and the "Model Clauses for the Use of the UNIDROIT Principles of International Commercial Contracts").

3.7 As for possible supranational or regional sources, an example might be the PECL developed by an independent group of experts and supported by the European Union.

3.8 The dynamic and evolving nature of international commercial law suggests that sources of rules of law that are becoming, or will become, generally accepted internationally, supranationally or regionally are likely to grow in number.

A neutral and balanced set of rules

3.9 This criterion includes three elements: first, that the rules of law designated must be *a set of rules* and not merely a small number of provisions. While comprehensiveness is not required, the chosen rules of law must be such as to allow for the resolution of common contract problems in the transborder context.

3.10 The second element is the *neutrality* of the set of rules. This aspect may be satisfied by the fact that the source of the rules of law is recognised as a neutral, impartial body, that is, one that represents diverse legal, political and economic perspectives.

3.11 The third element – that the rules be *balanced* – is intended to ensure that the rules of the chosen law reflect the presumption underlying party autonomy in commercial contracts according to which parties have equal bargaining power. The balance element relates to the substance of the rules and indicates that the designated rules should not advantage one party's interests over the other. This condition would therefore likely preclude references to rules that benefit one side of transactions in a particular regional or global industry.

Trade usages

3.12 The Principles are silent regarding the application of trade usages. The effect of trade usages on the parties' rights and obligations is instead determined directly either under the chosen law itself or by other rules governing the dispute (see Art. 9 CISG; Art. 1.9 UPICC; Art. 28(4) UNCITRAL Model Law; Art. 21(2) ICC Rules).

Unless the law of the forum otherwise provides

3.13 As noted in paragraph 3.1, existing arbitration statutes and arbitration rules commonly allow for the contractual choice of rules of law. The same opportunity, however, has not typically been contemplated when disputes are brought before national courts. While the Principles do not generally distinguish between arbitration and court proceedings with respect to choice of law by the parties, they recognise that a limitation on the freedom to choose rules of law is justified in judicial proceedings where the law of the forum confines the parties' freedom to a choice of State law.

Gap filling

3.14 Where parties have designated rules of law to govern their contracts, there may be matters to which these rules of law (as non-national sources of law) do not extend. For example, the UPICC article on the authority of agents does not deal with the relationship between principal and agent (Art. 2.2.1); similarly the CISG expressly states that it does not provide rules on the validity of contracts for the sale of goods (Art. 4(a) CISG). Parties designating either instrument as rules of law to govern their contract should be mindful of the potential need for gap filling and address it in their choice of law. By allowing the parties to choose more than one law to govern the contract, Article 2(2) also allows them to choose a residual law for gap-filling purposes.

> ***Illustration 3-1.*** *The choice of law agreement provides that "this contract shall be governed by the CISG without regard to the provisions of any national law, except provisions of the law of State X which apply to those matters not governed by the CISG".*

Illustration 3-2. *The choice of law agreement provides that "this contract shall be governed by the UIPCC and, with respect to issues not covered by those principles, by the law of State X".*

Article 4
Express and tacit choice

A choice of law, or any modification of a choice of law, must be made expressly or appear clearly from the provisions of the contract or the circumstances. An agreement between the parties to confer jurisdiction on a court or an arbitral tribunal to determine disputes under the contract is not in itself equivalent to a choice of law.

Introduction

4.1 The purpose of Article 4 is to determine the different ways in which a choice of law in the sense of Article 2(1) can be made. The provision seeks to provide clarity and ensure legal certainty and foreseeability in this context.

Choice of law generally

4.2 The parties may either expressly or tacitly choose a law to govern their contract. Article 4 is in line with similar provisions in other instruments (see Art. 7 Mexico City Convention; and Art. 3 Rome I Regulation).

4.3 The parties may choose the law of a State but also have the freedom to choose generally accepted non-State rules of law, particularly recognised principles of contract law and uniform law, unless the law of the forum provides otherwise (see Art. 3).

Express choice of law

4.4 The parties may expressly choose a law to govern their contract. An express choice of law agreement may be made before, at the same time as, or after the conclusion of the main contract (see Art. 2(3)). Usually a choice of law clause is included in the main contract. The parties should follow this practice. They are advised to state explicitly the law to which any disputes between them shall be subject. The use of a certain formula is not necessary. Phrases such as the contract is "governed by" or "subject to" a particular law meet the requirements of an express choice.

> ***Illustration 4-1.*** *Party A and Party B conclude a contract. They include the provision: "This agreement shall be governed by the law of State X." The law of State X therefore governs the contract.*
>
> ***Illustration 4-2.*** *Party A and Party B conclude a contract. They include the provision: "This agreement shall be governed by the UNIDROIT Principles of International Commercial Contracts." The UPICC therefore govern the contract, unless the law of the forum provides otherwise.*

4.5 An express choice can also be made by reference to some external factor, for instance the relevant place of establishment of one of the parties.

> ***Illustration 4-3.*** *Party A and Party B conclude a contract of sale. The contract includes the provision: "This agreement shall be governed by the law of the State of the business of the seller." The seller (Party A) has its relevant place of establishment in State X at the time of the conclusion of the contract. The law of State X therefore governs the contract.*

4.6 Since it is not required that a choice of law agreement must be in written form, an express choice of law can also be made orally (*cf.* Art. 5).

Tacit choice of law to reflect the real intention of the parties

4.7 A choice of law may also be made tacitly. To qualify as binding under Article 4, the tacit choice of law must be a real one although not expressly stated in the contract. There must be a real intention of both parties that a certain law shall be applicable. A presumed intention imputed to the parties does not suffice.

4.8 A tacit choice of law must appear clearly from the provisions of the contract or the circumstances. One has to take into account both the terms of the contract and the circumstances of the case. Generally, the terms of the contract are given priority. However, either the provisions of the contract or the circumstances of the case may conclusively indicate a tacit choice of law.

Tacit choice of law inferred from the provisions of the contract

4.9 A choice of law appears from the provisions of the contract when it can be inferred from those provisions that the parties intended to choose a certain law. There is no fixed list of admissible indicators but some of them may have more weight than others. The indicators may also corroborate each other.

4.10 A widely accepted example for a tacit choice is the use of a standard form by the parties. Where the contract is in a standard form which is generally used in the context of a particular system of law, this may indicate that the parties intended the contract to be governed by that law, even though there is no express statement to this effect.

> ***Illustration 4-4.*** *Party A and Party B enter into a marine insurance contract in the form of a Lloyd's policy of marine insurance. Because this contract form is based on English law, its use by the parties may indicate their intention to subject the contract to English law.*

4.11 The same is true where the contract contains terminology characteristic of a particular legal system or references to national provisions which make it clear that the parties were thinking in terms of, and intended to subject their contract to, that law.

> ***Illustration 4-5.*** *Party A and Party B conclude a contract which uses the legal language characteristic of a particular legal system. This may indicate that the parties intend their obligations to be determined according to that legal system.*

Choice of court clause as an indicator of a tacit choice of law

4.12 The question of choice of law and choice of a forum for dispute resolution should be distinguished. According to the second sentence of Article 4, an agreement between the parties to confer jurisdiction on a court to determine disputes under the contract is not in itself equivalent to a choice of law (see, in the same sense, Art. 7(2) Mexico City Convention). For example, the parties may have chosen a particular forum because of its neutrality or experience. The fact that the chosen court, under the applicable private international law rules, may apply a foreign law also demonstrates the distinction between choice of law and choice of court. Nevertheless, an agreement between the parties to confer jurisdiction on a court may be one of the factors to be taken into account in determining whether the parties intended the contract to be governed by the substantive law of that forum.

> ***Illustration 4-6.*** *Party A and Party B conclude a contract conferring exclusive jurisdiction on the courts of State X. Together with other provisions in the contract and / or the particular circumstances, this may or may not indicate that there is a tacit choice of the substantive law of State X.*

Arbitration agreement as indicator of a tacit choice of law

4.13 An agreement between the parties to confer jurisdiction on a localised arbitral tribunal to resolve disputes under the contract is not the same as a choice of law. According to the second sentence of Article 4, the choice of such an arbitral tribunal is also not a sufficient indicator, in itself, of the parties' tacit choice of law. The parties may have chosen a tribunal because of its neutrality or expertise. The tribunal may also apply a foreign law pursuant to applicable rules of private international law or the chosen arbitration rules. However, an arbitration agreement that refers disputes to a clearly localised seat may be one of the factors in determining the existence of a tacit choice of law.

> ***Illustration 4-7.*** *Party A and Party B conclude a contract under which they agree that all disputes arising out of, or in connection with, the contract are to be submitted exclusively to arbitration in State X under the rules of the ABC Chamber of Commerce. In the absence of other provisions in the contract and / or the particular circumstances, this will be insufficient to indicate a tacit choice of the law of State X.*

Circumstances indicating a tacit choice of law

4.14 The particular circumstances of the case may indicate the intention of the parties in respect of a choice of law. The conduct of the parties and other factors surrounding the conclusion of the contract may be particularly relevant. For instance, where the parties to a contract in the course of previous dealings made an express choice of the same law, it is reasonable to suppose that they also intended to have their subsequent contractual relations governed by this law. This principle may also apply in the context of related contracts.

> ***Illustration 4-8****. In the past Party A and Party B always concluded contracts of sale containing an express choice of the law of State X. However, in their most recent contract such a choice of law clause is missing without any explanation. A court or tribunal could therefore conclude that the parties also intended their most recent contract to be governed by the law of State X.*

Level of strictness of the criterion for the existence of a tacit choice of law

4.15 A tacit choice of law must appear clearly from the provisions of the contract or the circumstances. This means that the choice should be evident as a result of the existence of strong indications for such a choice.

> ***Illustration 4-9.*** *Party A and Party B conclude a contract drafted in the language of a certain State. However, the contract is formulated in a neutral type of language, avoiding legal terminology characteristic of that State's legal system. In the absence of other circumstances the use of the particular language would not be sufficient to establish a tacit choice of law.*

4.16 The Principles do not take a position as to procedural issues in connection with a tacit choice of law, in particular the taking of evidence and the standard and mode of proof (but see para. 9.11 on the burden or onus of proof).

Modification of a choice of law

4.17 A modification of a choice of law must be made expressly or appear clearly from the provisions of the contract or the circumstances. A modification occurs when the parties agree to subject their contract to a law other than the one previously applicable (*cf.* Art. 2(3)). Such a modification is also permissible in the form of a tacit choice.

No choice of law

4.18 If the parties' subjective intentions are neither expressed nor capable of being inferred from the provisions of the contract or from the particular circumstances of the case, the applicable law must be determined by other means. The resulting issues are not covered by the Principles.

Article 5
Formal validity of the choice of law

A choice of law is not subject to any requirement as to form unless otherwise agreed by the parties.

Introduction

5.1 The purpose of Article 5 is to determine the formal validity of a choice of law. Article 5 is motivated by a policy of upholding the parties' intention unimpeded by formalistic requirements (Preamble, para. 1 and Art. 1(1)).

No requirements as to form of choice of law

5.2 A choice of law need not comply with any formal requirements; for instance, it does not need to be in writing or attested by witnesses. The same applies to a modification of a choice of law (*cf.* Art. 2(3)). Article 5 applies to both an express and a tacit choice of law (see Art. 4).

> ***Illustration 5-1.*** *Party A and Party B conclude a contract and agree orally that the law of State X will govern the contract. The choice of the law of State X is formally valid.*
>
> ***Illustration 5-2.*** *Party A and Party B conclude an oral contract without expressly agreeing on the applicable law. However, a tacit choice of the law of State X can reasonably be inferred from the terms of the oral contract and / or the surrounding circumstances. The choice of the law of State X is formally valid.*

Substantive rule of private international law

5.3 Article 5 is atypical in that it provides a substantive rule of private international law rather than a conflicts rule (which refers to a national legal system). This rule can be justified on several grounds, including the following:

(a) the principle of party autonomy (Preamble, para. 1) indicates that, in order to facilitate international trade, a choice of law by the parties should not be restricted by formal requirements;

(b) most legal systems do not prescribe any specific form for the majority of international commercial contracts, including choice of law provisions (also see Art. 11 CISG; and Art. 1(2) (first sentence) and Art. 3.1.2 UPICC);

(c) many private international law codifications employ comprehensive result-oriented alternative reference rules in respect of the formal validity of a contract (including choice of law provisions), based on an underlying policy favouring the validity of contracts (*favor negotii*) (see, *e.g.*, Art. 13 Mexico City Convention; and Art. 11(1) Rome I Regulation).

5.4 The fact that the Principles are designed for international commercial contracts only (Preamble, para. 1 and Art. 1(1)) obviates the need to subject the choice of law to any formal requirements or other similar restrictions for the protection of presumptively weaker parties, such as consumers or employees.

Relationship with other provisions dealing with formal validity

5.5 The principle in Article 5 (no formal requirements for a choice of law) is consistent with Article 7, which provides that a choice of law may not be contested solely on the ground that the contract to which it applies is not valid.

5.6 Article 5 only concerns the formal validity of a choice of law. The remainder of the contract (the main contract) must comply with the formal requirements of at least one law

whose application is authorised by the applicable private international law rule (*cf.* Art. 9(2); and para. 5.3(c)). On the other hand, the law chosen by the parties also governs the formal (as well as the substantive) validity of the main contract (Art. 9(1)(e)).

> ***Illustration 5-3****. Party A and Party B conclude a contract, including an express choice of the law of State X, and the main contract would be formally valid in terms of the law of State X. The contract is formally valid.*
>
> ***Illustration 5-4****. Party A and Party B conclude a contract. A tacit choice of the law of State X may be inferred on the basis of certain provisions in the contract and / or the circumstances of the case, and the main contract would be formally valid in terms of the law of State X. The contract is formally valid.*
>
> ***Illustration 5-5****. Party A and Party B conclude a contract, including a choice of the law of State X, but the contract is formally invalid in terms of the law of State X. The contract will nonetheless be formally valid if it complies with the requirements in respect of formal validity in any one of the other legal systems governing formal validity in terms of the applicable rule of private international law.*
>
> ***Illustration 5-6****. Party A and Party B conclude a contract, including a choice of the law of State X. The contract is formally invalid if it does not comply with the requirements as to form in terms of the law of State X and also does not comply with the formal requirements of any one of the other legal systems governing formal validity in terms of the applicable rule of private international law.*

5.7 Article 2(3) provides that the formal validity of the contract is not adversely affected by a subsequent choice of law, or a modification thereof.

Agreement to the contrary

5.8 If the parties agree (for instance, in a letter of intent or a memorandum of understanding) that a choice of law clause between them will only come into existence when certain formalities are met, their preference in this regard must be respected. Also, if the parties agree that a choice of law clause cannot be changed except when certain formalities are met (for instance, a non-oral modification clause), this agreement must be respected (*cf.* Art. 2.1.13, 2.1.17 and 2.1.18 UPICC.)

Article 6
Agreement on the choice of law and battle of forms

Paragraph 1

Subject to paragraph 2,

a) whether the parties have agreed to a choice of law is determined by the law that was purportedly agreed to;
b) if the parties have used standard terms designating different laws and under both of these laws the same standard terms prevail, the law designated in the prevailing terms applies; if under these laws different standard terms prevail, or if under one or both of these laws no standard terms prevail, there is no choice of law.

Paragraph 2

The law of the State in which a party has its establishment determines whether that party has consented to the choice of law if, under the circumstances, it would not be reasonable to make that determination under the law specified in paragraph 1.

Introduction

6.1 Article 6(1)(a) follows a choice of law rule which is well established in international, supranational or regional instruments such as in Article 10(1) of the Rome I Regulation and Article 12(1) of the Mexico City Convention.

6.2 Article 6(1)(b) addresses, for the first time in a black letter rule, the issue of conflicting choice of law clauses in standard terms. The purpose of this provision is to promote legal certainty for an issue that is currently characterised by a high degree of uncertainty. The provision will further maximise party autonomy while, at the same time, avoid needless complexities.

6.3 Article 6(2) provides a limited exception clause. Similar provisions are to be found in other international, supranational or regional instruments such as Article 10(2) of the Rome I Regulation or Article 12(2) of the Mexico City Convention.

Application of the law purportedly agreed to (Art. 6(1)(a))

6.4 In line with the leading role ascribed to party autonomy, Article 6(1)(a) provides that the law designated in the choice of law clause determines whether the parties have reached an agreement on the applicable law. If that law confirms the existence of a choice of law agreement, then all issues relating to the remainder of the main contract are assessed under the chosen law as the applicable law (the *lex causae*) unless the opposing party can show the lack of agreement under the limited exception in Article 6(2) (see below).

6.5 Article 6 deliberately avoids the use of the expression "existence and material validity of the choice of law". The latter expression may be too specific to be meaningful across legal traditions, and may encourage wider grounds of challenge to the chosen law, thereby jeopardising the legal certainty that the Principles seek to achieve. Article 6 therefore refers only to an "agreement" which is intended to encompass all issues as to whether the parties have effectively made a choice of law.

6.6 Duress, misrepresentation and similar vices of consent are among the grounds that can be relied upon to demonstrate the absence of "agreement" if they specifically address the parties' agreement on the choice of law, which is to be considered independently from the main contract (see Art. 7). The existence and effect of these vices is to be determined under

the putatively chosen law, or, if Article 6(2) is exceptionally applicable, under the law designated in that paragraph.

Choice of law in standard forms

6.7 In international contract negotiations, parties frequently use standard terms or general conditions. According to a widely shared definition given in Article 2:209, paragraph 3 of the PECL, "[g]eneral conditions of contract are terms which have been formulated in advance for an indefinite number of contracts of a certain nature, and which have not been individually negotiated between the parties". According to Article 2.1.19, paragraph 2 of the UPICC, "[s]tandard terms are provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party".

6.8 The Principles do not require a particular form for the parties' agreement on choice of the applicable law (see Arts 4 and 5). Hence, the choice of law can very well be made in standard forms. If both parties designate the same law in their standard terms, or if only one party uses a choice of law clause in its standard terms, Article 6(1)(a) applies and the designated law determines whether there was indeed an "agreement" with respect to the applicable law. If, under this law, standard terms containing the choice of law clause are part of the contract and an agreement on the applicable law is established (see paras 6.7 and 6.8), the chosen law then governs the main contract as the applicable law (*lex causae*).

Choice of law in conflicting standard terms (battle of forms)

6.9 Standard terms in international contracts often contain conflicting choice of law clauses. The scenario of conflicting standard terms is commonly referred to as "battle of forms". In national jurisdictions four different ways exist to resolve the battle of forms: in some jurisdictions the standard terms first used prevail in principle ("first-shot rule"; applied *e.g.* in Dutch law); in others the standard terms last used prevail ("last-shot rule"; applied *e.g.* in English law and in the Contract Law of the People's Republic of China of 1999), whereas in other jurisdictions conflicting terms are to be disregarded ("knock-out rule"; applied *e.g.* in French and German case law). Other jurisdictions combine elements of the first three solutions (hybrid solution, such as in the US-American Uniform Commercial Commercial Code). There are also some jurisdictions in which the issue of conflicting standard terms has not yet been resolved (see T. Kadner Graziano, "Solving the Riddle of Conflicting Choice of Law Clauses in Battle of Forms Situations: The Hague Solution", *Yearbook of Private International Law* 14 (2012/2013) 71 at 74-81).

6.10 The existing international, supranational or regional instruments and most national private international law statutes have not addressed the question of the law applicable in situations involving conflicting choice of law clauses in standard terms. Commentators are divided as to which law should apply, and at least six different solutions, some of considerable complexity, are currently suggested (see Kadner Graziano, *art. cit.,* at 80-87). The courts often avoid the issue, circumvent it, or simply apply the *lex fori*. Consequently, parties to international contracts are unable to reliably predict which law will ultimately govern their contract.

6.11 Given the high degree of uncertainty that currently reigns in battle of forms scenarios, the Hague Conference decided to address this issue in Article 6(1)(b). This paragraph establishes a novel rule, which provides clear and predictable solutions to this complex problem. The following scenarios illustrate these solutions in various situations.

a) Situations presenting a false conflict: Article 6(1)(b), 1st alternative

6.12 ***Scenario 1:*** *Party A makes an offer and refers to its standard terms. These contain a clause designating the law of State X as the law applicable to the contract. Party B accepts the offer and refers to its own standard terms designating the law of State Y as the applicable law. With respect to battle of forms scenarios, the laws of State X and of State Y both provide that the standard terms last referred to prevail (last-shot rule).*

6.13 Scenario 1 is governed by Article 6(1)(b), 1st alternative. It provides that "if the parties have used standard terms designating different laws and under both of these laws the same standard terms prevail, the law designated in the prevailing terms applies". In Scenario 1, the parties have indeed designated different laws (the laws of States X and Y). Both of those laws follow the last-shot rule under which the standard terms last referred to prevail, including the choice of law clause in these terms. Since both laws designated by the parties solve the battle of forms in favour of the same standard terms, the apparent conflict is in fact a false conflict. Pursuant to Article 6(1)(b), 1st alternative, the choice of law clause in the standard terms last referred to (*i.e.*, the choice of the law of State Y) is deemed to have been agreed upon.

6.14 The same solution applies if both parties designate in their standard terms laws that follow the first-shot rule. In Scenario 1, this means that the law of State X would be deemed to have been agreed upon.

b) Situations presenting a true conflict: Article 6(1)(b), 2nd and 3rd alternatives

6.15 ***Scenario 2:*** *Party A designates in its standard terms the law of State X, and Party B designates the law of State Y. One of the designated laws follows the first-shot rule, while the other applies a last-shot rule.*

6.16 Scenario 2 presents a *true conflict* situation: the parties have designated different laws which resolve the battle of forms differently. This scenario is governed by Article 6(1)(b), 2nd alternative: "if the parties have used standard terms designating different laws and […] if under these laws different standard terms prevail, […] there is no choice of law". This means that, in Scenario 2, the choice of law clauses in both standard terms are thus to be disregarded and that the applicable law has to be found through the application of the rules that apply in the absence of choice. Article 6(1)(b), 2nd alternative thus establishes a knock-out rule at the private international law level.

6.17 ***Scenario 3:*** *Party A designates in its standard terms the law of State X, while Party B designates the law of State Y. State X follows the knock-out rule, while State Y follows either the knock-out rule or another rule, such as the first-shot or last-shot rule.*

6.18 This case also presents a *true conflict* and is governed by Article 6(1)(b), 3rd alternative: "the parties have used standard terms designating different laws and under one or both of these laws no standard terms prevail". Because at least one of the designated laws applies a knock-out rule, "no standard terms prevail" and thus both standard terms must be disregarded. The outcome then is that "there is no choice of law". As with Scenario 2, the applicable law is to be objectively ascertained through application of the rules that apply in the absence of choice.

General issues

6.19 At the substantive law level, some jurisdictions apply one rule to battle of forms scenarios under some circumstances and another rule under different circumstances. The determination of which standard terms "prevail" under Article 6(1)(b) must be based on the relevant circumstances not in general but *in the specific case under examination*.

6.20 At times it may be difficult to accurately determine a foreign law's precise rule or position on the battle of forms, and this can be particularly problematic in those systems in which the burden of ascertaining the content of foreign law rests with the court rather than the parties. For this reason, during the negotiations leading to the Principles, it was suggested that there be a duty imposed on the parties to assist, or co-operate with, the court in identifying the relevant foreign rule or position. Ultimately, the Principles do not impose such an explicit duty on the parties and instead leave this matter to the *lex fori*. Nevertheless, when adopting the Principles, national or international legislators may wish to consider imposing such a duty, if it is not already imposed under their procedural laws. In an arbitral context, the parties are obliged to co-operate in the resolution of their dispute given the contractual nature of the

arbitral agreement. The parties may be subject to an additional obligation to co-operate where the applicable arbitral rules so provide.

6.21 Some jurisdictions have not yet taken a position with respect to battle of forms conflicts. In a case involving at least one of those jurisdictions, it will be impossible to establish whether "under both of [the designated] laws" either (a) "the same standard terms prevail", or (b) "different standard terms prevail" (Art. 6(1)(b)). This case should be treated as one in which "no standard terms prevail", and consequently as a case in which "there is no choice of law" (Art. 6(1)(b), *in fine*).

The Principles and the CISG

6.22 With respect to contracts for the sale of goods, the CISG enters into consideration. The outcome of a given case may then depend on the interpretation of the rules on the scope of application of the CISG.

6.23 ***Scenario 4:*** *Party A to a transborder sales contract designates in its standard forms the law of State X, which is a Contracting State to the CISG, as the law applicable to the contract. Party B designates the law of State Y, which is a Contracting State to the CISG, but explicitly excludes the CISG; the general contract law of State Y provides a knock-out rule. The case is brought before a court in a Contracting State to the CISG.*

6.24 If the conditions for the application of the CISG under its Article 1(1) are met, the court will be treaty-bound to apply the CISG. However, according to Article 6 of the CISG, the parties may exclude its application. Party A has designated in its standard forms the law of CISG Contracting State X and, according to the prevailing judicial practice and academic opinion in the literature, a choice of the law of a Contracting State to the CISG is not considered to be an exclusion of the CISG. Party B, on the other hand, has provided for an explicit exclusion of the CISG in its standard terms.

6.25 The choice of law agreement is a separate contract, to be distinguished from the sales contract (see Art. 7). Under the Principles, the battle of forms concerning the choice of law agreement would fall under Article 6(1)(b), 3rd alternative. The reason is that: (a) Party A's standard terms designate the law of State X including the CISG (which has been interpreted as providing either a last-shot or a knock-out rule); and (b) Party B's standard terms designate the law of State Y, (excluding the CISG) which provides a knock-out rule. In this situation, under one (or, according to the interpretation of the CISG, both) of the designated laws "no standard terms prevail", leading to the conclusion that "there is no choice of law". Consequently, the choice of law clauses in both Party A and Party B's standard terms, as well as the exclusion of the CISG in Party B's standard terms, are, according to the Principles, to be disregarded.

6.26 If the CISG is interpreted as providing a knock-out rule for battle of forms situations, the above scenario would again fall under Article 6(1)(b), 3rd alternative and, in such a case, it would not matter which solution the law of State Y provides for battle of forms situations. The same would be true if, in Scenario 4, Party A designates the CISG as a free-standing set of rules of law and not as an integrated part of the designated law (see Art. 3 and para. 3.5).

6.27 The Principles thus provide a straightforward solution for the situations involving the CISG. However, whether the choice of law agreement, being a separate contract from the sales contract, would be governed by the Principles, or whether it would, together with the sales contract, be governed by the CISG, depends on the interpretation of the scope of application of the CISG. The Principles do not address this question and uncertainties concerning the scope of application of the CISG cannot be resolved by them. (For further illustrations regarding the possible interaction of the CISG and the Principles, see Kadner Graziano, *art. cit.*, at 94-99.)

Limited exception clause (Art. 6(2))

6.28 At present, it is widely accepted that, under exceptional circumstances, the application of the law, or of the rules of law, purportedly chosen may be excluded when it comes to determining whether a party has actually consented to a choice of law (*cf*. Art. 10(2) Rome I Regulation). To this end, Article 6(2) introduces an exception clause. It applies subject to two concurrent conditions: first, "under the circumstances, it would not be reasonable to make that determination under the law specified in paragraph 1" (*e.g.*, for reasons of duress or fraud or the consequences of silence in the process of contract formation) and, second, no valid agreement on the choice of law can be established under the law of the State in which a party invoking this provision has its establishment. Paragraph 2 is only relevant for cases falling within the scope of Article 6(1)(a) and, though only very exceptionally, (b), 1st alternative. In situations falling under Article 6(1)(b), 2nd and 3rd alternatives, the Principles apply a knock-out rule and there is no agreement on the applicable law.

Article 7
Severability

A choice of law cannot be contested solely on the ground that the contract to which it applies is not valid.

Introduction

7.1 Article 7 introduces the principle of severability. This means that a choice of law agreement is autonomous and independent from the contract that contains it or the contract to which it applies. Accordingly, the invalidity of the contract does not necessarily render invalid the choice of law. Rather, the law chosen by the parties applies to the issues to be decided following the invalidity of the main contract, unless the choice of law agreement, assessed independently, is also invalid. When the parties' choice of applicable law is not affected, the claim of invalidity, non-existence or ineffectiveness of the main contract is assessed according to the applicable law chosen by the parties, provided that the parties' choice is effective.

Parties' choice of law treated as separate from the contract to which it applies

7.2 A choice of law is based upon agreement of the parties. Such an agreement has a distinct subject matter and possesses an autonomous character with regard to the contract to which it applies. This is consistent with the approach followed in international and European instruments, such as Article 10 of the Rome I Regulation, according to which the parties' choice of law should be subject to an independent assessment that is not automatically tied to the validity of the main contract.

Scope of the rule

7.3 The choice of law agreement is usually contained in the main contract, but sometimes the agreement may be inferred from the surrounding circumstances, or may be contained in a separate document executed contemporaneously with, or subsequent to, the contract to which it applies (see Art. 4). The crux of Article 7 is that, even when the agreement is part of the contract, the agreement must be judged separately from the main contract. This means that the choice of law agreement is not affected by a claim that the main contract is invalid, non-existent or ineffective. However, where it is alleged that the parties did not enter into a contract, the severability doctrine may apply only if a choice of law agreement is shown to exist. Its existence is assessed according to the provisions of the Principles, notably Articles 4, 5, 6 and 9.

7.4 The Principles do not address the law governing certain issues listed in Article 1(3). Some of these issues (in particular those dealt with in Art. 1(3)(a) and 1(3)(c)) might also bear relation to the determination of the validity of a choice of law agreement.

Severability / separability as a widely recognised rule

7.5 The term "severability" has a well-understood meaning in the literature, where it is used to describe the "survival" of the choice of law clause if the underlying contract is found to be invalid. It is an accepted technical term and this is the reason why it has been chosen. In other languages, "severability" has no specific corresponding term and is translated into "separability". The word "separable" or "independent" is employed in the literature dealing with arbitration and choice of forum clauses.

7.6 Severability of an agreement on choice of court is the rule adopted by the 2005 Hague Choice of Court Convention, in its Article 3 *d)*. The severability rule of Article 7 is also consistent with the solutions adopted by many jurisdictions as well as by regional and international instruments.

7.7 In arbitration, the "separability" or "independence" principle is relied upon by courts to dismiss objections to arbitral jurisdiction asserting the invalidity of the contract. This principle is widely accepted in countries party to the 1958 *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, and is also expressly adopted by Article 16(1) of UNCITRAL Model Law as well as the ICC Rules (Art. 6.3 1998 Rules; Art. 6.9 2012 Rules) or others (Art. 23 1998 London Court of International Arbitration Rules; Art. 15.2 American Arbitration Association Rules; Art. 21.2 Swiss Rules of International Arbitration; Art. 23 UNCITRAL Arbitration Rules 1976 as revised in 2010 ("UNCITRAL Arbitration Rules")).

Parties' choice of applicable law not "contested solely on the ground that the contract to which it applies is not valid"

7.8 The adverb "solely" means that the formal or material invalidity of the main contract does not automatically lead to the invalidity of the choice of law agreement. The choice of law agreement may be declared invalid only on grounds specifically affecting it.

7.9 Whether or not parties' choice of applicable law is affected by the invalidity of the main contract depends on the particular circumstances. For example, arguments which seek to impugn the parties' consent to the main contract do not necessarily undermine their consent to the choice of law agreement, unless the circumstances are such as to demonstrate lack of consent to *both* the main contract and the choice of law agreement.

> ***Illustration 7-1.*** *Party A claims performance under the contract. Party B takes the position that the contract should be regarded as a major transaction and be subject to shareholder approval at a shareholders' meeting which has not taken place. Party B asserts that the contract is therefore invalid according to the corporate law of State X. If the contract is found to be invalid, this does not automatically invalidate the parties' choice of law agreement. The validity of the latter agreement should be raised and considered separately, under the provisions of the Principles.*
>
> ***Illustration 7-2.*** *A contract between Party A and Party B contains an agreement that it is governed by the law of State X. Under the law of State X, such a contract is invalid. Party A has performed the contract. The invalidity of the contract does not affect the choice of law of State X. That law applies for determining the consequences of invalidity, notably the entitlement to restitution when the contract has been performed, in whole or in part.*
>
> ***Illustration 7-3.*** *The contract is judged to be invalid as made because one party operated under a serious mistake as to the nature of the goods to be supplied. The validity of a choice of law remains unaffected.*

Defect affecting both the parties' choice of law agreement and the main contract

7.10 In some situations, the parties' choice of law agreement is affected by a defect that applies to both the agreement and the contract to which the agreement applies. This is notably the case where both the contract and the choice of law agreement, even if separate, are tainted by the same fraud or where a party lacks capacity to contract (a minor who may not enter the contract is also prevented from entering into a choice of law agreement). It should be recalled, however, that the Principles do not address the law governing the capacity of natural persons (Art. 1(3)).

> ***Illustration 7-4.*** *If a contract is judged to be invalid because one of the parties bribed the other or because one of the parties lacked capacity, a choice of law agreement contained in the contract, or affected by the same defect when concluded, will also be invalid.*

7.11 The choice of law clause is affected when the defect causing the invalidity of the main contract necessarily extends, by its very nature, to this clause. In such a situation, the invalidity will also have consequences for other clauses, such as an agreement on choice of court or the arbitration agreement in the same contract.

Article 8
Exclusion of *renvoi*

A choice of law does not refer to rules of private international law of the law chosen by the parties unless the parties expressly provide otherwise.

Introduction

8.1 The Principles provide for party autonomy and allow the parties to choose the law that will govern their contract. Article 8 is a specific rule concerning the applicability of rules of private international law.

8.2 Article 8 begins with the rule providing that a choice of law by the parties is to be interpreted as *not* encompassing the private international law rules of the chosen law in principle. This rule excludes the possibility of an unintentional *renvoi* and thus conforms to the parties' intent in general.

8.3 Nevertheless, in keeping with the very notion of party autonomy, Article 8 allows the parties, as an exception, to expressly designate the private international law rules of the chosen law. It is in contrast to Article 4 which permits both an express and a tacit choice of law. With regard to other aspects of choice of law, Articles 1 to 7 and 9 to 12 apply.

8.4 As used in Article 8, the phrase "rules of private international law" is confined to the rules determining the applicable law. It does not encompass rules of international adjudicatory jurisdiction, procedure or recognition of foreign judgments (see Introduction). The sources of private international law rules can be national, regional, supranational or international instruments, case law, customary law or even non-State law (Art. 3).

Exclusion of *renvoi*

8.5 Article 8 states that a choice of law by the parties does not include the private international law rules of the chosen law. This principle accords with the existing Hague Conventions which exclude the possibility of *renvoi* by stating that "the term 'law' means the law in force in a State other than its choice of law rules" (see*, e.g.,* Art. 12 *Hague Protocol of 23 November 2007 on the Law Applicable to Maintenance Obligations* (the "2007 Hague Protocol")). Other international or regional instruments generally also exclude *renvoi* (Art. 17 Mexico City Convention; Art. 20 Rome I Regulation; Art. 24 Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the Law Applicable to Non-Contractual Obligations; Art. 11 Council Regulation (EU) No 1259/2010 of 20 December 2010 Implementing Enhanced Cooperation in the Area of the Law Applicable to Divorce and Legal Separation). A minor exception in favour of *renvoi* exists only where the instrument extends its operation to non-Contracting or non-Member States (Arts 4 and 17 *Hague Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons* ("1989 Hague Succession Convention"); Art. 12 *Hague Convention of 14 March 1978 on the Law Applicable to Matrimonial Property Regimes* ("1978 Hague Matrimonial Property Convention"); Art. 34 Regulation (EU) No 650/2012 of the European Parliament and of the Council of 4 July 2012 on Jurisdiction, Applicable Law, Recognition and Enforcement of Decisions and Acceptance and Enforcement of Authentic Instruments in Matters of Succession and on the Creation of a European Certificate of Succession).

8.6 Aspiring to serve as a model and to promote international uniformity in private international law, the Principles similarly exclude the possibility of *renvoi,* except where the parties expressly provide otherwise. This exclusion honours the parties' intent by preventing the application of a law different from the parties' legitimate expectations. If parties' choice of law had to encompass its private international law rules by definition, it would indeed lead to uncertainty and unpredictability for the parties. The idea underlying the rule in Article 8 accords with the existing Hague Conventions that grant (limited) party autonomy (Arts 7, 8

and 12 2007 Hague Protocol; Arts 5, 6 and 17 1989 Hague Succession Convention; Arts 7 and 15 1986 Hague Sales Convention; Arts 3, 4 and 5 1978 Hague Matrimonial Property Convention).

8.7 Pursuant to the rule in Article 8, a generic choice of law clause is interpreted as being limited solely to the substantive rules of the chosen law to the exclusion of its private international law rules.

> ***Illustration 8-1.*** *A contract between Party A and Party B provides that "the parties agree that the law of State X will govern their contract". This provision is interpreted as referring solely to the substantive law of State X to the exclusion of its private international law rules.*

8.8 The rule of Article 8 does not prevent the parties from choosing an international, supranational or regional uniform law instrument, such as the CISG, to govern a contract that falls outside the territorial or substantive scope of the instrument (Arts 1(1)(a) and (b), 2 and 3 CISG) (see Commentary on Art. 3). The territorial or substantive scope of such instruments is indeed to be distinguished from the private international law rules of the chosen law in the sense of the rule of Article 8.

8.9 On the other hand, if an instrument or non-State law (Art. 3) that has been chosen by the parties themselves contains a reference to the law of a certain place or to the *lex fori*, this reference should be followed.

> ***Illustration 8-2.*** *Party A and Party B sign a contract that contains the following clause: "This contract shall be governed by the UNIDROIT Principles (2010)." According to the UPICC, the interest rate in case of failure to pay money is, under certain circumstances, the applicable rate fixed by the law of the State of the currency of payment (Art. 7.4.9(2)). Pursuant to this reference, the law of the State of the currency of payment is to be applied.*

Express choice of private international law rules

8.10 As an exception, Article 8 provides that the parties can expressly choose a law including its private international law rules. It enhances party autonomy by enabling the parties to indirectly choose the applicable substantive law via private international law rules. This principle, established in arbitration (see Art. 28(1) UNCITRAL Model Law), has also been extended to court proceedings. It deviates from the existing Hague Conventions and other instruments that allow (limited) party autonomy without granting the possibility of including the private international law rules (see paras 8.5 and 8.6).

8.11 The parties may have legitimate interests in choosing private international rules in arbitration in which the applicable private international law rules are not predetermined. This ensures that, at the very least, the applicable private international law rules are ascertainable. Similarly, in cases involving a multi-unit State, the parties may have an interest in choosing the internal conflict of laws rules of that State in order to avoid uncertainty.

> ***Illustration 8-3.*** *A contract between Party A and Party B points to an arbitral tribunal in State X with the following clause: "The arbitral award shall be made in accordance with the applicable law designated by the private international law rules of State X." The arbitral tribunal should apply the private international law rules of State X to determine the substantive law governing the contract.*

8.12 For the sake of legal certainty, Article 8 requires that a choice of private international law rules be made expressly. This requirement is an exception to Article 4 which provides for both an express and a tacit choice of law. An express choice can be made either orally or in written form (Art. 5). The wording of the parties must clearly indicate the choice of private international law rules. When the intent of the parties is not clear, it is to be interpreted on the

basis of the relevant circumstances. The parties should be aware of the risk of potential uncertainty when they include the private international law rules in their choice of law.

> ***Illustration 8-4.*** *The contract provides that "the law of State X" shall govern the contract. Such a provision is to be interpreted as pointing to the substantive law of State X because of the absence of any indication that the parties intended to include the private international law rules of State X.*

> ***Illustration 8-5.*** *The contract provides: "The contract shall be governed by the law that would be applied by the courts of State X." Such a provision is to be interpreted as a choice of the law of State X including its private international law rules. However, if the private international law rules of State X provide for party autonomy, it is unclear whether the parties' choice refers to rules on party autonomy (*e.g.*, Art. 7 1986 Hague Sales Convention) or only to the objective connecting factors in the absence of choice of law (*e.g.*, Art. 8 1986 Hague Sales Convention). The latter interpretation would be preferable to avoid* petitio principii*.*

8.13 A choice of private international law rules under Article 8 is governed by all other articles of the Principles, except for Article 4. Hence, the parties may choose private international law rules only for a part of the contract or modify their choice of private international law rules at any time without prejudice to the formal validity or third parties' rights (Art. 2). The parties may also designate non-State private international law rules (Art. 3). The choice of law agreement is governed by the substantive law to which the chosen private international law rules point (Art. 6): it is not subject to any formal requirements unless agreed otherwise between the parties (Art. 5); and it is severable from the main contract (Art. 7). Furthermore, in relation to the substantive law designated by the chosen private international rules, Articles 9, 10 and 11 apply.

8.14 When the Principles conflict with the chosen private international law rules, the conflict should be solved on a case-by-case basis.

> ***Illustration 8-6.*** *The parties designate the law of State X including its private international law rules. They subsequently modify their choice to the law of State Y, including its private international law rules. Unlike Article 2(3), the private international law rules of State Y do not allow the parties to modify their initial choice of law. In this case, Article 2(3) should prevail as the controlling private international law rule. This means that the parties' modification of their choice to the law of State Y is to be honoured.*

Article 9
Scope of the chosen law

Paragraph 1
The law chosen by the parties shall govern all aspects of the contract between the parties, including but not limited to –

a) interpretation;
b) rights and obligations arising from the contract;
c) performance and the consequences of non-performance, including the assessment of damages;
d) the various ways of extinguishing obligations, and prescription and limitation periods;
e) validity and the consequences of invalidity of the contract;
f) burden of proof and legal presumptions;
g) pre-contractual obligations.

Paragraph 2
Paragraph 1 e) does not preclude the application of any other governing law supporting the formal validity of the contract.

Introduction

9.1 The purpose of Article 9 is to describe the scope of the law chosen by the parties. Its structure is the following. First, it lays down the general rule that the law chosen by the parties governs *all aspects* of their contractual relationship. Secondly, it includes *a non-exhaustive list* of issues governed by such law. And thirdly, it makes clear that implementing States may add alternative connecting factors for the *formal validity* of the contract.

9.2 Article 9 is based on the principle that, unless the parties agree otherwise, the law chosen shall govern *all aspects of the contract*. The contract should be governed by the law chosen by the parties from its formation until its end. This approach ensures legal certainty, and uniformity of results and, in doing so, reduces the incentive for *forum shopping*: the law applicable to any aspect of the contractual relationship will be the law chosen by the parties, irrespective of the competent court or arbitral tribunal.

9.3 Naturally, the reference to "all aspects" does not prevent the parties from choosing different laws for different parts of the contract, in accordance with Article 2(2)(ii), or even from choosing a law only for one or more of the aspects listed in Article 9(1), for example, the interpretation of the contract.

9.4 Article 9(1) includes a list of seven questions governed by the law chosen by the parties. The terms *"… including but not limited to …"* indicates that the list is illustrative rather than exhaustive. The reason for mentioning those seven particular items is twofold. First, the list includes the most important aspects of any contract. This is the case, for example, for (a) and (b): interpretation, and rights and obligations arising from the contract. Second, the list clarifies that, in applying the Principles, certain issues are to be characterised as contractual, and thus they will be governed by the chosen law rather than another law, such as the *lex fori* or the *lex loci damni*. This is the case, for example, for prescription and limitation periods (Art. 9(1)(d)), burden of proof and legal presumption (Art. 9(1)(f)) or pre-contractual liability (Art. 9(1)(g)). This ensures a uniform characterisation of these questions and, accordingly, promotes uniformity of results.

Particular areas

9.5 The questions mentioned in Article 9(1)(a), *interpretation*, and Article 9(1)(b), *rights and obligations arising from the contract*, are probably the most relevant in practice and constitute the core of the issues governed by the law chosen by the parties. The chosen law determines what meaning is to be attributed to the words and terms used in the contract. Where the meaning of a word in a contract is ambiguous, the meaning must be ascertained using the canons of interpretation and construction of the law chosen by the parties. That law also determines the parties' rights and obligations, especially when they are not explicitly defined by the contract. Since the Principles apply only to contracts, the concept of "rights and obligations" should be understood as referring to "*contractual* rights and obligations", and not to non-contractual issues that may occur or arise between the contracting parties (but see para. 9.12).

9.6 Article 9(1)(c) refers to the *performance and the consequences of non-performance, including the assessment of damages.* The law chosen by the parties governs the conditions for the fulfillment of the obligations resulting from that law or from the contract, for example, the standard of diligence, the place and time of performance or the extent to which the obligation can be performed by a person other than the party liable (see M. Giuliano and P. Lagarde, "Report on the Convention on the Law Applicable to Contractual Obligations", [1980] OJ C282, p. 32 ("Giuliano-Lagarde Report")). The chosen law also governs the consequences of total or partial failure to perform those obligations, including the excuses for non-performance, and the assessment of damages.

9.7 The reference to *"the consequences of non-performance, including the assessment of damages"* is a reference to the substantive rules, *i.e.,* those aspects are included to the extent that they are governed by material law rules and lie within the powers conferred upon the court by the *lex fori* or *lex arbitri* (see Explanatory Report to the 1986 Hague Sales Convention, pp. 42-43; Giuliano-Lagarde Report, p. 32) Thus, questions such as the remedies for non-performance, for example*,* compensation and the determination of its amount, specific performance, restitution, the reduction for failure to mitigate a loss or the validity of penalty clauses, are subject to the law chosen by the parties.

9.8 Article 9(1)(d) refers to *the various ways of extinguishing obligations, prescription and limitations periods.* The law chosen by the parties governs all ways of extinguishing obligations, such as prescription or limitation of actions by the passage of time. Thus, the chosen law determines the commencement, computation and extension of prescription and limitation, and their effects, *i.e.*, whether they provide a defence for the debtor or they extinguish the creditor's rights and actions. The law chosen by the parties governs these issues irrespective of their legal characterisation under the *lex fori*. This ensures harmony of results and legal certainty (see Art. 12 *g)* 1986 Hague Sales Convention; Art. 12(1)(d) Rome I Regulation).

9.9 Article 9(1)(e) refers to the *validity and the consequences of invalidity of the contract.* The law chosen by the parties determines the formation of the contract, the condition for its validity and the grounds for avoidance. If according to that law the contract is null or invalid, the consequences of this circumstance, for example, the obligation of restitution and / or payment damages, are also governed by that law.

9.10 Article 9(1)(e) is closely linked to Article 7 (severability of the choice of law clause). According to this latter provision, it may be the case that the choice of law clause is valid, whereas the main contract to which it applies is null and void. The former provision makes clear that, in such a case, the consequences of the nullity of the contract are still governed by the law chosen by the parties.

9.11 Article 9(1)(f) refers to the *burden of proof and legal presumptions*. The Principles do not apply to evidence and procedural questions. However, the law chosen by the parties does apply to legal presumptions and burden of proof. Like other international instruments, the Principles follow a substantive characterisation of these issues, not a procedural one (see Art. 12 *g)* 1986

Hague Sales Convention; Art. 18(1) Rome I Regulation). Legal presumptions and rules determining the burden of proof contribute to clarifying the parties' obligations and thus are inextricably linked to the law governing the contract. Furthermore, a uniform characterisation of these issues ensures harmony of results and legal certainty. Conversely, procedural presumptions, *i.e.*, those based on procedural elements such as the effect of a failure to appear in court or the failure to deliver certain documents in the possession of one party, are excluded from the scope of the chosen law. The standard and mode of proof are also excluded.

9.12 Finally, Article 9(1)(g) refers to *pre-contractual obligations.* According to the Principles, the law chosen by the parties governs the rights and obligations of the parties during the formation period of the contract and the liability that may arise therefrom, for example, the information or undertakings given by the parties during that period. Therefore, once a contract has been concluded between the parties, the obligations that arose out of dealings prior to its conclusion are also subject to the law applicable to the contract. However, even before the contract is concluded, the parties may choose the law applicable to the contractual negotiations and therefore to the pre-contractual liability based, for example, on an unexpected breakdown of such negotiations.

Formal validity

9.13 Article 9(2) establishes that the formal validity of the contract is not prevented from being established other than by reference to the law chosen by the parties, if this is permitted by the private international law rules of the forum, or by the rules applied by an arbitral tribunal. This provision follows the well-established principle of *favor negotii*, which seeks to avoid formal invalidity as far as possible. It implies that, in relation to formal validity only, the applicable law may be determined by reference to connecting factors other than the law chosen by the parties. Those may include, for example, depending on the venue, the law of either of the States where either of the parties or their respective agents are present when the contract is concluded, the law of the State where either of the parties has its habitual residence at the time of conclusion, or the law of the State where the contract was concluded. This rule accordingly enables the national courts or arbitral tribunals to take other laws into consideration where the form of the contract is not valid under the applicable law. Nevertheless, once the law applicable to the contract is determined, any change of choice of law is without prejudice to the contract's formal validity (see Art. 2(3)).

Article 10
Assignment

In the case of contractual assignment of a creditor's rights against a debtor arising from a contract between the debtor and creditor –

a) if the parties to the contract of assignment have chosen the law governing that contract, the law chosen governs mutual rights and obligations of the creditor and the assignee arising from their contract;

b) if the parties to the contract between the debtor and creditor have chosen the law governing that contract, the law chosen governs (i) whether the assignment can be invoked against the debtor, (ii) the rights of the assignee against the debtor, and (iii) whether the obligations of the debtor have been discharged.

Introduction

10.1 Even when party autonomy is fully effectuated by the Principles, difficult questions arise in determining the applicable law in cases in which (i) the rights and duties of the parties are determined by two or more related contracts that are entered into by different combinations of parties and (ii) those contracts that provide that they are governed by different law. Among such complex contractual situations, the Principles focus on assignment because assignments are important and recurring transactions in international commercial practice.

10.2 Assignments and similar complex transactions involving overlapping contracts do not present unique issues with respect to the determination of the law governing each of the contracts when considered separately. There are, however, difficult issues in determining the law governing matters that relate to the intersection of those two contracts, particularly when they are governed by different laws. After all, the claim of an assignee against the obligor on the assigned contract is created by a combination of the assigned contract and the contract of assignment, and the parties to those two contracts may have chosen to have them governed by different laws. Moreover, the assignee was not a party to the assigned contract and did not participate in the choice of law in that contract while, similarly, the obligor was not a party to the assignment contract and did not participate in that contract's choice of law.

10.3 Accordingly, it is useful to examine how choice of law operates in assignment transactions in light of the frequency of assignments in international commerce and the potential for confusion as to which law governs which aspects of the relationship among the obligor, assignor and assignee when the contract between the obligor and the obligee / assignor is governed by a different law from the contract between the obligee / assignor and the assignee.

10.4 Article 10 provides rules that determine the role of the chosen law in assignment transactions in which the rights and duties of the parties are defined by two or more related contracts that are entered into by a different combination of parties and those contracts are stated to be governed by different laws.

10.5 ***Scenario 1.*** *Pursuant to a contract between Debtor and Creditor (Contract 1), Creditor has a claim against Debtor for a monetary sum. Contract 1 is stated to be governed by the law of State X and, under the Principles, that designation of applicable law is given effect. Pursuant to a contract between Creditor and Assignee (Contract 2), Creditor has assigned its claims against Debtor under Contract 1 to Assignee. Contract 2 is stated to be governed by the law of State Y and, under the Principles, that designation of governing law is given effect. The result of these two contracts, when considered together, may be to create a right of Assignee against Debtor.*

10.6 Although the Principles, in recognition of party autonomy, allow the parties to choose the law governing a contract, so that Contract 1 in Scenario 1 is governed by the law of State X (as chosen by the parties to that contract) and Contract 2 is similarly governed by the law of State Y, the Principles' deference to party autonomy tells us little about the law governing matters that affect the relationship between parties who have not contracted with each other (such as Debtor and Assignee) and, thus, have not exercised their autonomy to choose the law governing those matters. While Creditor and Assignee have chosen to have their contract governed by the law of State Y, Debtor has not agreed to the application of State Y's law. Similarly, while Debtor and Creditor have chosen to have their contract governed by the law of State X, Assignee has not agreed to the application of State X's law. As a result, applying either the law of State X or the law of State Y to the relationship between Debtor and Assignee created by the interaction of the two contracts cannot be said to be merely an application of party autonomy.

10.7 Accordingly, while the Principles generally defer to party autonomy for selection of the law governing the relationship between parties who have contracted with each other, rules are needed to determine which law applies when deference to the joint choice of the parties has no real meaning because the parties have not contracted with each other. Article 10 provides these rules.

Identification and application of the Principles to resolve issues raised by assignments

10.8 Article 10 is based on two principles: (i) rights and obligations as between two parties, created by a contract between them, should be governed by the law governing that contract; and (ii) obligations under contracts that are assigned should continue to be governed by the law governing the contract that created them.

10.9 Applying these two principles to the relationship created by assignment leads to the following conclusions. First, the law chosen by the assignor (Creditor in Scenario 1) and the assignee in the contract of assignment governs their mutual rights and obligations arising from that contract. Second, the law chosen by the obligor (Debtor in Scenario 1) and the obligee (Creditor in Scenario 1) in their contract creating the assigned right determines, *inter alia*, (i) whether the assignment can be invoked against the obligor, (ii) the rights of the assignee against the obligor, and (iii) whether the obligations of the obligor have been discharged.

10.10 Applying this analysis to the facts set out in Scenario 1, the contractual obligations created between Creditor and Assignee under Contract 2, and the determination of whether that contract effectively transfers, as between Creditor and Assignee, Creditor's rights under Contract 1 to Assignee, are governed by the law of State Y. On the other hand, (i) whether Debtor's obligation is now owed to Creditor or to Assignee (including determination of the effect of any anti-assignment clauses in Contract 1), and (ii) if an obligation is owed to Assignee by Debtor as a result of the assignment, the nature and extent of the Debtor's obligation (including determination of the effect of any doctrines pursuant to which an assignee may take free of certain defences of an obligor) are governed by the law of State X.

International precedents

10.11 The matter of the law governing assigned obligations is addressed in the 2001 *United Nations Convention on the Assignment of Receivables in International Trade* ("UN Receivables Convention"). The matter is also addressed in the Rome I Regulation and in the UNCITRAL Legislative Guide on Secured Transactions ("the Guide"). Article 10 is consistent with these precedents. Article 28(1) of the UN Receivables Convention (recommendation 216 of the Guide) refers issues between the assignor and the assignee to the law governing the assignment, and defers to party autonomy for choosing that law: "The mutual rights and obligations of the assignor and the assignee arising from their agreement are governed by the law chosen by them." Article 29 of the UN Receivables Convention (recommendation 217 of the Guide) addresses the law applicable to the relationship between the obligor on the assigned contract and the assignee: "The law governing the original contract (the assigned contract)

determines the effectiveness of contractual limitations on assignment as between the assignee and the debtor, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and whether the debtor's obligations have been discharged".

Related issues

10.12 Other contexts in which rights are determined by reference to two or more contracts between different sets of parties include subrogation and delegation. While Article 10 does not provide rules for determining which law governs the various issues that may arise in those contexts, the rules of Article 10 may be applied to those situations by analogy.

Article 11
Overriding mandatory rules and public policy (*ordre public*)

Paragraph 1
These Principles shall not prevent a court from applying overriding mandatory provisions of the law of the forum which apply irrespective of the law chosen by the parties.

Paragraph 2
The law of the forum determines when a court may or must apply or take into account overriding mandatory provisions of another law.

Paragraph 3
A court may only exclude application of a provision of the law chosen by the parties if and to the extent that the result of such application would be manifestly incompatible with fundamental notions of public policy (*ordre public*) of the forum.

Paragraph 4
The law of the forum determines when a court may or must apply or take into account the public policy (*ordre public*) of a State the law of which would be applicable in the absence of a choice of law.

Paragraph 5
These Principles shall not prevent an arbitral tribunal from applying or taking into account public policy (*ordre public*), or from applying or taking into account overriding mandatory provisions of a law other than the law chosen by the parties, if the arbitral tribunal is required or entitled to do so.

Overview

11.1 Article 11 recognises two classes of limitation upon the application of the principle of party autonomy set out in Article 2. Notwithstanding the law chosen by the parties, a court may (a) apply or take into account "overriding mandatory provisions" of the law of the forum (Art. 11(1)) or another law (Art. 11(2)), and (b) decline to apply a provision of the law chosen by the parties if it would be manifestly incompatible with fundamental notions of public policy (*ordre public)* of the forum (Art. 11(3)) or a State whose law would apply to the contract had the parties not exercised their choice (Art. 11(4)).

11.2 The result is that a national court may apply overriding mandatory provisions of the law of the forum (see paras 11.14-11.18) or of a third State (see paras 11.19-11.23) even if the parties have not chosen the law of those States to govern their contract. A court may also refuse to apply a provision of the law chosen by the parties because it is manifestly incompatible with fundamental notions of public policy (*ordre public*) of the law of the forum (see paras 11.24-11.28) or of the identified third State, *i.e.*, that State whose law would be applicable if the parties had not exercised their freedom to choose the applicable law (see paras 11.29-11.34).

11.3 These classes of limitation must be carefully circumscribed if the principle of party autonomy is not to be unduly weakened. Accordingly, they must be limited to rules and policies which can be said to be of fundamental importance within the legal systems from which they originate (see paras 11.16 and 11.25).

11.4 The law of the forum plays a central role in Article 11. It is by reference to the law of the forum that a court will determine whether a provision displays the characteristics necessary to constitute an "overriding mandatory provision" or a public policy of a sufficiently fundamental nature as to be capable under these Principles of overriding the law chosen by the parties (Art. 11(1) and (3); see paras 11.14 and 11.24). It is also the law of the forum which determines when a court is able to apply or take into account the overriding mandatory laws or public policy of a third State (Art. 11(2) and (4); see paras 11.22 and 11.30).

11.5 The classes of limitation recognised by Article 11 qualify the applicable law to a certain extent, but they do not invalidate the parties' choice. In the case of overriding mandatory provisions, the applicability of the chosen law is supplemented by the application of the mandatory provision (which prevails over the chosen law only to the extent that the two are irreconcileable). In the case of public policy, the applicability of the chosen law is limited only to the extent that it cannot be applied consistently with the identified public policy. Beyond these limits, the chosen law falls to be applied, as set out elsewhere in these Principles.

11.6 Article 11(5) stands apart from the rest of the Article. As the Commentary on the provision (see paras 11.32-11.34) makes clear, it recognises that arbitral tribunals and national courts operate in different contexts in their treatment of overriding mandatory rules and public policy. Article 11 provides, therefore, that an arbitral tribunal may take into account public policy or overriding mandatory provisions of any law, but only where it is "required or entitled to do so".

The relationship of Article 11 to the principle of party autonomy

11.7 The Preamble states that the Principles "affirm the principle of party autonomy with limited exceptions" (see Preamble, para. 1). Within the material scope of the Principles, the most important qualifications to the application of the law chosen by the parties are those set out in this Article.

11.8 While constituting restrictions upon the application of the law chosen by the parties, these qualifications buttress the principle of party autonomy. By acknowledging and defining the exceptional circumstances in which a national court or arbitral tribunal may legitimately override the choice made by the parties to a contractual relationship in the exercise of the power conferred on them by Article 2(1), the provisions described in the following paragraphs provide an essential "safety valve" (*Guardianship of Infants (The Netherlands v. Sweden)* (1958) 25 ILR 254, 270: Judge Lauterpacht, describing public policy (*ordre public*) as a "general principle of law"). This control mechanism in turn can be seen as a means of reinforcing the confidence that a legal system reposes in the parties and as protecting the parties' legitimate expectations. Without provisions of this kind, which protect the integrity of a legal system and the society that it represents, the freedom to choose the law applicable to a contract might not be accepted at all and, if recognised, would be at risk of being undermined or negated on insubstantial or spurious grounds.

11.9 Article 11 permits the application, on an exceptional basis, of two categories of restrictions on the application of the law chosen by the parties: overriding mandatory provisions and public policy (*ordre public*). These two elements are commonly dealt with in separate provisions in national and international instruments, including all of the Hague Conference's Conventions dealing with choice of law issues over the past 50 years (see, *e.g.*, Arts 16-17 1978 Hague Agency Convention; Arts 17-18 1986 Hague Sales Convention; Art. 11 2006 Hague Securities Convention).

11.10 There is no doubt that the categories of overriding mandatory provisions and public policy are "closely connected", and they may be considered to share the same doctrinal basis and, in effect, to be two sides of the same coin. Nevertheless, their separate treatment in the Principles has the advantage, in particular, not only of consistency with the majority of existing international instruments but also in allowing a clear distinction to be drawn between (a) situations in which application of the chosen law is displaced because a specific, positive rule of the *lex fori* or another legal system takes priority and is applied instead (application of an overriding mandatory provision), and (b) situations in which application of the chosen law is blocked because it, or rather its application in a particular case, is repugnant to the fundamental policies of the forum or another legal system whose law would apply to the contract absent the parties' choice (application of *ordre public*).

11.11 The priority given to the principle of freedom of choice in Article 2 requires that the use of overriding mandatory provisions and public policy to overcome provisions of the parties'

chosen law be restricted. Any limit on the application of the law chosen by the parties must be justifiable, clearly defined and no wider than necessary to serve the objective pursued. In line with this restrictive approach, the Principles emphasise the exceptional character of public policy and overriding mandatory provisions.

11.12 Article 11 distinguishes between the role of overriding mandatory provisions and public policy in court proceedings (see Art. 11(1) to (4)) and their role in proceedings before an arbitral tribunal (see Art. 11(5)). In relation to court proceedings, Article 11 also distinguishes between the limiting effect of rules and policies of the forum (Art. 11(1) and (3)) and that of rules and policies of legal systems other than that of the forum or that chosen by the parties (Art. 11(2) and (4)).

11.13 Article 11 does not address the application of mandatory provisions and public policy of the law chosen by the parties. That is because a choice of law within Article 2 carries with it (subject only to the limits set out in the present Article) the application of *the whole* of the chosen law, whether or not falling within one or other of these two categories. Although Article 2 permits the parties to choose the law applicable to only part of a contract (*i.e.*, to some provisions, but not others) and to choose different laws to govern different parts, it does not allow the parties to pick and choose between individual rules of that law so as to exclude the application of certain specific rules of contract law while applying others (see para. 2.9, Illustration 2-3). For the most part, therefore, it will be a matter for the chosen law to determine whether a particular legal provision within the sphere of application of these Principles is one from which the parties are free to depart by the terms of their contract or is one which has mandatory effect.

Overriding mandatory provisions of the law of the forum (Art. 11(1))

11.14 Article 11(1) provides that the law chosen by the parties may be qualified by the overriding mandatory provisions of the law of the forum. Such overriding mandatory provisions continue to have effect notwithstanding the parties' choice of a different law, and will prevail in the event that they are irreconcileable with provisions of the chosen law.

11.15 Article 11(1) takes into account the approaches adopted in international and regional instruments, and the domestic laws of various jurisdictions, in order to yield to "local" overriding mandatory rules.

11.16 "Overriding mandatory provisions" is not defined in the Principles (compare Art. 9(1) Rome I Regulation). The term, found in several regional and national instruments, is generally understood to refer to provisions of law (in Article 1(1), the law of the forum) that must, according to their proper construction, be applied to the determination of a dispute between contracting parties irrespective of the law chosen to govern the contract. They are *mandatory* provisions in the sense that it is not open to the parties to derogate from them by the terms of their contract or otherwise. They are *overriding* provisions in the sense that a court must apply them even if the parties have chosen a law other than that of the forum to govern their contractual relationship. The presence of these two characteristics serves to emphasise the importance of the provision within the relevant legal system, and to narrow the category of provisions to which the Principles will apply. Overriding mandatory provisions are likely to be limited to those which are regarded as important for safeguarding the public interests of the forum (see Art. 9(1) Rome I Regulation).

11.17 It is not necessary that an overriding mandatory provision should take a particular form (*i.e.*, it need not be a provision of a constitutional instrument or statute), or that its overriding, mandatory character should be expressly stated. In every case, the law of the forum must be applied to determine (a) whether a particular provision is capable of having the effects described, and (b) whether, having regard to its terms (including its territorial application) and any relevant surrounding circumstances, it actually has those effects in the case in question. Nevertheless, the exceptional nature of the Article 11 qualifications to party autonomy should caution against the conclusion that a particular provision is an overriding mandatory provision in the absence of clear words to that effect.

11.18 The impact of Article 11(1) is also limited in the following way: it controls the application of the chosen law *only to the extent* that such application is incompatible with the concurrent application to the parties' relationship of the relevant overriding mandatory provision. Importantly, the conclusion that the chosen law is, in one or more respects, incompatible with an overriding mandatory provision of the law of the forum does not invalidate the parties' choice or, save to the extent of any incompatibility, negate the consequences of that choice under Articles 2 and following. The chosen law must be applied to the greatest possible extent consistently with the overriding mandatory provision.

> ***Illustration 11-1.*** *A statutory provision such as the following (Art. X) would bring the substantive provision to which it refers (Art. Y) within the scope of Article 11(1):*
>
> *Article X*
> *(1) The application of Article Y extends to contracts and proposed contracts the proper law of which is or would be the law of a State in which this Statute applies or to which this Statute extends. It applies notwithstanding any agreement or waiver to the contrary.*
>
> *(2) For the purposes of sub-section (1), where the proper law of a contract or proposed contract would, but for an express provision to the contrary included or to be included in the contract or in some other contract, be the law of a State in which this Statute applies or to which this Statute extends, then, notwithstanding that provision, Article Y applies to the contract.*
>
> ***Illustration 11-2.*** *Party A and Party B conclude a contract under which Party A is appointed Party B's commercial agent in State X. The contract stipulates that it is governed by the law of State Y and is subject to the exclusive jurisdiction of the courts of State X. Upon termination of the contract, Party A sues Party B in State X, claiming compensation under the law of State X. A statute of State X regulating commercial agency arrangements provides for an indemnity upon the termination of the agency contract and also includes a provision to the effect that "the parties may not derogate from the indemnity provisions to the detriment of the commercial agent before the agency contract expires". The court in State X may (or may not) interpret those words as justifying the conclusion that the indemnity provisions provided by the statute are overriding mandatory rules, displacing the otherwise relevant rules of the law of State Y regarding indemnity chosen by the parties to govern their contract. In order to reach that conclusion, the court must be satisfied not only that the provision, if it applies, is one from which the parties are not free to derogate but also that the provision must be applied notwithstanding that the parties have chosen the law of State Y to govern their relationship.*

Overriding mandatory provisions of another law (Art. 11(2))

11.19 Article 11(2) deals with the possible application of the overriding mandatory provisions "of another law", *i.e.,* the law of a State other than that of the forum or of the law chosen by the parties.

11.20 Certain international instruments, such as the 1978 Hague Agency Convention and the *Rome Convention of 19 June 1980 on the Law Applicable to Contractual Obligations*, contain provisions allowing the courts to give effect, on a discretionary basis and subject to certain conditions, to the overriding mandatory provisions of another law. Current State practice and opinion as to the utility of provisions of this kind, however, diverges widely. Article 11(2) seeks to accommodate this diversity within the Principles by delegating to the law of the forum the questions whether and under which circumstances third-country overriding mandatory provisions may or must be applied or taken into account. A similar solution is found in Article 11(2) of the Mexico City Convention.

11.21 The reference in Article 11(2) to the law of the forum includes its rules of private international law. It is broad enough to encompass discretionary provisions of the kind referred to above as well as more specifically limited provisions (see, *e.g.*, Art. 9(3) Rome I Regulation). The definition of the category of overriding mandatory provisions, and the relationship between those provisions and provisions of the chosen law, are to be understood in the same way as for Article 11(1) (see paras 11.14-11.18).

11.22 Article 11(1) and (2) complement one another in the sense that the law of the forum will decide whether an overriding mandatory provision of another law is to take precedence over an overriding mandatory provision of the law of the forum. During the meeting of the Special Commission, a suggestion was made that the first two paragraphs of Article 11 be merged together, to ensure the Principles remained concise. That proposal was, however, rejected. The Special Commission agreed to retain the two distinct paragraphs, particularly as this may be useful, for didactic purposes, where the Principles might be used as a model for legislators who may wish to define more clearly the role of overriding mandatory provisions of a third country.

11.23 Article 11(2) does not preclude the application of provisions of the chosen law that permit or require a court to take account of the law of a third country as a circumstance relevant to their application on the facts of a particular case (*e.g.*, a rule of contract law suspending or terminating performance which has become illegal under the law of the place of chosen performance).

> ***Illustration 11-3.*** *Party A and Party B conclude a contract for the rental by Party B of a commercial goods vehicle, knowing that it is to be used to smuggle historical artifacts from State Y to State X. The contract is expressed to be governed by the law of State Z. Under the cultural objects law of State Y, the export of historical artifacts without a licence is a criminal offence and all contracts whose purpose is to facilitate smuggling are illegal and unenforceable. Party A fails to provide the vehicle, and Party B sues Party A in State X. Assuming that the contract is valid and enforceable under the law chosen by the parties (*i.e.*, the law of State Z), the law of State X will determine whether and, if so, to what extent overriding mandatory provisions of the law of State Y are to be applied or taken into account. If, under the law of State X, the overriding mandatory provisions of the law of State Y ought to be applied or taken into account, the law of State Y must then be considered to determine whether the provisions of the cultural objects law have the status of overriding mandatory provisions for this purpose.*

Public policy (*ordre public*) of the forum (Art. 11(3))

11.24 Under Article 11(3), application of a provision of the chosen law may be excluded only if the result of such application conflicts with fundamental notions of public policy (*ordre public*) of the forum. Three requirements must be met in order for Article 11(3) to apply: first, there must be a policy of the forum State of sufficient importance to justify its application to the case in question ("fundamental notions of public policy" or "*ordre public*"); secondly, the chosen law must be obviously inconsistent with that policy ("manifestly incompatible"); and thirdly, the manifest incompatibility must arise in the application of the chosen law to the dispute before the court. These requirements reflect the *leitmotiv* of the Principles, *i.e.,* facilitating party autonomy as much as possible, and serve to control attempts to invoke public policy arguments to deny the efficacy of the chosen law.

11.25 As to the first requirement, the use of the words "fundamental notions of public policy" and the internationally accepted expression "*ordre public*" emphasise that Article 11(3) is concerned with policies of the legal system of the forum (in whatever form) that are so important that they extend to contracts of an international character notwithstanding that the parties are empowered to choose (and have, in the case in question, chosen) another law to govern those contracts. Accordingly, the category is much narrower than the concept of "public policy" as it may apply to domestic contracts. It is, of course, not sufficient that the chosen law adopts an approach different from that of the law of the forum. It is necessary that the

application of the chosen law would violate a fundamental policy of the forum of the kind described.

11.26 As to the second requirement, the words "manifestly incompatible" (used, *e.g.*, in Art. 17 1978 Hague Agency Convention and in Art. 21 Rome I Regulation) serve to emphasise that any doubt as to whether application of the chosen law would be incompatible with the forum's fundamental policies must be resolved in favour of the application of the former.

> ***Illustration 11-4.*** *Party A, a resident of State X, visits Party B's casino in State Y. During the visit, the parties conclude a wagering contract, governed by the law of State Y. Party A fails to pay and Party B sues Party A in State X. Wagering contracts are considered to be against public policy in State X, but are legal, binding and enforceable under the law of State Y. Whether or not the court in State X will refuse to apply the rules upholding enforceability of the contract under the law chosen by the parties will depend on whether or not (i) the public policy of State X is regarded as a fundamental policy of that State which extends to all wagering contracts, even those concluded outside the State with a non-resident party (Party B) and expressed to be subject to a law that does not prohibit such contracts; and (ii) whether the enforcement of the contract in Party B's favour would be manifestly incompatible with that policy.*

11.27 Article 11(3) emphasises the third requirement, namely, that it is the result of *applying* the chosen law in a particular case that must be assessed for compliance with public policy. This, however, does not exclude the possibility that a law is so outrageous that its application under any circumstances would offend the fundamental policies of the forum – it is the public interests of the forum and not the private interests of the parties that must prevail.

> ***Illustration 11-5.*** *Party C and Party D, both resident in State X, conclude a contract for the sale by Party C of his or her art collection to Party D at a price which is lower than its market value. Following a* coup d'état *in State X, the new regime adopts legislation depriving of their nationality all members of a minority community of which Party C is a member, and providing that all contracts made otherwise than between nationals of State X are to be cancelled. Party C flees State X with part of his or her art collection, and seeks political asylum in State Y. Party D sues Party C in State Y. The court in State Y may (or may not) consider that the legislation of State X, insofar as it discriminates on unjustifiable grounds, offends the public policy of State Y and that the contract should be upheld even though its enforcement would be financially disadvantageous to Party C as the person discriminated against.*

11.28 The law chosen by the parties may only be excluded "to the extent" that its application would be incompatible with the forum's public policy. Thus, as in the case of overriding mandatory provisions, the existence of an incompatibility of this kind does not deprive the parties' choice of law of any effect. Instead, the chosen law must be applied to the greatest possible extent consistently with the public policy of the forum. Such application may produce an outcome which is both coherent and consistent with the forum's public policy. If, however, the non-application of a provision of the chosen law produces an outcome which is incomplete or incoherent, the law of the forum should normally be applied to identify any gap-filling rule. It is, however, possible that the parties may themselves have provided for the consequences of a conflict with the public policy of the forum and, if they have done this and their choice can be given effect consistently with public policy, that expression of their autonomy should prevail.

> ***Illustration 11-6.*** *Party A sues Party B in the courts of State X for breach of contract. Party A seeks compensatory and punitive damages in accordance with the law of State Y chosen by the parties to govern the contract and any disputes to which it gives rise. Under the law of State X, it is considered a fundamental principle of law that punitive damages are not available in relation to contractual claims. Under Article 11(3), the court in State X could exclude the application of the law of State Y with respect to the punitive damages claim, but the law of State Y must still be applied to determine Party A's claim for compensatory damages.*

Public policy (*ordre public*) of a State the law of which would be applicable in the absence of a choice of law (Art. 11(4))

11.29 Article 11(4) was added by the Special Commission in recognition in certain legal systems of the relevance of the public policy of a third State, specifically that whose law would apply if the parties had not exercised their freedom of choice.

11.30 Article 11(4), like Article 11(2), defers to the law of the forum, including its rules of private international law, to determine the role (if any) to be played by the public policy (*ordre public*) of a third country. Unlike Article 11(2), however, Article 11(4) permits reference only to the law which would be applicable to the contract in the absence of a choice of law under the forum's own private international law rules. For this purpose, it will obviously be necessary to put to one side not only an express choice of law provision but also any provision of the contract or other circumstance which is taken to demonstrate a tacit choice (see paras 4.9-4.16).

11.31 Subject to any further restrictions imposed by the law of the forum, the category of public policy (*ordre public*) to which reference may be made and the limits on its application are to be understood as being subject to the same requirements and restrictions as the exclusionary principle in Article 11(3) (see para. 11.28).

Arbitral tribunals and public policy (*ordre public*) and overriding mandatory provisions (Art. 11(5))

11.32 Article 11(5) reflects the different state of affairs facing arbitral tribunals as opposed to national courts in relation to mandatory rules and public policy. Arbitral tribunals, unlike courts, do not operate as part of the judicial infrastructure of a single legal system, and are subject to a range of legal influences. Moreover, the Principles, by their very nature as a non-binding instrument, do not (and cannot) grant an arbitral tribunal any authority beyond that which it already has pursuant to its mandate and cannot predict the exact circumstances in which an arbitral tribunal will be constituted and called upon to reach a decision.

11.33 Consequently, Article 11(5) does not confer any additional powers on arbitral tribunals and does not purport to give those tribunals an unlimited and unfettered discretion to depart from the law chosen by the parties. Instead, it serves to clarify that the Principles, particularly Article 11, do not prevent an arbitral tribunal from taking into account public policy or overriding mandatory provisions of any law, but only where it is "required or entitled to do so". That wording requires the tribunal to consider the legal framework within which its decision-making processes are conducted, having regard (in particular) to the agreement of the parties, the designated or deemed seat of the arbitration, any institutional rules applicable to the arbitration and the potentially controlling influence of national courts applying local arbitration legislation.

11.34 For example, arbitral tribunals may be subject to an express duty to endeavour to render an "enforceable award" (see, *e.g.*, Art. 41 ICC Rules and Art. 32.2 1998 London Court of Arbitration Rules; see also Art. 34(2) UNCITRAL Arbitration Rules stating that the award be "final and binding"). It is a controversial question whether a duty of this kind requires the tribunal to have regard to the overriding mandatory provisions and policies of the seat, however identified, or of the places where enforcement of any award would be likely to take place. Article 11(5) does not express any view on this controversy. It does, however, emphasise that (at least in the first instance) it is for the tribunal to form a view as to the existence and scope of the duties imposed on it (and the powers granted to it), and to apply or take into account the provisions or policies of a law other than that chosen by the parties to govern their contract only if it considers that it is under a legal obligation (or is otherwise entitled) to do so.

Article 12
Establishment

If a party has more than one establishment, the relevant establishment for the purpose of these Principles is the one which has the closest relationship to the contract at the time of its conclusion.

Introduction

12.1 Article 12 determines the relevant establishment when a party has more than one establishment. The Article points to the establishment that has the closest relationship to the contract at the time of its conclusion. This provision is applicable in relation to Articles 1(2) and 6(2).

Rationale

12.2 In determining the relevant establishment in the case of multiple business locations, Article 12 has primarily followed the model of Article 10(a) of the CISG. A provision such as Article 5(h) of the UN Receivables Convention, which, in case of multiple places of business, refers to the place from which the central administration of the assignor or the assignee operates, was not adopted. This is because, for the purpose of the Principles, the main establishment or a subordinate establishment other than the central administration of the party was considered to be sufficiently meaningful to determine internationality of the contract (Art. 1(2)) or the law governing the consent to the choice of law (Art. 6(2)).

The notion of establishment

12.3 For the sake of legal certainty, Article 12 uses the term "establishment" rather than "place of business". The Principles do not provide a definition of establishment, but, in broad terms, an establishment means a party's constant and continuous business location. It encompasses a centre of administration or management, headquarters, principal and secondary places of business, a branch, an agency and any other constant and continuous business location. The physical presence of the party, with a minimum degree of economic organisation and permanence in time, is required to constitute an establishment. Hence, the statutory seat of a company without more does not fall within the notion of establishment because it is not the location from which the company's business activities are controlled. Similarly, a party who has its main establishment in State X and directs its business activities to State Y solely via the Internet, is not deemed to have an establishment in State Y.

12.4 Because the Principles apply only to international contracts in which each party is acting in the exercise of its trade or profession (Art. 1(1)), Article 12 does not use the expression "habitual residence" to include natural persons acting within their private sphere, especially consumers and employees.

Time at which a company's "establishment" is to be determined

12.5 Pursuant to Article 12, the location of a company's establishment is fixed at the time of the conclusion of the contract (*cf.* Art. 19(3) Rome I Regulation). Thus, in most cases, the relevant establishment will be determined by looking at the centre of operations through which the contract was negotiated and concluded. This respects the legitimate expectations of the parties and provides legal certainty.