Choice of law in the light of EU legislation

In recent years, there has been a rise of contracts concluded between parties having registered seat in different countries or involving cross-border commercial undertakings, or where there is a tendency to make a contract subject to foreign law even when the relationship itself lacks any international element. This gives rise to complex issues of jurisdiction and applicable law in situations where two Czech entities enter into relationship that is by their choice subject to application of foreign law, yet the substance of their relationship is entirely domestic.

Czech businesses should carefully consider, before entering into a contractual relationship with another Czech or foreign entity, the pros and cons of choosing applicable foreign law or jurisdiction. The importance of this choice is often underestimated in the light of visions centring on a potential business opportunity and anticipated profits. In other cases, weaker players may not be entirely in situation to negotiate governing law with stronger partners, and thus the only option is to enter or not enter into a contract under the given terms.

Freedom of choice of law is one of the cornerstones of the system of conflict-of-law rules established under the Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (“Rome I” or “Regulation”). Rome I is based on the principle of autonomy of contractual will of the parties. Should parties fail to choose governing law, or such choice is not validly made, Rome I provides the rules determining applicable law in absence of choice. General principle applies that a contract should be governed by the law of the country with which it is most closely connected.

Parties may subject their contract to foreign law provided that they make this choice expressly or when the choice is clearly demonstrated by the circumstances of the case. This does not however mean that choice of court venue does automatically determine applicable law, even though the jurisdiction may be one of the factors in determining whether choice of law is clear and express in the light of other circumstances. Another prerequisite of a valid choice of law is that it is made in compliance (i) with essential prerequisites of the applicable law as chosen by the parties, and (ii) the formal requirements of the law which governs it in substance under the Rome I Regulation or of the law of the country where it is concluded.

Regardless of this liberal approach assumed in Rome I, the contractual freedom re choice of law is not absolute and has certain limitations. Article 3(3) of the Regulation limits choice of law in connection with provision of law of other countries that cannot be derogated from by agreement. In some cases, even a valid choice of law may be limited in cases when two parties having habitual residence in one country choose different applicable law for relationship lacking any international element. Having in mind protection of Member States’ interests in applicability of their mandatory regulation, choice of law is limited with the proviso that such choice cannot abrogate regulation that cannot be derogated from by contract. In other words, two Czech entities, whose mutual performance does not extend beyond the national territory, may choose foreign law as governing
law for their contract, but that choice does not free them from the obligation to observe Czech peremptory rules.

Rome I also laid down rules for determining applicable law in cases where no choice is made. For instance, as a standard, a contract relating to a right in rem in immovable property shall be governed by the law of the country where the property is situated, a services contract shall be governed by the law of the country where the service provider has his habitual residence etc., and as so forth stipulated in Article 4. The general principle applies that where no choice of law has been made by the parties, the contract shall be governed by the law of the country with which it is most closely connected.

In cases where choice of law is made with the view of evading stricter regulation imposed by the Czech law, the above rules make it nearly impossible to avoid Czech or Community peremptory rules. In other words, choice of foreign law will not make one’s life much easier. The same applies to choices of venue outside the country of the applicable law as such choice nearly always results in complications and higher costs of proceedings. Choice of national law always seems to be the safer approach in terms of predictability of the outcome of eventual litigation. On the other hand, Czech entrepreneurs whose business activities are cross-border in their nature should remember that in certain cases their conduct will be subject to foreign peremptory rules (for instance in connection with consumer contracts which are by rule governed by the law of the country where the consumer has his habitual residence). Specific choice of law regulation is imposed on individual employment contracts, insurance contracts and contracts of carriage.

The new Czech Act No. 91/2012, on International Private Law, coming into force on 1 January 2014, and replacing the obsolete Act No. 97/1963, represents one of the cornerstones of the private law reform in the Czech Republic after its major overhaul this year. The provisions of the new Act on International Private Law relating to contracts and choice of law (as set out in the Act’s Sec 87) fully adhere to the principles stipulated by the Rome I.

The Regulation will continue to apply and will be unaffected even if the proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law is adopted. Since the Common European Sales Law, if adopted, will not cover every aspect of a contract, the existing rules of the law chosen by the parties that is applicable to the contract will still regulate such residual questions.

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