Rome I Regulation on Law Applicable to Contractual Obligations Comes into Force

January 19, 2010

Parties entering into commercial agreements should be aware of the practical implications of this new EU Regulation.

Introduction

The courts of all EU Member States other than Denmark are now applying the Rome I Regulation (593/2008/EC) ("Rome I"), a new EU Regulation, to determine the governing law of contracts entered into on or after 17 December 2009.

The rules set out in Rome I do not differ significantly from those contained in the Rome Convention on the law applicable to contractual obligations of 1980 (the "Rome Convention"). Despite this, there are some important changes which will have practical implications for commercial parties.

The Significance of Governing Law Clauses in Contracts

A governing law clause specifies the substantive system of law applicable to an agreement. If a dispute arises, the substantive law is determinative of the rights and obligations of the parties. However, the governing law clause does not necessarily specify how a dispute is to be resolved. Within the European Union, the Rome Convention or now Rome I provides the rules that EU courts must apply when deciding which Member State’s substantive law should govern a dispute.

Scope

Rome I applies to contractual obligations arising in civil and commercial matters. There are, however, a number of specific exclusions, for example, contractual obligations "arising under bills of exchange, cheques and promissory notes and other negotiable instruments to the extent that the obligations under such other negotiable instruments arise out of their negotiable character"; arbitration agreements; agreements on choices of court; and certain company matters.

Two matters should be noted by non-EU parties. Rome I rules will be applied by the courts of Member States even if the application of those rules results in a non-EU law, e.g., Chinese law, being the governing law of the agreement. Further, the courts of Member States will apply Rome I even if some or all of the parties appearing before them are non-European.

Timing

Rome I will be applied to agreements entered into on or after 17 December 2009. The governing law of agreements entered into prior to 17 December 2009 will continue to be determined by reference to the Rome Convention. The practical impact of this is that litigators now need to consider carefully which regime applies to their dispute.
Freedom of Choice

Party autonomy is the bedrock of Rome I. The whole purpose is to allow parties to an agreement to be able to choose the law that will govern their commercial relationship. The choice must be made expressly or be clearly demonstrated by the terms of the contract or by the circumstances of the case (a slightly different test to that found in the Rome Convention).

Applicable Law in the Absence of Choice

Rome I differs from the Rome Convention in providing specific rules to be used when the parties have not made an express choice (Article 4). In summary:

Eight rules deal with specific types of agreement. One example is that sale of goods is governed by the law of the country of the seller’s habitual residence. For companies, habitual residence is defined as the place of central administration. For a natural person acting in the course of business, it is their principal place of business.

In cases not covered by the eight rules, Rome I has the same rules as the Rome Convention: The agreement will be governed by the law of the country of habitual residence of the party required to effect “characteristic performance” of the contract.

Notwithstanding the two points above, if it is clear from all the circumstances of the case that an agreement is manifestly more closely connected with the law of a different country, then the law of that country will be applied.

Circumstances in which a Choice may be Modified

Like the Rome Convention, Rome I sets out various circumstances in which a choice of governing law made by the parties to an agreement can, at least partially, be modified:

Where all other elements relevant to the situation at the time of the parties’ choice are located in a country other than the country whose law has been chosen, the parties’ choice will not prejudice the application of mandatory provisions of the law of that other country, i.e., those which cannot be derogated from by agreement. This principle also applies to Community law provisions which cannot be derogated from by agreement in circumstances where all other elements are located in one or more EU Member States but the law of a non-Member State had been chosen.

Overriding mandatory provisions of the law of the forum, i.e., the place where the dispute is being heard, can be applied irrespective of the law that would otherwise be applicable. Overriding mandatory provisions are provisions “the respect for which is regarded as crucial by a country for safeguarding its public interest, such as its political, social and economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable”.

A court can refuse to apply provisions of the law that would be manifestly incompatible with the public policy of the forum.

A practical effect of these changes is that lawyers opining on the validity of choice of law clauses in transaction documents will have to amend their formal legal opinions to reflect these provisions.

A Question of Assignment?

The rules in the Rome Convention relating to assignment and subrogation have been tidied up. However, the European Commission is to produce a report on the effectiveness of assignments (Article 14) as against third parties by June 2010. This was a controversial issue in the early negotiations for Rome I, but ultimately it was put to one side in order to secure agreement within a reasonable timescale. The issue is principally whether the effectiveness of an assignment as against a third party should be governed by the law of the agreement or by the assignor’s home law. The UK Government plans to consult with interested parties in the next few months in order to take their views on this issue on board.
Whilst the rules in Rome I are not radically different from the rules previously applied by the English courts, there are, nevertheless, some changes which do have at least three practical consequences for commercial parties.

The first is timing. As 17 December 2009 has passed, parties must now ascertain whether Rome I or the Rome Convention will apply to their dispute. If Rome I is applicable, there are now specific rules to be used when the parties have not made a choice on governing law.

Second, there are now additional circumstances in which a choice of law may be modified. This will be immediately apparent to parties obtaining formal legal opinions on their transaction documents, as those opinions are likely to require amendments to reflect the provisions of Rome I.

Third, lawyers should be aware of the upcoming review on assignments. Those active in the financial markets in particular will need to be alert to future developments in this area. McDermott will be monitoring such developments closely.

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