

Rome I and Rome II: A Handbook to Determine the Law Governing Contractual and Non-Contractual Obligations

BY NORMAN PEPE

Introduction

This Client Alert aims to provide in-house counsel who are involved in international transactions with an overview of the recent uniform European conflict-of-law rules governing the process by which the law applicable to contractual and to non-contractual obligations is selected.

Regulation (EC) No 864/2007 of 11 July 2007 applies to non-contractual obligations (the "Rome II Regulation"), and Regulation (EC) No 593/2008 of 17 June 2008 applies to contractual obligations (the "Rome I Regulation" and, together with the Rome II Regulation, the "Rome Regulations")¹.

By way of background, whilst the Rome I Regulation has reformed and replaced the 1980 Convention on the Law Applicable to Contractual Obligations (the "Rome Convention") in the Member States of the European Union², uniform regulations detailing the governing law for non-contractual obligations (such as the Rome II Regulation) is an absolute novelty for European countries. Given that the origins of both Rome Regulations may be traced back to the Rome Convention, this Client Alert also intends to highlight the main innovations in this recent legislation as distinguished from the Rome Convention.

Due to their self-executing nature, the Rome Regulations³ can be seen as a single set of uniform rules which apply directly to Member States and replace their domestic law and which cover certain types of contractual, non-contractual, and pre-contractual obligations in those situations where there is a conflict of law⁴. The rules are a coordinated whole and aim to synchronise, on a continental scale, the laws applicable to legal relationships irrespective of the country of the court in which an action is brought, and ultimately to further implement the European internal market⁵.

Both of the Rome Regulations recognise party autonomy and therefore allow parties to select their own governing law. However, where no valid choice of law is made by the parties, the Rome Regulations provide a general rule as to the applicable law (the *lex loci damni* for non-contractual obligations, and the law of the country with which the contract is most closely connected for contractual obligations), and then specific rules applicable to certain circumstances. However, it should also be noted that the Rome Regulations also contain "escape clauses" which allow a departure from the specific rules, for example where it is clear from the relevant circumstances that the situation is manifestly more closely connected with another country, in which case the law of such other country will apply.

In order to clarify how the process of selecting the applicable law works in practice, we have divided this Client Alert into 3 parts: (a) Part I: freedom of choice of the parties; (b) Part II: the position under contract where the parties do not select a governing law; and (c) Part III: the position for non-contractual obligations where the parties do not select a governing law.

Part I - Freedom of choice

Pursuant to the Rome Regulations, parties are entitled to submit both contractual and non-contractual obligations to the law of their choosing *provided that* such choice of law is:

- (a) either expressed or is demonstrated with reasonable certainty by the circumstances of the case^{6,7};
- (b) valid, i.e. it satisfies (i) the substantive requirements of the law applicable to the “governing law” clause (i.e. the law stipulated by the parties)⁸; and (ii) the formal requirements set out in the law governing the obligations in question (i.e. presumably the law chosen by the parties) or in the law of the country where the choice has been formalised⁹; and
- (c) with respect to non-contractual obligations only, made (i) in an agreement entered into *after* the event giving rise to the damage (a post-tort agreement) or (ii) in an agreement concluded *before* the event giving rise to the damage (a pre-tort agreement) provided that the pre-tort agreement has been freely negotiated¹⁰ by the parties pursuing a commercial activity¹¹.

In light of (c) above, practitioners may want to consider reviewing their “pro-forma” confidentiality agreements. As these are usually the first legal documents that parties involved in negotiations enter into, it may be appropriate to expand the scope of the “governing law” clause so to coordinate the law chosen to govern contracts with the law chosen to govern non-contractual/pre-contractual obligations which arise or are likely to arise from the negotiations and any subsequent related activity.

Likewise, it may be advisable for similar provisions to be inserted into letters issued to bidders to establish with certainty the law governing the right of offerors and bidders to withdraw from the bid process.

It should be noted that the freedom of choice provided for by the Rome Regulations is not absolute but subject to certain exclusions, restrictions, and limitations¹² including as follows:

1. the parties cannot select the law applicable to non-contractual obligations arising from unfair competition, acts restricting free competition, or infringement of intellectual property rights¹³. Instead, such obligations are governed by the law selected on the basis of the connecting factors¹⁴;
2. the parties can select the law governing insurance contracts unless such contracts are “insurance contracts covering a large risk”¹⁵ in which case, the parties may only choose within a limited number of governing laws^{16, 17};
3. in some circumstances, even if the parties have validly stipulated the law applicable to their obligations, certain considerations may justify a limited application of the parties’ chosen law, for example when parties select a foreign law to govern a wholly “internal” or “intra-Community” situation. To protect the Member States’ and the Community’s interests in the application of their mandatory rules in those circumstances where the factual circumstances do not justify otherwise, “parallel” provisions of the Rome Conventions specify that the choice of a law made by parties will not prejudice¹⁸:
 - (a) the law of the country where all of the elements relevant to the case are located¹⁹, to the extent that provisions of law which cannot be derogated from by agreement are concerned; and
 - (b) the provisions of Community law (to the extent that such provisions cannot be derogated from by agreement) where (i) the chosen law is not the law of a

Member State and (ii) all of the elements relevant to the case are located in one or more Member States²⁰;

4. in relation to a consumer contract, the protection afforded to the consumer under the law of the country where he has his habitual residence²¹. It should be noted that this cannot be derogated from by agreement²².

Part II – What law applies to the contractual position where the parties do not choose a governing law (Rome I Regulation)?

If the parties to a contract do not stipulate the law governing such contract, then Rome I Regulation sets out a number of rules. These are intended to achieve the highest degree of predictability as to the applicable governing law, and, where necessary, to grant courts with the discretion required to determine the law that is most closely connected to the relevant situation²³.

Pursuant to the Rome I Regulation, as a general rule, where the parties do not choose the governing law, then contracts will be governed by the law of the country with which they are most closely connected.

However:

1. the Rome I Regulation also provides an extensive set of rules for particular types of contracts which prevail over the general rule. These are divided into two sub-sets of provisions²⁴;
2. the law selected pursuant to (1) above may, where “escape clauses” apply, be overridden by the law of the country with which the contract is manifestly more closely connected.

In order to clarify the interaction between the general rule, specific rules, and escape clauses, and ultimately to determine the law governing a contract where the parties do not select a governing law, we have prepared the following “decision tree”:

Question 1

Is the contract in question:

- (i) a contract of carriage (goods and/or passengers);
- (ii) a consumer contract;
- (iii) an insurance contract; or
- (iv) an individual employment contract?

Answer 1

If the answer is “yes”, then the law selected in accordance with Article 5 (*Contracts of Carriage*), 6 (*Consumer Contracts*), 7 (*Insurance Contracts*), or 8 (*Individual Employment Contracts*) of the Rome I Regulation (as applicable) will govern the contract.

For example, if the contract is a consumer contract (i.e. a contract concluded between a consumer and a professional) which does not qualify as a contract of carriage or an insurance contract (otherwise Article 5 or 8, as the case may be, of Rome I Regulation will apply), then²⁵ the contract will be governed by the law of the country where the consumer has his habitual residence, provided that (i) the professional (a) pursues his commercial or professional activities in such country or (b) directs such activities to that country or to several countries including that country, and (ii) the contract falls within the scope of such activities. If requirements either in (a) or (b) above are not fulfilled, the law governing the consumer contract will be the law selected pursuant to Art. 4 of Rome I Regulation, i.e. proceed to Question 2.

If the contract in question is an insurance contract (irrespective of whether it also qualifies as a consumer contract) it will be necessary to distinguish between (i) "insurance contracts covering a large risk"²⁶ which are governed by the law of the country where the insurer has his habitual residence²⁷ and (ii) any other insurance contracts, which are governed by the law of the Member State where the risk is located at the time the contract is concluded^{28, 29}. However, where the risks covered by insurance contracts other than "insurance contracts covering a large risk" are located in more than one Member State, the contract will be treated, for the purposes of identifying the governing law, as several contracts, each relating to only one Member State.

If the answer is "no", then go to Question 2.

Question 2

Does the contract in question fall within one, and only one, of the types of contracts listed in the table below?

Answer 2

If the answer is "yes", then the law specified in the column "Law Applicable" will govern the contract. Please note however that before concluding which law applies, it is still necessary to proceed to Question 4 in order to ascertain whether an "escape clause" applies.

| | Type of Contract | Law Applicable |
|-----|--|--|
| (a) | Sale of Goods | Law of the country of the seller's habitual residence |
| (b) | Contract for the Provision of Services | Law of the country of the services provider's habitual residence |
| (c) | Contract relating (i) to a right <i>in rem</i> in immovable property <i>or</i> (ii) to a tenancy of immovable property | Law of the country where the property is situated |
| (d) | Contract relating to a tenancy of immovable property concluded for temporary private use for a period of no more than 6 months | Notwithstanding (c) above, law of the country of the landlord's habitual residence, provided that the tenant (i) is a natural person and (ii) has his habitual residence in the same country |
| (e) | Franchise Contract | Law of the country of the franchisee's habitual residence |
| (f) | Distribution Contract | Law of the country of the distributor's habitual residence |
| (g) | Sale of Goods by Auction | Law of the country where the auction takes place, if such place can be determined |
| (h) | Contract concluded within a multilateral system as defined in Article 4(1), point (17), of Directive 2004/39/EC, in accordance with non-discretionary rules and governed by a single law | Law governing the relevant multilateral system |

If the answer is "no", then go to Question 3.

Question 3

Is the contract in question not included in any of the types of contracts listed in the table above, or are its elements covered by more than one of the contracts listed in the table above?

Answer 3

If the answer is “yes”, then the law of the country where the party required to effect the characteristic performance of the contract (usually the non-pecuniary obligation) has his habitual residence will govern the contract. However, before concluding which law applies, again it is necessary to proceed to Question 4 in order to ascertain whether an “escape clause” applies.

If the answer is “no”, then the law of the country with which the contract is manifestly most closely connected will govern the contract. In making such determination, account should be taken *inter alia* of whether the contract in question has a close relationship with another contract(s)³⁰.

Question 4³¹

If the answer to Question 2 or 3 is “yes”, is the contract in question manifestly more closely connected with a country other than that indicated in Answer 2 or 3 (as applicable)?

Answer 4

If the answer is “yes”, then the law of the country with which the contract is manifestly more closely connected will govern the contract. Again, in making such determination, account should be taken *inter alia* of whether the contract in question has a close relationship with another contract(s)³².

If the answer is “no”, then the law provided in Answer 2 or 3 (as applicable) will govern the contract.

For the sake of completeness, it should be noted that Rome I Regulation (as opposed to the Rome Convention) has introduced new rules with regards multiple liability and set-off, as follows:

- a) if a creditor has a claim against several debtors all of whom are liable for the same claim, and one of the debtors has already satisfied the claim in whole or in part, the law governing the debtor’s obligation towards the creditor also governs the debtor’s right to recourse from the other debtors³³. Notwithstanding this the other debtors may rely on the defences they might have against the creditor to the extent available under the law governing their obligations towards the creditor;
- b) where the right to set-off is not agreed between the parties, set-off shall be governed by the law applicable to the claim against which the right to set-off is asserted³⁴.

Part III –What law applies to non-contractual obligations where the parties do not choose a governing law (Rome II Regulation)?

If the parties do not specify their choice of governing law, under the Rome II Regulation the general rule is that the law governing the non-contractual obligations³⁵ between such parties is the *lex loci damni*, i.e. the law of the country in which the injury is sustained or the property is damaged^{36,37}.

However, this general principle can be set aside as follows:

1. when the parties have their habitual residence in the same country, the law of this common country will apply³⁸;

2. the “escape clause”³⁹ allows a judge to apply in any case the law of the country that, in light of all of the circumstances of the case, is manifestly more closely connected with the tort/delict in question;
3. there are specific rules for special types of torts/delicts “where the general rule does not allow a reasonable balance to be struck between the interests at stake”⁴⁰, namely: product liability⁴¹; unfair competition and acts restricting free competition⁴²; environmental damage⁴³; infringement of intellectual property rights⁴⁴; and industrial actions⁴⁵; and
4. special regimes also apply to cases where damage is caused by an act other than a tort/delict, such as unjust enrichment⁴⁶, *negotiorum gestio*⁴⁷ and *culpa in contrahendo*⁴⁸.

In particular, with respect to non-contractual obligations arising out of unjust enrichment (including payment of amount wrongly received) the following “cascade” of rules applies (i.e. where the law applicable cannot be determined on the basis of rule (a) below, then rule (b) will be considered, and so on):

- (a) if the non-contractual obligation concerns a relationship existing between the parties (a contract or a tort/delict) that is closely connected with the unjust enrichment, the law governing that relationship also governs the non-contractual obligation;
- (b) where the parties have their habitual residence in the same country when the event giving rise to unjust enrichment occurs, the law of that country shall apply;
- (c) finally the law of the country in which the unjust enrichment took place shall apply.

As in-house counsel will know, *culpa in contrahendo* is of great relevance on a daily basis. Negotiations are often entered into which do not result in transactions but which do give rise to a number of claims. However, for the purposes of the Rome II Regulation, the notion of *culpa in contrahendo* includes not only the breakdown of contractual negotiations but also the violation of a duty of disclosure and any other non-contractual obligations directly linked to the dealings preceding the conclusion of a contract^{49,50}.

In the absence of a choice of law made by the parties, non-contractual obligations arising out of dealings before a contract is concluded will be governed by the law applicable to the contract, or the law that would have been applicable to it had it been entered into (with the result that the applicable law will be indirectly selected through the rules set out in Rome I Regulation). However, where the law applicable cannot be determined on the basis of this connecting factor, it will be the *lex loci damni* or the law of that country where the parties have their habitual residence when the event giving rise to the damage occurs.

The special regimes of unjust enrichment and *culpa in contrahendo* provide escape clauses from the specific rules where it is clear from all relevant circumstances that the relevant non-contractual obligation is manifestly more closely connected with another country.

Conclusions

The adoption of the Rome Regulations should be welcomed by all parties engaging in international transactions. The introduction of a set of uniform rules is expected to enhance the predictability of court decisions, provide greater legal certainty, reduce the practice of “forum shopping”, and, ultimately, integrate the legal systems of Member States. However, at this stage it is still unclear as to whether this is a preliminary step towards the introduction of uniform substantive law at a European level⁵¹.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

London

Norman Pepe
+44 020 3023 5100
normanpepe@paulhastings.com

Milan

Alberto Del Din
+39 02 30414 000
albertodeldin@paulhastings.com

¹ Rome I Regulation and Rome II Regulation have started applying from 17 December 2009 and 11 January 2009, respectively.

² With the exception, however, of the United Kingdom and Denmark, which have exercised their opting-out rights pursuant to the relevant protocols annexed to the Treaty on European Union and to the Treaty establishing the European Community.

³ Also in combination with Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I).

⁴ For a description of the scope of the Rome Regulations (including the matters excluded therefrom), see Art. 1 of Rome I Regulation and Art. 1 of Rome II Regulation.

⁵ See Recital 6 of Rome I Regulation and Recital 6 of Rome II Regulation: “The proper functioning of the internal market creates a need, in order to improve the predictability of the outcome of litigation, certainty as to the law applicable and the free movement of judgments, for the conflict-of-law rules in the Member States to designate the same national law irrespective of the country of the court in which an action is brought”.

⁶ “Choice of forum [...] does not *per se* imply a tacit choice-of-law, but should be regarded as one of the factors to be taken into account when determining whether a choice-of-law is demonstrated with reasonable certainty”; Paolo Bertoli, *Choice of Law by the Parties in the Rome II Regulation*, in *Rivista di Diritto Internazionale*, 2009, 03, 697.

⁷ Art. 3(1) of Rome I Regulation, and Art. 14(1) of Rome II Regulation.

⁸ See Articles 3(5) and 10 of Rome I Regulation. Rome II Regulation lacks similar provisions. However, according to the prevailing opinion, the principle that a “governing law” clause has to be governed by the law stipulated by parties is consistent with the spirit and the purpose of the choice-of-law rule set out in Rome II Regulation and, therefore, has to apply also to cases falling within the scope of such regulation; see S. Sendmeyer, in *The Freedom of Choice in European Private International Law. An Analysis of Party Autonomy in the Rome I and Rome II Regulation*, in *Contratto e impresa / Europa*, 800.

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- ⁹ See Art. 11 of Rome I Regulation and Art. 21 of Rome II Regulation. The formal validity of a “governing law” clause in a consumer contract or a contract relating to a right *in rem* in immovable property or to a tenancy of immovable property shall be assessed on the basis of the law of the country where the consumer has his habitual residence or (subject to certain conditions) in which the property is located, respectively (see Art. 11, paragraphs 4 and 6, of Rome I Regulation).
- ¹⁰ According to a strict interpretation, to comply with this requirement the parties need to individually negotiate the “governing law” clause and, therefore, “governing law” clauses set forth in pre-drafted general (standard) conditions are not acceptable. Conversely, a more liberal opinion considers the “free negotiation” requirement satisfied if it is demonstrated, regardless of the “governing law” clause being contained in pre-drafted general conditions, that the parties intended to choose the governing law (see Paolo Bertoli, *Choice of Law by the Parties in the Rome II Regulation*, in *Rivista di Diritto Internazionale*, 2009, 03, 697). From a practical viewpoint, a specific acceptance of the “governing law” clause by the parties may reduce the risk that the choice of law is subsequently challenged on the basis of a lack of “free negotiation”.
- ¹¹ So as to avoid abuses of choice of law clauses by stronger parties against weaker parties: see Art. 14(1), (a) and (b), of Rome II Regulation.
- ¹² In this Part I we will not discuss the limitations generally applicable to all governing laws selected in accordance with the connecting factors set forth in the Rome Regulations (including also choice-of-law rules), such as the overriding mandatory provisions and the public order of the forum.
- ¹³ Articles 6(4) and 8(3) of Rome II Regulation.
- ¹⁴ Set forth in Articles 6 and 8 of Rome II Regulation.
- ¹⁵ As defined in Directive 73/239/EEC.
- ¹⁶ That is the laws set out in letters (a) to (e) of Art. 7(3) of Rome I Regulation (i.e. the law of the Member State where the risk is located; the law of the country where the policy holder has his habitual residence; *etc.*).
- ¹⁷ Please note, however, that if the domestic laws included in the list grant greater freedom of choice of law for such insurance contracts, the parties may take advantage of that freedom.
- ¹⁸ In the opinion of some scholars, this “non-prejudice” mechanism should not result in a prevalence *tout court* of the EC or national mandatory provisions, but will require that those mandatory rules are applied pursuant to a fungibility test, *i.e.* “(i) a comparison between the content, and effects, of the application or non-application, of the applicable law and the mandatory rule at stake, and (ii) application of the latter only if its aim is not adequately pursued by the former”. According to this interpretation, “mandatory rules may prevent only the application of certain provisions of the applicable law, or simply impose a certain interpretation of it” (see Paolo Bertoli, *Choice of Law by the Parties in the Rome II Regulation*, in *Rivista di Diritto Internazionale*, 2009, 03, 697).
- ¹⁹ Art. 3(3) of Rome I Regulation, and Art. 14(2) of Rome II Regulation.
- ²⁰ Art. 3(4) of Rome I Regulation, and Art. 14(3) of Rome II Regulation.
- ²¹ In Part II and Part III we will discuss that, when dealing with the applicable law in the absence of a choice of law by parties, the Rome Regulations frequently refer to the concept of “habitual residence”. The relevant notion is set out in Art. 19 of Rome I Regulation and Art. 23 of Rome II Regulation. In general terms the “habitual residence” of a person is where such person has his principal place of business, if the person is a natural person acting in the course of his or her business activity, or the central administration, if the person is a company or other body (whether corporate or unincorporated). However, if the contract is concluded in the course of the operation of a branch, agency or any other establishment, or if, under the contract, performance is the responsibility of such branch, agency or other establishment, or the event giving rise to the damage occurs, or the damage arises, in the course of the operation of a branch, agency or any other establishment, the “habitual residence” is the place where such branch, agency or other establishment is located.
- ²² Art. 6(2) of Rome I Regulation.
- ²³ See Recital 16 of Rome I Regulation.
- ²⁴ The first sub-set includes Art. 4(1), (2) and (3), of Rome I Regulation, the second sub-set comprises Articles 5 to 8 thereof and prevails over the former as explicitly provided in Art. 4(1) of Rome I Regulation.
- ²⁵ Pursuant to Art. 6(1) of Rome I Regulation.
- ²⁶ As defined in Directive 73/239/EEC.
- ²⁷ Subject, however, to the “escape clause” set out in Art. 7, paragraph 2, last sub-paragraph, of Rome I Regulation.
- ²⁸ Such “localization” of the risk to be performed in accordance with Art. 7, paragraph 6, of Rome I Regulation.

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- ²⁹ Please note that, irrespective of the type of insurance contract, the exceptions set out in Art. 7, paragraph 4, of Rome I Regulation will apply.
- ³⁰ See Recital 21 of Rome I Regulation.
- ³¹ See Recital 20 of Rome I Regulation.
- ³² See Recital 20 of Rome I Regulation.
- ³³ Pursuant to Art. 16 of Rome I Regulation.
- ³⁴ See Art. 17 of Rome I Regulation.
- ³⁵ See Art. 4, paragraph 1, of Rome II Regulation.
- ³⁶ See Recital 17 of Rome II Regulation.
- ³⁷ This connecting factor is meant to "ensure a reasonable balance between the interests of the person claimed to be liable and the person who has sustained damage": see Recital 16 of Rome II Regulation.
- ³⁸ See Art. 4(2) of Rome II Regulation.
- ³⁹ See Art. 4(3) of Rome II Regulation.
- ⁴⁰ See Recital 19 of Rome II Regulation.
- ⁴¹ See Art. 5 of Rome II Regulation.
- ⁴² See Art. 6 of Rome II Regulation.
- ⁴³ See Art. 7 of Rome II Regulation.
- ⁴⁴ See Art. 8 of Rome II Regulation.
- ⁴⁵ See Art. 9 of Rome II Regulation.
- ⁴⁶ See Art. 10 of Rome II Regulation.
- ⁴⁷ See Art. 11 of Rome II Regulation.
- ⁴⁸ See Art. 12 of Rome II Regulation.
- ⁴⁹ See Recital 30 of Rome II Regulation.
- ⁵⁰ According to the Rome II Regulation, the concept of *culpa in contrahendo* "is an autonomous concept and should not necessarily be interpreted within the meaning of national law".
- ⁵¹ The aspiration of the European legislator for a uniform substantive law at European level is clearly reflected in Recital 14 of the Rome I Regulation ("Should the Community adopt, in an appropriate legal instrument, rules of substantive contract law, including standard terms and conditions, such instrument may provide that the parties may choose to apply those rules.").