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EDITORIAL COMMENTS

On the way to a Rome I Regulation

Background

Before the entry into force of the Maastricht Treaty, a number of Community instruments were adopted in the field of private international law[1] under former Article 220 EC (now Art. 293 EC). The Brussels Convention on Jurisdiction and the Recognition and Enforcement of Judgments of 1968 is an outstanding example. The Rome Convention on the Law Applicable to Contractual Obligations of 1980[2] was not based on the old Article 220 EC, but was from the outset regarded as a natural follow-up to the Brussels Convention.[3] Whereas the Maastricht Treaty provided for a harmonization of private international law within the third pillar, the Amsterdam Treaty moved this field to the first pillar (Arts. 61, 65 EC). Since the late 1990s the Community has been very active in adopting several regulations for judicial cooperation in civil matters[4] on this basis; moreover, the Brussels I Convention has been converted into a Regulation.[5] With regard to the law applicable to *non-contractual* obligations, the Commission presented a proposal (on 22 July 2003) for a Regulation,[6] which in its amended version[7] is likely to be adopted in the course of 2006.

As for the Rome Convention, on 14 January 2003 the Commission issued a Green Paper on the conversion of the Rome Convention of 1980 into a Community instrument and its modernization;[8] this was followed by a Proposal for a Regulation on the law applicable to contractual obligations (Rome I) at the end of 2005.[9] With its Green Paper, raising some twenty

1. Or, used as synomym, "conflict of laws". This field of law comprises questions of international jurisdiction, recognition and enforcement of foreign judgments, and choice of law, respectively.
2. O.J. 1980, C 266/1; O.J. 1998 C 27/36 (integrated version).
3. See the report by Giuliano and Lagarde on the Rome Convention, O.J. 1980, C 282/1, 5.
4. Brussels II Regulation, Insolvency Regulation, Service Regulation, Regulation on Taking Evidence Abroad, Regulation on the Enforcement of Undisputed Claims.
5. O.J. 2001, L 12/1.
6. COM(2003)427.
7. COM(2006)83.
8. COM(2002)654.
9. 15 Dec. 2005, COM(2005)650.

questions, the Commission launched a wide-ranging consultation process. The questions related, *inter alia*, to the conversion of the Convention into a directive or regulation, the inclusion of the relevant secondary Community legislation on consumer contracts and on insurance contracts in the new instrument, the scope of party autonomy and the treatment of mandatory rules, the modernization of the rules on consumer and employment contracts. There were more than eighty replies from academics, academic institutions, economic and other organizations, most of them in favour of such a conversion and some modernization.[10] This far-reaching response may be taken as a signal that the conflict rules on the law applicable to contracts are of great importance not only as a field of study for academia, but foremost for the economic actors.

Given the fact that the Rome Convention of 1980 has not met with too much criticism in the past, it is no surprise that the Proposal of 2005 essentially carries on the existing body of those Convention rules that have proven sound and workable in practice. This comment will not address these rules, but rather concentrate on the "modernization" aspects of the Proposal – and on those issues which the Proposal has not yet tackled.

Four major changes

Apart from a new provision on agency relationships and a number of changes of a more technical character, four major changes deserve a comment.

(a) *Freedom of choice* of the applicable law (party autonomy) forms the basis of the Rome Convention and, of course, is carried on by the Proposal. It accords with the fundamental freedoms (if not actually required by them) and it ideally conforms with the home State principle which is promoted by (some) Community legislation. Though not wholly undisputed, the Rome Convention only allows for the choice of a law of a *State (country)* as applicable law – in marked contrast to modern tendencies in the field of arbitration, where arbitral tribunals have increasingly become empowered to apply the general principles of international commercial law as the applicable law chosen by the parties. In its Article 3(2), the Proposal in a somewhat revolu-

10. The replies are accessible on internet (europa.eu/int/). For two encompassing and thorough replies see e.g. Max-Planck Institute for Foreign Private and Private International Law, Comments on the European Commission's Green Paper on the Conversion of the Rome Convention of 1980 on the Law Applicable to Contractual Obligations into a Community Instrument and its Modernization, 68 RabelsZ (2004), 1; Magnus and Mankowski, "The Green Paper on a Future Rome I Regulation – on the Road to a Renewed European Private International Law of Contracts", 103 ZvglRWiss (2004), 131.

tionary turn authorizes the parties to choose a non-State body of law ("… the principles and rules of the substantive law of contract recognized internationally or in the Community."). Though Article 3(2) does not specify *who* is regarded as competent to "recognize" these principles and rules, it is clear from the Explanatory Memorandum of the Proposal that it is above all the international commercial community that is given this competence, by its observable practice.[11] Whereas a reference to the *lex mercatoria* will not suffice (because of the lack of precision and concreteness), the *UNIDROIT* principles, the *Principles of European Contract Law*, and a future optional *Community instrument* will be regarded as bodies of law that may be chosen. There is no doubt that Article 3(2) may thus serve as a basis for the *Common Frame of Reference* which is in the making[12] to become used and perhaps accepted in the commercial world.

It is submitted that this expansion of party autonomy is to be applauded. The choice of a non-State body of law has become quite common in combination with an arbitral clause. This has led to a somewhat awkward divide between State courts (applying only State law as chosen law) and arbitral tribunals (also applying non-State law). Article 3(2) is meant to bridge this divide. State courts will no longer have to "nationalize" an international commercial contract by subjecting it to the legal system of a State. It has to be acknowledged that the reference to "… principles and rules … *recognized internationally* …" involves a lack of precision, and thereby creates some uncertainty. However, this is not necessarily too much of a problem: if parties choose a private codification as applicable law that is not (yet) recognized by the international commercial community, State courts will have to accept this choice at least as a stipulation of contract terms, in accordance with the law applicable in the absence of a valid choice of an applicable law.

(b) In the *absence of a choice* of the applicable law, the Rome Convention follows the principle that the law of the State to which the contract has its *closest connection* applies. This "rule" (which is really more of an approach) is supplemented by some presumptions for the existence of the closest connection – the most important being the seat (or branch, subsidiary or other establishment involved in the transaction) of the contract partner who provides the characteristic service. If the characteristic performance cannot be determined, it is the closest connection that decides the law applicable. If one of these presumptions is applicable, an exception clause allows for flexibility in a setting where the contract has much stronger connections with another legal order. Taking these rules together, the Rome Convention has attempted

11. COM(2005)650, p. 5.
12. See Editorial Comments: European Contract Law: Quo Vadis? 42 CML Rev. (2005), 1.

to find a sensible compromise between the goal of legal certainty and adequate treatment of the contract in the individual case.

The Proposal departs from this compromise in order to enhance legal certainty (in its Art. 4(1)). The presumptions are to be converted into fixed rules for a number of contract types,[13] and the applicable law will (usually) be the law of the place where the party performing the service characterizing the contract has his habitual residence.[14] For all other contracts, the characteristic performance criterion will decide. The exception clause will be abolished altogether. If a characteristic service cannot be determined, the law of the country with which the contract is most closely connected applies.

This modernization effort is remarkable for at least two reasons. In a *comparative* perspective it is interesting to note that the Proposal dramatically deviates from the results reached in the Inter-American Convention on the Law Applicable to International Contracts,[15] which (to some degree inspired by the Rome Convention) opted for the "closest ties" approach, but rejected the characteristic performance as a relevant criterion. Whereas the Americas go for the adequate treatment of a contract in the individual case at the expense of legal certainty, Europe seems to go the other way. In a *historical* perspective, it should be recalled that, by relating the applicable law to certain contract types, the Proposal takes up an approach already discussed in European academic quarters a hundred years ago, later finding its way into the Polish code of 1926, and into the more recent codifications of Czechoslovakia (1948), the German Democratic Republic (1975), and Austria (1978), respectively. The Proposal, thereby, departs from the approaches that have been characteristic for the UK ("proper law of contract") and (West) Germany ("presumed" or "hypothetical will"; "centre of gravity" approach). It opts for more legal certainty at the expense of flexibility and justice in the individual case.

To take a fair view of the Proposal, one must take into account that the move towards more legal certainty may be explained as a reaction to the somewhat unsatisfactory case law in the Member States: in some jurisdictions the exception clause of the Rome Convention seems to have been used as an escape route to avoid the application of the presumptions. It is, nevertheless, submitted that the Commission may have gone too far in its endeavour to secure legal certainty. International commercial contracts are not only

13. Sale; provision of services; franchise contract; licence contract etc.

14. Or, if the contract is concluded by a branch, subsidiary or other establishment, the location of this branch etc.: Art. 18(1).

15. Of March 17, 1994. For a comment on this convention see e.g. Juenger, "Contract Choice of Law in the Americas", 25 AJCL (1997), 195.

concluded on a standard basis, but often in a highly individualized manner which may call for an ad hoc analysis on that basis. The "hard and fast" rule approach of the Proposal does not seem to be an adequate approach for treating such contracts. In the Explanatory Memorandum the Commission relates its approach to the competence of the parties to choose the applicable law.[16] It is, however, hard to comprehend how the competence of the parties to choose the applicable law relates to the question, whether, in the absence of such a choice, the applicable law should be determined by hard and fast rules or on an individual basis ("closest ties", "most significant relationship"). Intuition tends more to suggest an argument the other way around: the less certainty provided by the applicable conflicts rules, the more the parties to the contract might be inclined to exercise their freedom to choose in order to create certainty. It is submitted that it might be preferable to retain the exception clause, but to bind its application to tight preconditions.

(c) With regard to *consumer contracts* the Rome Convention, in the absence of a choice of the applicable law by the parties, in essence distinguishes between "passive" and "active" consumers: the law of the State of habitual residence of the consumer is applied to (certain types of) consumer contracts under the condition that the conclusion of the contract is closely connected with the market of that State ("passive" consumers). Conversely, where the consumer has sought out the undertaking (professional) in the latter's State of residence (seat), the law of that State is applied. Where the parties have made a choice of the applicable law, the legal situation is more complex: the parties have the freedom to choose the applicable law, but this choice is supplemented in favour of the "passive" consumer by the mandatory provisions of the law of the State of his habitual residence, which must be taken into account. Moreover, some of the consumer contract directives provide for a protection of the "passive" *and* "active" consumer in cases of choice of the law of a non-Member State: the Member States have to apply the minimum protective standards of the relevant directive if the contract has close contacts with the Community. This state of law has been strongly criticized as it leads to hybrid solutions in the form of application of provisions of two legal orders, which entails complex legal issues and a demand for costly legal counselling out of proportion with the usually small claims brought by consumers.

The Proposal seeks major changes to the present system. Firstly, it basically introduces a new and simple conflicts rule covering all consumer contracts (with a professional acting in the exercise of his trade or profession),

16. COM(2005)650, p. 5.

barring some specified contracts.[17] Secondly, consumer contracts would be governed by the law of the Member State in which the consumer has his habitual residence, provided that the professional pursues his trade or profession in this Member State or directs his activities to that Member State, and the contract falls within the scope of such activities (Art. 5(1) and (2)). In all other cases, the rules discussed above under (b) would apply. Thirdly, the special rule for consumer contracts leading to the law of his habitual residence will be mandatory, thus excluding party autonomy.

The Proposal, at least in its theoretical concept, looks revolutionary. By excluding party autonomy, the highly criticized hybrid solution of applying provisions of two legal orders to a consumer contract is evaded.[18] The Proposal should, moreover, be applauded for extending the scope of the special rule for consumer contracts basically to *all* consumer contracts. Whether the exceptions provided for in Article 5(3) are really justified remains open to debate. What is more important, the Proposal specifies the conditions for the application of the special rule for consumer contracts along the lines set out in Article 15 of the Brussels I Regulation, thereby replacing the somewhat old-fashioned criteria of the Rome Convention by the *targeted activity* criterion which takes into account modern selling techniques via internet.

Despite these undisputable advantages, the special rule for consumer contracts is open to strong criticism for more than one reason. It is highly embarrassing that the special rule is given a unilateral character: it is applicable only in favour of a consumer with habitual residence in one of the Member States. Whereas the Rome Convention formulated its provisions (in the tradition of "classic" private international law) in an omnilateral manner, the current proposal deviates from this approach without any justification. If consumers have to be protected in the international arena against the application of an unknown legal order, such protection should be accorded irrespective of their habitual residence inside or outside the Community. The Proposal will lead to the application of the law of the habitual residence of the *professional* with regard to contracts with consumers resident outside the Community. This has the smell of a conflicts rule in favour of professionals (resident in the Community), discriminating against consumers resident in third countries.

Moreover, the total exclusion of party autonomy for consumer contracts that are covered by the special rule of Article 5(2) seems to work as an over-

17. Art. 5(2) and (3); the excluded contracts are: contract of carriage; contracts relating to a right *in rem* or a right of user in immovable property; contract for the supply of a services exclusively supplied in another country.

18. It should, however, be noted that, at present the parties to a contract can also evade this hybrid solution by simply abstaining from their freedom to choose an applicable law.

protection of the "active" consumer. There may be many reasons why a consumer may in a special setting prefer the choice of a legal order other than the law of his habitual residence. The exceptions listed in Article 5(3) may take care of these interests to some extent, but not totally. Moreover, in some cases (the "Euro movers") it may not be certain at all where a person has his habitual residence. Those persons have a natural and strong interest in being able to choose the applicable law. And finally, the concept of the fundamental freedoms of the EC Treaty implies a freedom of consumers to choose among the professionals located in the markets of the other Member States. It is in the light of these considerations that the proposed Regulation should not exclude party autonomy, but, to the contrary, guarantee it also with regard to consumer contracts. The necessary protection of consumers should be taken care of by other means. For instance, choice-of-law clauses in standard contracts may be regarded as void when used in consumer contracts (under the conditions circumscribed in the special rule of Art. 5(2) of the Proposal). In contrast, choice-of-law clauses that have been negotiated by the parties or even demanded or proposed by the consumer might be accepted as valid, without necessarily turning to the hybrid solution of the Rome Convention as applied today. And the protection of the consumer could, perhaps, be enhanced by some kind of form requirement for the choice (agreement) of the applicable law, and beyond that by an obligation of the professional to give sufficient information on the potential disadvantages and consequences of the choice-of-clause. Such an approach would correspond nicely with the normative Community concept of a reasonably circumspect and informed consumer.

(d) One of the main reasons for a reform of the Rome Convention is the need to integrate the EU conflicts rules of the consumer contract directives into the more general conflicts rules of the Convention. Insofar as Article 5(1) of the Proposal extends to *all* consumer contracts, the aims of the provisions in the directives are (to a large extent) taken care of. Article 3(5) of the Proposal obviously assumes a further need to protect consumers in a situation where party autonomy is not excluded by Article 5(1) and (2). This is the case e.g. where an "active" consumer with habitual residence in Member State A, as a tourist in Member State B, concludes a contract with a professional having the habitual residence in non-Member State C. Article 3(5) provides in this case that the "choice shall be without prejudice to the application of such mandatory rules of Community law as are applicable to the case." As Article 3(5) is not restricted to the protection of consumers, it is even meant to be generally applicable where Community law works with mandatory rules, such as in the commercial agents directive.

The approach taken by the Proposal in Article 3(5) is noteworthy for a number of reasons. Firstly, it leads to the same hybrid solutions which the Proposal attempts to evade by Article 5(1) with regard to consumer contracts. Secondly, the provision is formulated in a unilateral, and not in an omnilateral fashion, thereby deviating again and without justification from the traditional approach followed in private international law. Thirdly, the provision is wholly uncoordinated with the situation in which the parties have not agreed on a choice of the applicable law, and in which, under the conditions set forth in Article 4 of the Proposal, the law of a third country would become applicable. As long as the Proposal does not contemplate applying mandatory rules of Community law alongside the law determined on the basis of the characteristic performance criterion, then the mere *choice* of that law by the parties should not trigger the application of mandatory Community rules either.

Unresolved issues

The Proposal for a Regulation on the law applicable to contractual obligations is noteworthy not only for its modernization efforts, but also for what it has not (yet) achieved.

(a) The Green Paper raised the question how insurance contracts should be treated in a Community instrument. In contrast to the Rome Convention, the Proposal no longer excludes insurance contracts covering risks located within the territory of a Member State from its scope of application, but, in Article 22 of the Proposal, the conflict rules of the insurance directives are attributed priority. This solution will prolong the paradoxical situation that risks located inside and outside the Community follow a totally different set of conflict rules – a compromise that finds its explanation in the legislative history, and, with regard to the directives, in the specific economic and political interests pursued by the Member States in the 1980s. The Community legislator should have the courage to put an end to this.

(b) In its Article 8, the Proposal deals with the tricky (and hotly disputed) issue of the so-called internationally mandatory rules. These rules are (now) defined in Article 8(1) as "rules the respect for which is regarded as crucial by a country for safeguarding its political, social or economic organization to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract…". Following the example of Article 7(2) and (1) of the Rome Convention, Article 8(2) of the Proposal empowers the courts of a Member State to apply the internationally mandatory rules of the *forum*, whereas Article 8(3) of the Proposal empowers the courts to give "effect … to the (internationally)

mandatory rules of the law of another country with which the situation has a close connection." Member States will not have the power to make a reservation against the application of Article 8(3) of the Proposal.

Given the many uncertainties related to Article 7 of the Rome Convention, it is disappointing that the Proposal has not taken up the task of clarifying them. The first issue on which the courts of the Member States seem to disagree relates to the question whether the choice of the applicable law, or its application under Article 4 or Article 5, also leads to an application of the internationally mandatory rules of the *lex causae*, or whether internationally mandatory rules would solely to be applied on the basis of Article 8(2) and (3) of the Proposal. Article 11 of the Proposal which deals with the scope of the applicable law does not give any indication. The issue needs a clarification insofar as Article 8(3) sentence 2 of the Proposal offers some discretion to the court as to whether such a mandatory rule shall be applied or not, whereas the courts would not have any discretion where the mandatory rule is part of the *lex causae*. A second question that has emerged in the Proposal relates to the relationship between Article 8(2) and Article 3(5) of the Proposal: do the mandatory rules of the *forum* also comprise rules of *Community* law, and if so, do they comprise only internationally mandatory rules? What is then the relevance of Article 3(5)? Does this provision (in contrast to Art. 8(2)) also refer to mandatory rules that may not be classified as "internationally" mandatory?[19] And if so what makes them so important that they have to be applied besides the chosen law? Questions over questions.

It is to be expected that those Member States that have made a reservation against the application of Article 7(1) of the Rome Convention will, in the Council, uphold their opposition also *vis-à-vis* Article 8(3) of the Proposal. It is submitted, however, that these Member States should rethink their position, at least with regard to the internationally mandatory rules of *the other Member States*. In this regard, courts should even be obliged to apply them without any discretion. The reasons for that are manifold. The Brussels I Regulation contains options enabling a claimant to choose between specified courts. These options generate the risk of "forum shopping"[20] if the courts apply different conflicts rules. Insofar, harmonized conflicts rules may be regarded as a natural and necessary corollary to the Brussels I Regulation, preventing such forum shopping. The case for an obligation to apply internationally mandatory rules of the other Member States is all the more convincing when, as under the Brussels I Regulation, the parties are attrib-

19. Cf. in this sense Art. 3(4) of the Proposal.

20. See Explanatory Memorandum, p. 2. On p. 8 the Memorandum refers to "a genuine European justice area".

uted the competence to agree on the jurisdiction of courts, so that a deliberate evasion of the mandatory rules of a Member State can be prevented. Moreover, the application of these rules will not lead to an inappropriate intrusion into the freedom of the parties nor to an application of unforeseen provisions. The reason for that is that internationally mandatory rules of the other Member States may only be applied if they do not contravene the fundamental freedoms. Any court of a Member State has the power to scrutinize the mandatory rules of other Member States in this respect.

An obligation to apply the internationally mandatory rules of the other Member States seems necessarily to go hand-in-hand with Article 3(2) of the Proposal: if the parties are given the freedom to choose internationally recognized principles and rules of substantive law as the applicable law, such a choice will never lead to the application of internationally mandatory rules of another Member State. Therefore much is to be said for the contention that internationally mandatory rules of a Member State should no longer be treated as part of the *lex causae*, but should be applied independently of the *lex causae* by the courts in all Member States in the same fashion and to the same extent as they are applied by the courts of the Member State that has adopted the rule.

Summary

Summing up this comment, it is submitted that the "Proposal for a Regulation on the law applicable to contractual obligations (Rome I)" still needs further reflection and discussion. In part, the Proposal should be criticized for its unilateral (if not provincial) approach, in part for over-protecting the consumer at the expense of the new generation of multi-resident Union citizens. The quest for legal certainty seems to go too far. Insurance contracts should be covered irrespective of the location of the risk. The Proposal should be applauded for giving the parties the freedom to choose generally recognized principles and rules of substantive law as applicable law, but this approach should be complemented by an obligation of the courts to apply the internationally mandatory rules of the other Member States. Thereby a genuine European area of justice would be put into reality.