Rome II and the Law Applicable to Non-Contractual Obligations

Introduction

On 11 January 2009, a fundamental change to the way in which the law applicable to non-contractual obligations will be determined under English law took place when Regulation (EC) No 864/2007 on the law applicable to non-contractual obligations (Rome II) came into effect. The existing common law basis for determining applicable law was replaced by the directly applicable Rome II Regulation.

Rome II represents a significant departure from the former state of affairs under English law in certain respects, but it does give parties the potential for achieving greater certainty in their cross-border dealings. For the first time, parties are able to choose (subject to some exceptions) the law applicable to their non-contractual obligations. In addition, a standard set of rules for determining the applicable law where no express choice has been made came into effect across Europe.

“Non-contractual” obligations relate primarily to tortious claims, but also include such things as breach of statutory duty, unjust enrichment and restitutionary claims. However, the liability of the state in the exercise of state authority, revenue and customs, family, matrimonial, wills and succession, promissory notes, negotiable instruments, nuclear damage, the law of companies and defamation claims are expressly excluded from the auspices of Rome II.

Rome II was approved by the Council and European Parliament on 11 July 2007 and came into force on 11 January 2009. It only applies to events giving rise to damage after it came into force.

Whilst Rome II is directly applicable and takes effect in the United Kingdom without the necessity for implementing legislation, the Law Applicable to Non-Contractual Obligations (England and Wales and Northern Ireland) Regulations 2008 (SI 2008/2986) also came into effect on 11 January 2009. Those Regulations make some consequential amendments to existing legislation and extend the scope of Rome II to conflicts between the laws of different parts of the United Kingdom and/or any of those parts and Gibraltar.

Practising lawyers across Europe, as well as companies and financial institutions engaged in cross-border business, will need to come to terms with the changes which Rome II makes to the rules as to which law is applicable for torts and other non-contractual obligations and the consequential changes which will be necessary to contracts.
Objectives

The fundamental objective of Rome II is to standardise the rules by which the law applicable to non-contractual obligations is determined, with the aim of ensuring that the courts of all EU Member States (save for Denmark, which has opted out of the Rome II regime) apply the same choice of law rules to disputes involving non-contractual obligations. It is anticipated that this will give rise to increased legal certainty, facilitate mutual recognition of judgments and reduce the incidence of forum shopping. Whether this will actually be the case, remains to be seen.

Rome II will enable parties doing business across borders to predict the law that will apply to their activities with greater certainty. It also, for the first time, allows them to influence the law that will govern their non-contractual obligations by contractually agreeing on a choice of law.

The General Rule

In virtually all EU Member States the applicable law, in civil and commercial matters, for non-contractual obligations used to be determined by the place where the harmful act was committed (lex loci delicti commissi). By way of example, if Party A committed a harmful act in Germany in relation to which Party B suffered loss in England, then pursuant to the former position, the law applicable to Party A’s act would have been German law. However, now that Rome II has come into force, this is no longer the case.

The fundamental change introduced by Rome II is that the lex loci delicti commissi principle has been replaced by the general rule that the law applicable to non-contractual obligations will be determined on the basis of where the damage occurs, or is likely to occur, regardless of the country or the countries in which the act giving rise to the damage occurs (Article 4). Returning to the previous example, for Party A’s harmful act, committed after 11 January 2009, the applicable law will be determined by the jurisdiction in which the damage occurs to Party B (England).

There are, however, a number of exceptions. The general rule will not be applied where:

- both parties have their habitual residence in the same country at the time when the damage occurs (Article 4(2));
- the tort is ‘manifestly more closely connected’ with another country (Article 4(3));
- the parties have agreed on a particular law to govern their non-contractual obligations (Article 14);
- there are mandatory rules of the forum (Article 16); or
- the application of a provision of the law that would normally be determined by Rome II is ‘manifestly incompatible’ with the public policy of the forum (Article 26).

However, note that special rules apply to product liability, unfair competition, environmental damage, intellectual property and industrial action.

Article 14

Article 14 is arguably the most significant introduction to English Law precipitated by Rome II. Parties have not previously been able to agree contractually as to the law that will apply to their non-contractual obligations. However, subject to some exceptions, Article 14 now allows parties to make such an agreement.

A distinction is made in Rome II between agreements which pre-date and post-date the occurrence of the event giving rise to the damage. In each case, a choice of applicable law must be ‘expressed or demonstrated with reasonable certainty’.

Agreements between the parties as to the applicable law which post-date the event (e.g. once a dispute has already arisen or the damage has occurred), can be freely made. Therefore, after damage has occurred to Party B, it is free to agree with Party A the law that will be applicable to Party A’s act.
However, agreements on the law applicable to non-contractual obligations which pre-date the event causing damage can only be made where:

1) the parties are pursuing a commercial activity; and
2) the agreement is freely negotiated.

It will be interesting to see how the question of whether an agreement has been ‘freely negotiated’ is developed by the courts and whether consideration of the parties’ respective bargaining positions will be necessary. In addition, whilst a contract on one party’s standard terms may not comply with this test, it remains to be seen as to whether the inclusion of such a provision in a standard form contract (such as ISDA agreements) is treated as being ‘freely negotiated’ for these purposes.

Whilst choosing a governing law for non-contractual obligations gives the parties greater certainty as to the precise nature and scope of their legal relationships, there remains a possibility that a party will be bound by that choice, even if a dispute arises under which the law of the country where the damage occurred might have been more favourable. However, in most commercial, cross-border agreements, the benefit to the parties of agreeing on the applicable law in respect of their non-contractual obligations will most likely far outweigh the potential risk that the ‘default’ applicable law would be more favourable to them.

With the advent of Rome II, parties who engage in cross-border business with a number of counterparties now face the risk that, unless an agreement as to the applicable law has been made, a tortious act committed in one jurisdiction which causes damage to a number of claimants in a variety of jurisdictions may give rise to claims under a number of applicable laws. The risk associated with managing litigation proceedings in relation to the same act under separate applicable laws militates strongly towards agreeing the applicable law in advance, where possible.

A simple governing law clause, containing an Article 14.1(b) choice of applicable law agreement, might look as follows:

“This Agreement and any non-contractual obligations arising out of or in connection with it, shall be governed by and construed in accordance with English law.”

From now onwards, parties should expect to see this type of wording in draft agreements.

Exceptions to Article 14

There are certain mandatory provisions of Rome II. For example:

- where all elements relevant to the situation, at the time the event giving rise to damage occurs, are located in a country other than the country whose law has been chosen, the parties’ choice will not prejudice the application of that country’s law from which the parties cannot derogate by agreement (Article 14.2);
- where all elements relevant to the situation, at the time the event giving rise to damage occurs, are located in one or more Member States, the parties’ choice will not prejudice the application of any Community law which cannot be derogated from by agreement (Article 14.3); or
- where the dispute relates to unfair competition (Article 6) or infringement of IP rights (Article 8), in relation to which special rules apply.

What the Governing Law will Affect

Rome II has ‘universal application’ (Article 3). This means that the courts of Member States will be able to apply the rules in Rome II to determine non-contractual obligations, even if the application of those rules results in the substantive law of a non-Member State being applied (e.g. the English courts will be able to apply the laws of New York to a non-contractual dispute, if the provisions of Rome II lead to that conclusion).
Once the applicable law has been ascertained, that law will govern not only the basis and extent of a party’s liability, but also factors such as burden of proof, grounds for exemption from, and limitation of, liability and the existence, nature and assessment of damages (Article 15).

The practical significance of this is that where the governing law of the non-contractual obligation is not the law of the forum, the court will presumably have to hear expert evidence on the relevant principles of that governing law (e.g. how damages are calculated, etc.).

The applicable law will not, however, affect issues of evidence or procedure, which will be determined by the jurisdiction of the court in which any proceedings are to take place.

**Pre-Contractual Issues**

Article 12 provides that that the law governing a non-contractual obligation arising out of pre-contractual dealings, whether the contract was actually concluded or not, will be the law that applies to the contract itself (or that would have been applicable to it had it been entered into).

Although in English law, pre-contractual negotiations are generally not binding, the effect of Article 12 is that parties to abortive negotiations who had included a governing law clause in their draft agreement may find themselves bound by it in respect of any non-contractual liabilities which may arise (such as negligent misrepresentation or a breach of confidence).

Great care will, therefore, be required during cross-border negotiations to ensure that foreign law does not impose unexpected, but binding, non-contractual obligations on the parties. For example, some jurisdictions imply obligations of good faith in commercial negotiations, which are not recognised under English law.

If there is any doubt as to which law is to apply to the contractual and non-contractual relationship, then an express agreement should be made at the outset of negotiations to ensure certainty.

**Unjust Enrichment and Negotiorum Gestio**

*(Articles 10 and 11)*

In unjust enrichment claims and/or claims arising from negotiorum gestio (where a person acts for another without authority, which entitles the quasi agent to reimbursement of expenses, but not remuneration—similar in many respects to quantum meruit) the governing law of the relationship between the parties (either contractual or arising in relation to a tort) determines the law applicable to the relevant non-contractual obligation.

If there is no relationship, but the parties have their habitual residence in the same country at the time the relevant event takes place, the applicable law will be that of the country of residence. If none of these apply, the law of the non-contractual obligation will be that of the country in which the unjust enrichment/negotiorum gestio took place.

**Competition Issues (Article 6)**

Where non-contractual obligations arise out of an act of unfair competition (under English law, this generally equates to breach of statutory duty), the applicable law will be the law where the competitive interest or the interests of consumers are likely to be affected.

Similarly, where an act of unfair competition harms a specific competitor, then the general rule set out in Article 4 will apply—i.e. subject to the exceptions identified previously, the applicable law will be determined by reference to the country in which the damage occurs. As with the general theme of Rome II, the emphasis is on the jurisdiction in which the injured party suffers loss.
Whilst the parties are not able to derogate from the provisions of Article 6 by agreeing an applicable law, the injured party is given a choice under Article 6.3(b) to select either:

- the applicable law of the jurisdiction in which the damage occurred; or
- where a defendant is sued in the court of its domicile, the applicable law of that court, provided that the market in that Member State has been directly and substantially affected by the unfair competition.

There is therefore a limited prospect of forum shopping for a claimant in these circumstances.

**Intellectual Property Rights (Article 8)**

The law applicable to non-contractual obligations arising from the infringement of intellectual property rights is that of the country in which the protection is claimed. Where there is an infringement of a unitary Community intellectual property right (such as a Community Trade Mark) and the issue is not governed by a Community instrument, the applicable law will be the law of the country in which the infringement was committed.

As with the provisions relating to unfair competition, parties are not permitted to derogate from the rules set out in Article 8. There is, therefore, no scope for the parties to agree on an alternative applicable law.

**Conclusion**

Rome II came into force on 11 January 2009 and has significant implications for long term and future cross-border contracts.

Consideration should be given to all key cross-border contractual relationships (and negotiations for the same) to determine what applicable law is likely to prevail and to consider whether the parties should seek to agree a law for non-contractual obligations. If there is any doubt and/or any particular concern regarding non-contractual liabilities, this is an issue on which legal advice should be sought.
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