

The Common Law Rules Governing the Choice of Law in Contract

Aim:

To outline the common law rules governing the choice of law in contract.

Objectives.

After careful study of the following notes, and other prescribed readings for this lecture, you will be able to:

1. Explain what is meant by the proper law of a contract and how it may be ascertained;
2. Explain the circumstances under which statutory provisions may override the parties' choice of law;
3. Explain what is meant by the putative proper law of a contract.

Introduction

For English conflict of laws purposes, a 'contract' may acquire a different meaning from that used in English domestic law. Thus in *Re Bonacina (1912)* an agreement made in Italy and unsupported by consideration was regarded as a contract.

In common with the domestic law of contract, choice of law in a conflicts-of-law contract case has a substantial foundation at common law. However, with effect from 1 April 1991, a fundamental change has been brought about by the enactment of the *Contracts (Applicable Law) Act 1990, (C(AL)A 1990)*. This Act replaces the provisions of the common law in the areas where it applies. The C(AL)A 1990 was enacted to give the force of law, subject to reservations, to the *1980 Rome Convention on the Law Applicable to Contractual Obligations (the Rome Convention)*.

Nevertheless, that the common law will continue to apply in conflicts cases for years to come, there is no doubt: reasons for this include *article 1(2)* of the Rome Convention which excludes certain matters from the Convention; and *article 17* which provides that the Rome Convention is not retrospective, i.e. it is inapplicable to contracts made before the Convention came into force.

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The legal system under which a contract is created and by which it is governed is known as *the proper law of the contract*. In *Amin Rasheed Shipping Corp. v Kuwait Insurance Co. (1983)*, Lord Diplock described the proper law of a contract as: '... the substantive law of the country which the parties have chosen as that by which their mutually legally enforceable rights are to be ascertained ...'

Suggestions as to what the proper law of the contract is.

Two connecting factors have been suggested as being appropriate to govern the law of a contract, viz;

- (i) *Lex loci contractus* (law of the place where the contract was made);
- (ii) *Lex loci solutionis* (law of the place where performance of the contract was due.)

However, each of these connecting factors has its limitations. For example, the *lex loci contractus* may be entirely fortuitous as in a situation where a South African business man and an American business man may agree in London to the sale of goods situated in Germany. English law has no 'close or real connection' with the transaction yet it would be the proper law of the contract if the *lex loci contractus* prevailed.

Focus on the *lex loci solutionis* as the proper law of the contract may be inappropriate for a couple of reasons:

- (i) the parties respective obligations may take place in different countries, e.g. the seller agrees to deliver goods in Germany in exchange for the buyer's promise to pay the price in New York. It would be highly unsatisfactory (and totally impractical) for the parties to have their respective obligations governed by different laws.
- (ii) (ii) The place of performance of the contract may not have been determined at the time of formation of the contract and then it may be determined unilaterally, e.g. a port of delivery for (say) a cargo of oil from the Gulf states may not be specified until the vessel is at sea. It is uncertain as to what would be the proper law before the place of performance is known.

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Accordingly, there is no generally applicable connecting factor that can be used in English law to determine the proper law of the contract. Nevertheless, a significant feature of English law is the principle of party autonomy; i.e., '*the proper law of the contract ... is the law which the parties intended to apply*' per **Lord Atkin**.¹ This would appear to be a manifestation of *consensus ad idem*, a subjectivist approach.²

A Subjectivist or an Objectivist approach to the Proper Law? An Overview.

Either a subjectivist view or an objectivist view may be appropriate in determining the proper law of a contract. Both views were expressed in the **Amin Rasheed** case. Representing the subjectivist view is part of **Lord Diplock's** dictum in which he said, with respect to a contract contained in an insurance policy:

'English conflict rules accord to the parties to a contract a wide liberty to choose the law by which their contract is to be governed. So the first step is to examine the policy in order to see whether the parties have, by its express terms, or by necessary implication from the language used, evinced a common intention as to the system of law by reference to which their mutual rights and obligations under it are to be ascertained.'

From this, it would appear that a subjectivist view prevails where the parties have expressly chosen the law to govern their agreement, or, at least, the proper law can be inferred or implied.

In contrast the *objectivist view* was expressed by **Lord Wilberforce** in the same case (**Amin Rasheed**) where, *in the absence of a choice of law* he said that: '*... it is necessary to seek the system of law with which the contract has its closest and most real connection.*'

Clearly, then, neither view is generally applicable.

Ascertaining the Proper Law

(A) The Subjectivist Approach

i. Where the Parties have Expressly Chosen a Law to Govern Their Agreement.

In **Vita Food Products Inc. v Unus Shipping Co. Ltd. (1939)**, **Lord Wright** said that: '*provided the intention expressed is bona fide and legal, and provided there is no reason for avoiding the choice on grounds of public policy*' the intention of the parties as to the choice of law prevails.³

Three points with respect to the parties choice of law are:

- (a) They can choose a law which has no obvious connection with the contract and still be bona fide and legal.
- (b) If the choice of law was made for the 'specific purpose of avoiding the consequence of the illegality' ... then it is not bona fide and legal;
- (c) There is no reported English case in which a choice of law clause has been struck down by the courts.

ii. Where the Parties have Impliedly Chosen the Proper Law.

Case law has established that the parties to a contract may be deemed to have impliedly chosen the law to govern it perhaps by including a term relating to the resolution of a dispute by way of arbitration in a particular forum. Thus the tenuous connection with English law "as the proper law" in **Tzortzis v Monark Line A/B (1968)** was due to the inclusion in the contract of an arbitration clause subjecting the parties to arbitration in London. Whereas '*the fact that the parties have agreed arbitration shall take place in England is an important factor and in many cases it may be a decisive factor ... it would ... be highly anomalous if our law required the mere fact of arbitration ... in England to be decisive as to the proper law of the contract*' per **Lord Reid** in **Compagnie Tunisienne de Navigation v Compagnie d'Armement Maritime (1971)**. The leading case on the impliedly chosen proper law is now: **Amin Rasheed. v. Kuwait Insurance Co. (1983)**.

Amin Rasheed Shipping Corp. v Kuwait Insurance Co. (1983). P, a Liberian company resident in Dubai, insured a ship with D, the Kuwait Insurance Company. When a claim made by P under this policy was rejected by D, P sought an order to serve a writ on D under RSC **O.11** which could be granted, providing the contract '*by its terms, or by implication, [was] governed by English law.*' There was no express choice of English

¹ *R v International Trustee For The Protection Of Bondholders (1937)*

² N.B.: Whereas the proper law governs most aspects of the contract, questions of capacity, formation, performance and illegality are not necessarily governed by the proper law

³ That the parties to the contract 'are entitled to make such an agreement' was confirmed: by **Lord Reid** in **Whitworth Street Estates Ltd v. James Miller and Partners Ltd (1970)**

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law, nor was it clear as to what was the implied law: both Kuwaiti law and English law had claims to being the proper law of the contract.

Favouring Kuwaiti Law

Policy was issued in Kuwait;
Insurers were Kuwaiti;
Payment of claims to be made in Kuwait.

Favouring English Law

English language used in the contract;
Premiums to be made in Sterling;
Contract made in English form.
(all relatively insignificant)

However, the surrounding circumstances as well as the terms of the contract itself 'point[ed] ineluctably to the conclusion that the intention of the parties was that their mutual rights and obligations under [the policy] should be determined in accordance with the English law of marine insurance' per *Lord Diplock*. A significant factor in reaching this conclusion was that at the time of making the contract, Kuwait had no law of marine insurance!

So, from the *Amin Rasheed* case, it may be deduced that the contemporary approach to the resolution of what is the impliedly chosen proper law is to take into account 'the rest of the contract and relevant surrounding facts.' However, that no single factor will be decisive gives rise to the unfortunate consequence of great uncertainty as to the impliedly chosen proper law in the case under consideration. That pursuit of the case to the House of Lords may be required in order to resolve the issue is an expensive, if necessary, way to do it.

The *Amin Rasheed* case may also be cited as authority for renvoi not having a role in contract. *Lord Diplock* said that the proper law of a contract was the 'substantive law of the country which the parties have chosen as that by which the mutual legally enforceable rights are to be ascertained, but excluding any renvoi, whether remission or transmission, that the courts of that country might themselves apply if the matter were litigated before them.'

(B) Objectivist View i.e., Where the Parties have Neither Expressly nor Impliedly Chosen the Proper Law.

When there is neither an expressed nor an implied choice of law then 'the court has to impute an intention or to determine for the parties the proper law which, as just and reasonable persons, they ought to or would have intended if they had thought about the question when they made the contract.' per *Lord Wright* in *Mount Albert Borough Council v Australasian Assurance Societv (1938)*.

The factors which help the court determine the proper law of the contract are those with which the transaction had its 'closest and most real connection' per *Lord Simonds* in *Bonython v Commonwealth of Australia (1951)*; (approved by *Lord Wilberforce* in *Amin Rasheed*, supra).

As to the determination of the relevant factors, this involves the court in 'an exercise of judgement, a weighing of a multitude of factors ... [Indeed] ... There is no limit to the number of factors, provided only they have some bearing on the "transaction".' per *Donaldson MR* in *Amin Rasheed Shipping v Kuwait Insurance (1983)*.

The 'closest and most real connection' of the 'transaction' is then determined by a 'system of law' and not by 'the country' with which the contract is most closely connected.⁴

Presumptions as an aid to Ascertaining the Objectivist View

Whereas, in the past, judges were prepared to rely on presumptions in favour of particular legal systems, e.g. the *lex loci contractus*, or the *lex loci solutionis*, or, perhaps, the law of the flag in shipping cases, reliance on such presumptions was disapproved of by the Court of Appeal in the *Coast Lines Case (1972)*. However, the statement of *Megaw LJ* in that case that: 'presumptions, once fashionable during the earlier development of English private international law, are now whether for good or ill, out of fashion and rejected' should, perhaps, be reconsidered in the light of the presumptions contained in *Article 4* of the *Rome Convention on Contractual Obligations*.⁵

⁴ cf. Article 4, Rome Convention, next lecture

⁵ See the next lecture

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The Impact of Statutory Provisions on the Expressed Choice of Law.

That certain statutory provisions of the *lex fori* can override elements of the law chosen by the parties to govern their contract there is no doubt. For example, s.153(5) *Employment Protection (Consolidation) Act 1978* provides that where an employee ordinarily works in Great Britain, then 'for the purposes of this Act it is immaterial whether the law which (apart from this Act) governs [that] person's employment is the law of the United Kingdom, or of a part of the United Kingdom or not'. Accordingly, an employee can rely on the protection afforded to him under the 1978 Act even if the rest of his contract is governed by a foreign law. Furthermore, s.27(2)(a) of the *Unfair Contract Terms Act 1977* provides that where it appears to the court that a choice of law has been 'imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of the Act,' the Act shall continue to apply.

The 'Proper Law of the Contract' When it is Uncertain That a Contract Has Been Concluded: The Putative Proper Law.

When the existence of a valid contract is in issue, perhaps because a vitiating factor is claimed to be present, it cannot be said that the issue in question is governed by the proper law: if there is no contract there can be no proper law. Accordingly, as *Collier* notes: 'In these situations it has been suggested [by, *inter-alia*, *Dicey and Morris*; and *Cheshire and North*] and held [in *The Parouth* (1982) that the putative proper law, that is that system of law which would be the proper law assuming that there is a valid contract, should govern. This not very logical device is adopted, since there is no other way of deciding the question at issue.'

It is uncertain as to whether the parties to a contract can choose a particular legal system as the putative proper law. *Cheshire and North*, and *Dicey and Morris* appear to believe that the answer is 'no': that the putative proper law would be that system of law with which the purported contract has its closest and most real connection; any express choice of the parties would be ignored. *Collier* finds this difficult to accept and cites *Ackner L.J.* as having had no difficulty in deciding that an expressly chosen law could be the putative proper law in *The Mariannina* (1983).

Choice of Law and Aspects of Simple Contracts

Formation of the Contract.

That English law determines where a contract is formed there is no doubt: *Entores v Miles Far East Corporation* (1955); *Brinkibon v Stahag Stahl* (1982)

Whether a contract has been concluded is, apparently, determined by the putative proper law: *The Parouth* (1982). Thus, whether an *offer* has been *accepted* is determined by the putative proper law:

Albeiko Schumaschinen v Kamborian Shoe Co. (1961) A letter posted in England and sent to Switzerland contained an offer. The offeree alleged that he posted a reply in Switzerland, although it 'was never received by the offeror. Whereas English law decides that a contract is made when the letter of acceptance is posted, irrespective of whether the offeror receives it, Swiss law provides that the contract is concluded only if the offeror receives the letter of acceptance.

HELD: *Salmon J* found that the offeree failed to prove that he had in fact posted the letter of acceptance. However, he indicated that had the offeree proved that the letter had been posted, then Swiss law, as the putative proper law, would be used in ascertaining whether a contract had been concluded.

The putative proper law will also determine whether *consideration* is a necessary element of a contract. If the putative proper law is English law then the absence of consideration will render a purported contract *void ab initio*. However, if the putative proper law does not require consideration as a necessary element of a valid contract, then a valid contract may result: *Re Bonacina* (1912)

Validity and Vitiating Factors.

Formal validity.

Here the concern is *not* with procedural formalities (which are governed by the *lex fori*, e.g. enforcing a contract of guarantee under the *Statute of Frauds 1677*) but with non-procedural formalities such as a contract for the conveyance or creation of a legal estate in land having to be in a deed: s.52(1) *LPA 1925*. It is likely that compliance with either the *lex loci contractus* or the *putative proper law* will suffice to formally validate the contract.

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Essential Validity.

The proper law determines whether the contract or its terms, including exemption clauses, are valid and effective. If a contract made in England is procured through pressure which amounts to duress, it is voidable by the innocent party:

Dimskal Shipping v I.T.W.F. [1991] 4 All E.R. 871 The International Transport Workers' Federation had threatened to 'black' Dimskal's vessel while it was in a Swedish port unless Dimskal entered into new contracts with the crew, and pay back-dated increased wages. Dimskal avoided the 'blackening' by agreeing to the demand and paying the money. The proper law of the contract was English law, under which a contract induced by duress is voidable by the innocent party. One form of duress is illegitimate economic pressure and this includes the 'blackening' of a ship. On this basis, *Dimskal* sued ITWF in London for a declaration that the contracts were void for duress and for return of the sums paid under the void contracts. Economic pressure amounting to duress was not unlawful in Sweden. **HELD:** Dimskal succeeded: the terms were invalid under the proper law.

Interpretation.

Whereas interpretation of the terms of a contract is usually governed by its proper law, it is permissible for the contracting parties themselves to nominate one legal system to govern the contract and to specify that another system be used to interpret it, i.e. 'the parties may well contemplate that different parts of their contract shall be governed by different law' per *Upjohn J* in *Re Helbert Wagg (1956)*

Performance or Discharge of Obligations

It is a matter for the proper law to determine whether the parties obligations have been discharged by:

- performance: *Mount Albert Borough Council v Australasian Temperance & Assurance Society (1938)*:
or
- frustration: *Jacobs v Credit Lyonnaise (1884)*: or
- breach: *Jacobs v Credit Lyonnaise (1884)*

Capacity

At least three possibilities arise: Capacity can be governed by;

- (i) *the lex domicilii* of each contracting party (unreasonable); or
- (ii) *the proper law of the contract* (unrealistic if based on subjectivist approach; but o.k.. if on objectivist approach?); or
- (iii) *the lex loci contractus* (which may be entirely fortuitous).

However, in the absence of any established view in English law, perhaps there is merit in the suggestion that the rule varies depending on who is seeking to rely upon the incapacity e.g. a party who is capable under his *lex domicilii* should not be able to plead incapacity under the proper law of the contract.

Illegality.

In *Mackender v Feldia (1966)*, *Diplock L.J.* said:

- [a] 'English courts will not enforce an agreement, whatever be its proper law, if it is contrary to English law, whether statute law or common law;
- [b] nor will they enforce it, even though it is not contrary to English law, if it is void for illegality under the proper law of the contract.
- [c] Furthermore, subject to one exception, the English courts will not enforce performance or give damages for non-performance of an act required to be done under a contract, whatever be the proper laws of the contract, if the act would be illegal in the country in which it is required to be performed. The exception ... is where the illegality is a breach of a revenue or fiscal law of a foreign state.'

Thus, *Diplock LJ's* dictum refers to illegality under:

- (i) the *lex fori* (proposition [a]);
- (ii) the proper law of the contract (proposition [b]); and
- (iii) the *lex loci solutionis* (proposition [c]).

Proposition [a] causes no problems providing the statute in question is regarded as an overriding statute. (See, for example: *Boissevain v Weil (1950)*).

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Dalmia Dairy Industries Ltd. v National Bank of Pakistan (1987) illustrates proposition [b].

Until recently, *Ralli Bros. v Compagnia Naviera Sota Y Azinar (1920)* has been regarded as the leading case on proposition [c].

Ralli Bros. Case [1920] 2 K.B. 287. Here, Spanish shippers contracted with R, English charterers, in London, to carry goods from Calcutta to Barcelona. The shippers were to be paid £50/ton freight in Barcelona on delivery there. [i.e. Barcelona was the place where the contract was to be performed]. However, after the voyage had begun, but before the goods arrived in Barcelona, a Spanish law enacted that freight must not exceed £10/ton freight. Accordingly, the charterers, R, agreed to pay £10 but no more. The shippers brought an action in England for the balance.

HELD: English law, which was the proper law of the contract, regarded the Spanish legislation as a frustrating event. The action for recovery of the balance was unsuccessful.

Perhaps the major uncertainty relating to the *Ralli Bros.* case was, in fact, whether it was illegal under the *lex loci solutionis* or whether English public policy prevented the contract from being enforced.

A clear exception to *Diplock LJ's* proposition [c] in *Mackender v Feldia* is the decision in: **Howard v Shirlstar Container Transport (1990)**. Two aircraft had been leased from Shirlstar for private use in Nigeria. When the hire instalments became overdue, S was entitled to repossess the aircraft. They aimed to do this by engaging H, a qualified pilot, to recover them under contracts which provided, *inter alia*, for the payment of £25,000 to H 'for successfully removing [each] aircraft ... from Nigerian airspace.' [The contract provided for half the amount to be paid when the aircraft was removed from Nigerian air space and the other half on return of the aircraft to England]. H went to Lagos, Nigeria, with a wireless operator (his fiancée) where he found one of the aircraft parked at the airport. They prepared it for take-off with the assistance of two British engineers who were there. Then, when H was warned that 'powerful people wished to prevent them taking the aircraft', and that his life and that of his wireless operators was in danger, he took off in the aircraft without obtaining permission from air traffic control at the airport. The aircraft was flown to the Ivory Coast where it was seized by the Ivory Coast Government and subsequently returned to Nigeria. H and his wireless operator were allowed to come back to England where he sued for the second instalment because S refused to pay the full amount on the basis that the contract had been illegally performed in Nigeria i.e. H taking off without permission.

HELD: Although the court would not normally enforce a contract which would enable a plaintiff to benefit from his criminal conduct, since to do so would be an affront to the public conscience, there were circumstances where it would be wrong to disqualify a plaintiff from recovery, even though his claim was derived from conduct which constituted a statutory offence. Here the conscience of the court would not be affronted by allowing the plaintiff to succeed since he had committed the illegal act to save his life and that of his wireless operator. H succeeded in his claim.

Summary

The common law rules governing the choice of law in contract are applicable to contracts, the terms of which were agreed upon, *pre* 1 April 1991. The rules were clear and represented (approximately) 140 years development of common law.

When ascertaining the proper law, it would appear that a subjectivist view applies whether the parties to the contract have expressly or impliedly chosen a law to govern their agreement. However, in the absence of any agreement, express or implied, it would appear that an objectivist view prevails. That presumptions as an aid to ascertaining an objectivist view were said to be going 'out of fashion' and, accordingly, should be rejected, contrasts with the provisions of the Rome Convention which apply to contracts the terms of which were agreed upon on or after 1 April 1991.

References:

Forsyth, Conflict of Laws Textbook, London: HLT Publications, 7/e 1993

McClellan, J.D. Morris: The Conflict of Laws. London: Sweet & Maxwell, 4/e 1993.

Workshop Questions

1. Nickel, domiciled and resident in Akkadia, agrees to sell to Zinc, domiciled and resident in Lavonia, 10 tons of copper from Nickel's mine in Numibia. The agreement is concluded by exchange of letters. It is expressed to be governed by Numibian law. The price is 1,000 U.S. dollars per ton payable in Akkadia in Akkadian francs. The copper is to be transported by ship from Numibia and delivered to Zinc in Lavonia. Any dispute arising out of the agreement is to be determined by the English courts only.

By Akkadian law, but no other law, Akkadian copper producers are forbidden to sell copper for less than 2,000 U.S. dollars per ton. By Lavonian law, but no other law, a contract to import copper into Lavonia must be registered with a solicitor. This has not been done. While the ship carrying the copper was on the high seas, Akkadia enacted a law forbidding delivery of copper by Akkadian residents to Lavonia.

Zinc tendered payment to Nickel in Akkadia of the equivalent in Akkadian francs of 10,000 U.S. dollars. Nickel refused to accept it, saying that the agreement was invalid under both Akkadian law and Lavonian law. The ship's captain obeyed Nickel's order not to deliver the copper to Lavonia. Zinc wishes to sue Nickel for non-delivery.

Advise Zinc. [Q2 1991]

2. Umma, an Egyptian exporter, sent from Cairo (Egypt) to London (England) a telex to Victor, a Brazilian importer, offering to sell him some Egyptian potatoes to be delivered to Rio de Janeiro (Brazil). The message also stated that any contract would be governed by Egyptian law and the price was to be paid into Umma's bank account in Switzerland. Umma received a telex from Victor accepting the offer. Umma shipped the potatoes, but before they reached Rio de Janeiro, Victor sent another telex to Umma purporting to repudiate the contract. Umma replied, saying that he refused to accept the repudiation. Victor returned to Brazil. The potatoes arrived at Rio de Janeiro, but Victor refused to accept or pay for them.

Umma now sues Victor in England for the price. Victor argues that he is not liable:

- (a) because Umma's first telex contained misrepresentations and by Egyptian law these render the contract void;
- (b) that by Brazilian law it is illegal for anyone resident in Brazil to make payments in Switzerland; and
- (c) that Umma's action is time barred under Egyptian law, though not under English law.

Advise Umma. [Q7 1989]