THE DRAFT HAGUE PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS

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Introduction to the Draft Hague Principles on Choice of Law in International Commercial Contracts

I.1 When parties enter into a contract that has connections with more than one State, the question of which set of legal rules governs the transaction necessarily arises. The answer to this question is obviously important to a court or arbitral tribunal that must resolve a dispute between the parties but it is also important for the parties themselves, in planning the transaction and performing the contract, to know the set of rules that governs their obligations.

I.2 Determination of the law applicable to a contract without taking into account the expressed will of the parties to the contract can lead to unhelpful uncertainty because of differences between solutions from State to State. For this reason, among others, the concept of "party autonomy" to determine the applicable law has developed and thrived.

I.3 Party autonomy, which refers to the power of parties to a contract to choose the law that governs that contract, enhances certainty and predictability within the parties' primary contractual arrangement and recognises that parties to a contract may be in the best position to determine which set of legal principles is most suitable for their transaction. Many States have reached this conclusion and, as a result, giving effect to party autonomy is the predominant view today. However, this concept is not yet applied everywhere.

I.4 The Hague Conference on Private International Law (**"the Hague Conference"**) believes that the advantages of party autonomy are significant and encourages the spread of this concept to States that have not yet adopted it, or have done so with significant restrictions, as well as the continued development and refinement of the concept where it is already accepted.

I.5 Accordingly, the Hague Conference has promulgated the Hague Principles on Choice of Law in International Commercial Contracts (**"the Principles"**). The Principles can be seen both as an illustration of how a comprehensive choice of law regime for giving effect to party autonomy may be constructed and as a guide to "best practices" in establishing and refining such a regime.

Choice of law agreements

I.6 The parties' choice of law must be distinguished from the terms of the parties' primary contractual arrangement (**"main contract"**). The main contract could be, for example, a sales contract, services contract or loan contract. Parties may either choose the applicable law in their main contract or by making a separate agreement on choice of law (hereinafter each referred to as a **"choice of law agreement"**).

I.7 Choice of law agreements should also be distinguished from "jurisdiction clauses" (or agreements), "forum selection clauses" (or agreements) or "choice of court clauses" (or agreements), all of which are synonyms for the parties' agreement on the forum (usually a court) that will decide their dispute. Choice of law agreements should also be distinguished from "arbitration clauses" (or agreements), that denote the parties' agreement to submit their dispute to an arbitral tribunal. While these clauses or agreements (collectively referred to as **"dispute resolution agreements"**) are often combined in practice with choice of law agreements, they serve different purposes. The Principles deal only with choice of law agreements and not with dispute resolution agreements.

Nature of the Principles

I.8 As their title suggests, the Principles do not constitute a formally binding instrument such as a Convention that States are obliged to directly apply or incorporate into their domestic law. Nor is this instrument a model law that States are encouraged to enact. Rather, it is a non-binding set of *principles*, which the Hague Conference encourages States to incorporate into their domestic choice of law regimes in a manner appropriate for the circumstances of each State. In this way, the Principles can guide the reform of domestic law on choice of law and operate alongside existing instruments on the subject (see Rome I Regulation and Mexico City Convention both of which embrace and apply the concept of party autonomy).

I.9 As a non-binding instrument, the Principles differ from other instruments developed by the Hague Conference. While the Hague Conference does not exclude the possibility of developing a binding instrument in the future, it considers that an advisory set of non-binding principles is more appropriate at the present time in promoting the acceptance of the principle of party autonomy for choice of law in international contracts and the development of well-crafted legal regimes that apply that principle in a balanced and workable manner. As the Principles influence law reform, they should encourage continuing harmonisation among States in their treatment of this topic and, perhaps, bring about circumstances in which a binding instrument would be appropriate.

I.10 While the promulgation of non-binding principles is novel for the Hague Conference, such instruments are relatively common. Indeed, the Principles add to a growing number of non-binding instruments of other organisations that have achieved success in developing and harmonising law. See, *e.g.*, the influence of the UNIDROIT Principles and the PECL on the development of contract law.

Purpose and scope of the Principles

I.11 The overarching aim of the Principles is to reinforce party autonomy and to ensure that the law chosen by the parties has the widest scope of application, subject to clearly defined limits (Preamble, para. 1).

I.12 In order for the Principles to apply, two criteria must be satisfied. First, the contract in question must be "international". A contract is "international" within the meaning given to that term in the Principles unless the parties have their establishments in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State (see Art. 1(2)). The second criterion is that each party to the contract must be acting in the exercise of its trade or profession (see Art. 1(1)). The Principles expressly exclude from their scope certain specific categories of contracts in which the bargaining power of one party – a consumer or employee – is presumptively weaker (see Art. 1(1)).

I.13 While the aim of the Principles is to promote the acceptance of party autonomy for choice of law, the principles also provide for limitations on that autonomy. The most important limitations to party autonomy, and thus the application of the parties' chosen law, are contained in Article 11. Article 11 addresses limitations resulting from overriding mandatory rules and public policy (*ordre public*). The purpose of those limitations is to ensure that, in certain circumstances, the parties' choice of law does not have the effect of excluding certain rules and policies that are of fundamental importance to States.

I.14 The Principles provide rules only for situations in which the parties have made a choice of law (express or tacit) by agreement. The Principles do not provide rules for determining the applicable law in the absence of party choice. The reasons for this

exclusion are twofold. First, the goal of the Principles is to further party autonomy rather than provide a comprehensive body of principles for determining the law applicable to international commercial contracts. Secondly, a consensus with respect to the rules that determine the applicable law in the absence of choice is currently lacking. The limitation of the scope of the Principles does not, however, preclude the Hague Conference from developing rules at a later date for the determination of the law applicable to contracts in the absence of a choice of law agreement.

Content of the Principles

I.15 The Preamble and 12 articles comprising the instrument may be considered to be an international code of current best practice with respect to the recognition of party autonomy in choice of law in international commercial contracts, with certain innovative provisions as appropriate.

I.16 Some provisions reflect an approach that is the subject of wide, international consensus. These include the fundamental ability of the parties to choose the applicable law (Preamble, para. 1 and Art. 2(1)) and appropriate limitations on the application of the parties' chosen law (see Art. 11). It is to be expected that a State that adopts a regime that supports party autonomy would necessarily adopt rules consistent with these provisions.

I.17 Other provisions reflect the view of the Hague Conference as to best practice and provide helpful clarifications for those States that accept party autonomy. These include provisions addressing the ability of parties to choose different laws to apply to different parts of their contract (see Art. 2(2)), to tacitly choose the applicable law (see Art. 4) and to modify their choice of law (see Art. 2(3)), as well as the lack of a required connection between the chosen law and the transaction or the parties (see Art. 2(4)). Also, in line with many national regimes and regional instruments, Article 7 provides for the separate treatment of the validity of a choice of law agreement from the validity of the main contract; and Article 9 describes the scope of the applicable law. Other best practice provisions provide guidance as to how to determine the scope of the application of the chosen law in the context of a triangular relationship of assignment (see Art. 10) and how to deal with parties that have establishments in more than one State (see Art. 12). Such best practice provisions provide important advice to States in adopting or modernising a regime that supports party autonomy. However, the Hague Conference recognises that a State can have a well-functioning party autonomy regime that does not accept all of these best practices.

I.18 Certain provisions of the Principles reflect novel solutions. One of the salient features is found in Article 3, which allows the parties to choose not only the law of a State but also "rules of law", emanating from non-State sources, within certain parameters. Historically, choice of norms or "rules of law" has typically been contemplated only in an arbitral context. Where a dispute is subject to litigation before a State court, private international law regimes have traditionally required that the parties' choice of law agreement designate a State system of law. Some regimes have allowed parties to incorporate by reference in their contract "rules of law" or trade usages. Incorporation by reference, however, is different from allowing parties to choose "rules of law" as the law applicable to their contract.

I.19 Other innovative provisions are contained in Articles 5, 6 and 8. Article 5 provides a substantive rule of private international law that no particular form is required for a choice of law agreement to be valid, unless otherwise agreed by the parties. Article 6

provides, *inter alia*, a solution to the vexed problem of the "battle of forms" or, more specifically, the outcome when both parties make choices of law via the exchange of "standard terms". Article 8 provides for the exclusion of *renvoi* but, unlike many other instruments, allows the parties to expressly agree otherwise.

Envisaged users of the Principles

I.20 The envisaged users of the Principles include lawmakers, courts and arbitral tribunals, and parties and their legal advisors.

a. For *lawmakers (whether legislators or courts)*, the Principles constitute a model that can be used to create new, or supplement and further develop, existing rules on choice of law (Preamble, paras 2-3). Because of their non-binding nature, lawmakers at a national, regional, supranational or international level can implement the Principles in whole or in part. Lawmakers also retain the possibility of making policy decisions where the Principles defer to the law of the forum (see Arts 3, 11(2) and 11(4)).

b. For *courts and arbitral tribunals*, the Principles provide guidance as to how to approach questions concerning the validity and effects of a choice of law agreement, and resolve choice of law disputes within the prevailing legal framework (Preamble, paras 3-4). The Principles may be useful, in particular, for addressing novel situations.

c. For *parties and their legal advisors*, the Principles provide guidance as to the law or "rules of law" that the parties may legitimately be able to choose, and the relevant parameters and considerations when making a choice of law, including important issues as to the validity and effects of their choice, and the drafting of an enforceable choice of law agreement.

I.21 Users of the Principles are encouraged to read the articles in conjunction with the Preamble and Commentary. The Commentary accompanies each article and serves as an explanatory and interpretative tool. The Commentary includes many practical examples illustrating the application of the Principles. The structure and length of each commentary and illustration varies depending on the level of detail required to understand each article. The Commentary also includes comparative references to regional, supranational, or international instruments and to drafting history, where such references assist with interpretation. Users may also wish to consult the bibliography and materials accessible on the Hague Conference website.

THE DRAFT HAGUE PRINCIPLES ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL CONTRACTS

Preamble

1. This instrument sets forth general principles concerning choice of law in international commercial contracts. They affirm the principle of party autonomy with limited exceptions.

2. They may be used as a model for national, regional, supranational or international instruments.

3. They may be used to interpret, supplement and develop rules of private international law.

4. They may be applied by courts and by arbitral tribunals.

Article 1 – Scope of the Principles

1. These Principles apply to choice of law in international contracts where each party is acting in the exercise of its trade or profession. They do not apply to consumer or employment contracts.

2. For the purposes of these Principles, a contract is international unless each party has its establishment in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State.

3. These Principles do not address the law governing –

a) the capacity of natural persons;

b) arbitration agreements and agreements on choice of court;

c) companies or other collective bodies and trusts;

d) insolvency;

e) the proprietary effects of contracts;

f) the issue of whether an agent is able to bind a principal to a third party.

Article 2 – Freedom of choice

1. A contract is governed by the law chosen by the parties.

2. The parties may choose –

a) the law applicable to the whole contract or to only part of it; and

b) different laws for different parts of the contract.

3. The choice may be made or modified at any time. A choice or modification made after the contract has been concluded shall not prejudice its formal validity or the rights of third parties.

4. No connection is required between the law chosen and the parties or their transaction.

Article 3 – Rules of law

The law chosen by the parties may be rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.

Article 4 – Express and tacit choice

A choice of law, or any modification of a choice of law, must be made expressly or appear clearly from the provisions of the contract or the circumstances. An agreement between the parties to confer jurisdiction on a court or an arbitral tribunal to determine disputes under the contract is not in itself equivalent to a choice of law.

Article 5 – Formal validity of the choice of law

A choice of law is not subject to any requirement as to form unless otherwise agreed by the parties.

Article 6 – Agreement on the choice of law and battle of forms

1. Subject to paragraph 2 –

a) whether the parties have agreed to a choice of law is determined by the law that was purportedly agreed to;

b) if the parties have used standard terms designating two different laws and under both of these laws the same standard terms prevail, the law designated in the prevailing terms applies; if under these laws different standard terms prevail, or if under one or both of these laws no standard terms prevail, there is no choice of law.

2. The law of the State in which a party has its establishment determines whether that party has consented to the choice of law if, under the circumstances, it would not be reasonable to make that determination under the law specified in paragraph 1.

Article 7 – Severability

A choice of law cannot be contested solely on the ground that the contract to which it applies is not valid.

Article 8 – Exclusion of renvoi

A choice of law does not refer to rules of private international law of the law chosen by the parties unless the parties expressly provide otherwise.

Article 9 – Scope of the chosen law

1. The law chosen by the parties shall govern all aspects of the contract between the parties, including but not limited to –

a) interpretation;

b) rights and obligations arising from the contract;

c) performance and the consequences of non-performance, including the assessment of damages;

d) the various ways of extinguishing obligations, and prescription and limitation periods;

e) validity and the consequences of invalidity of the contract;

f) burden of proof and legal presumptions;

g) pre-contractual obligations.

2. Paragraph 1 *e)* does not preclude the application of any other governing law supporting the formal validity of the contract.

Article 10 – Assignment

In the case of contractual assignment of a creditor's rights against a debtor arising from a contract between the debtor and creditor –

a) if the parties to the contract of assignment have chosen the law governing that contract, the law chosen governs mutual rights and obligations of the creditor and the assignee arising from their contract;

b) if the parties to the contract between the debtor and creditor have chosen the law governing that contract, the law chosen governs –

i) whether the assignment can be invoked against the debtor;

ii) the rights of the assignee against the debtor; and

iii) whether the obligations of the debtor have been discharged.

*Article 11 – Overriding mandatory rules and public policy (*ordre public*)*

1. These Principles shall not prevent a court from applying overriding mandatory provisions of the law of the forum which apply irrespective of the law chosen by the parties.

2. The law of the forum determines when a court may or must apply or take into account overriding mandatory provisions of another law.

3. A court may exclude application of a provision of the law chosen by the parties only if and to the extent that the result of such application would be manifestly incompatible with fundamental notions of public policy (*ordre public*) of the forum.

4. The law of the forum determines when a court may or must apply or take into account the public policy (*ordre public*) of a State the law of which would be applicable in the absence of a choice of law.

5. These Principles shall not prevent an arbitral tribunal from applying or taking into account public policy (*ordre public*), or from applying or taking into account overriding mandatory provisions of a law other than the law chosen by the parties, if the arbitral tribunal is required or entitled to do so.

Article 12 – Establishment

If a party has more than one establishment, the relevant establishment for the purpose of these Principles is the one which has the closest relationship to the contract at the time of its conclusion.

Preamble

<u>Paragraph 1</u>
This instrument sets forth general principles concerning choice of law in international commercial contracts. They affirm the principle of party autonomy with limited exceptions.

<u>Paragraph 2</u>
They may be used as a model for national, regional, supranational or international instruments.

<u>Paragraph 3</u>
They may be used to interpret, supplement and develop rules of private international law.

<u>Paragraph 4</u>
They may be applied by courts and by arbitral tribunals.

P.1 The Preamble introduces the nature (Preamble, para. 1), objective (Preamble, para. 1) and intended purposes (Preamble, paras 2-4) of the Principles as a non-binding instrument.

Preamble, paragraph 1

P.2 The provisions of the instrument are "general principles"; a term that reflects their character as part of a non-binding instrument. The Principles address party autonomy in choice of law in international commercial contracts, as described in Article 1(1)-(2); they do not apply to consumer or employment contracts (see Art. 1(1)). The instrument may be considered as a code of current best practice with respect to choice of law in international commercial contracts, as recognised at an international level, with certain innovative provisions where appropriate.

P.3 The objective of the Principles is to encourage the spread of party autonomy to States that have not yet adopted it, or have done so with significant restrictions, as well as the continued development and refinement of the concept where it is already accepted. Party autonomy meets the legitimate expectations of the parties in this environment and, as such, advances foreseeability and legal certainty. Certainty is enhanced, in particular, as the law to be applied in the absence of a choice of law by the parties depends on the forum in which a dispute is heard. Party autonomy enables the parties to choose a neutral law or the law they consider most appropriate for the specific contract. The Principles therefore affirm the freedom of parties to an international commercial contract (see Art. 1(1)-(2)) to choose the law applicable thereto (see Arts 2-3). The Principles, however, provide limited exceptions to party autonomy in Article 11 (overriding mandatory rules and public policy).

Preamble, paragraph 2

P.4 One of the objectives of the instrument is the acceptance of its principles in present and future private international law instruments, producing a substantial degree of harmonisation of law, on a national, regional, supranational and international level, giving effect to party autonomy in choice of law in international commercial contracts.

Preamble, paragraph 3

P.5 The Principles may be used by courts and arbitral tribunals (Preamble, para. 4) to interpret, supplement and develop rules of private international law. These rules may exist on a national (including state and provincial), regional, supranational or international level and may be part of, for instance, conventions, regulations, legislation or case law. *Interpretation* here refers to the process of explaining, clarifying or construing the meaning of existing rules of private international law. *Supplementation* in this context refers to the refinement of an existing rule of private international law that does not sufficiently or appropriately provide for a particular type of situation. Although the *development* of rules of private international law may include their constructive interpretation or supplementation, the concept in the context of this paragraph particularly refers to the addition by legislatures or, in certain systems, by courts, of new rules where none existed before or effecting fundamental changes to pre-existing ones. Of course, the interpretation, supplementation and development of rules of private international law must take place within the boundaries of binding law (for instance, the Vienna Convention).

Preamble, paragraph 4

P.6 Both courts and arbitral tribunals are invited to apply the Principles. All articles have been drafted for use by courts and arbitral tribunals and, with only two exceptions, the articles do not differentiate between courts and arbitral tribunals. (The last portion of Article 3 ("unless the law of the forum provides otherwise") applies exclusively to courts, while Article 11 differentiates between courts (see Art. 11(1)-(4)) and arbitral tribunals (see Art. 11(5).)

Article 1
Scope of the Principles

Paragraph 1

These Principles apply to choice of law in international contracts where each party is acting in the exercise of its trade or profession. They do not apply to consumer or employment contracts.

Paragraph 2

For the purposes of these Principles, a contract is international unless each party has its establishment in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State.

Paragraph 3

These Principles do not address the law governing –

a) **the capacity of natural persons;**
b) **arbitration agreements and agreements on choice of court;**
c) **companies or other collective bodies and trusts;**
d) **insolvency;**
e) **the proprietary effects of contracts;**
f) **the issue of whether an agent is able to bind a principal to a third party.**

Introduction

1.1 The purpose of Article 1 is to determine the scope of application of the Principles. This scope is defined by three criteria: the Principles apply to choice of law agreements (i) in contractual matters when the contract is (ii) international (see paras 1.13-1.21) and (iii) commercial (see paras 1.5-1.12).

1.2 Article 1(1) delimits the scope of application of the Principles and describes the types of contracts to which the Principles apply. Article 1(2), together with Article 12, contains a definition of international contracts. Article 1(3) contains a list of issues or matters excluded from the scope of the Principles.

Article 1(1)

Rationale

1.3 The Principles apply to choice of law agreements in international contracts in which each party is acting in the exercise of its trade or profession. An explicit clarification is included confirming that the Principles do not apply to consumer or employment contracts.

1.4 The scope of application of the Principles is confined to commercial contracts because in these contracts party autonomy is widely accepted. In 2008, "[t]he Council invited the Permanent Bureau to continue its exploration of this topic concerning international business-to-business contracts with a view to promoting party autonomy" (Conclusions and Recommendations adopted by the Council on General Affairs and Policy of the Conference (1-3 April 2008), p. 1), and in 2009, "[t]he Council invited the Permanent Bureau to continue its work on promoting party autonomy in the field of international commercial contracts" (Conclusions and Recommendations adopted by the

Council on General Affairs and Policy of the Conference (31 March – 2 April 2009), p. 2). The rationale is to establish and enhance party autonomy in international contracts, but only in those situations in which both parties act in their professional capacity, and the risks of an abuse of party autonomy are therefore minimised.

Definition of commercial contracts

1.5 The scope of the Principles is limited to "commercial contracts", as is explicitly referred to in the Preamble (para. 1) and the title of the instrument. The term "commercial contracts" is used, among other instruments, by the UNIDROIT Principles. Article 1(1) clarifies the meaning of the quoted term both affirmatively and negatively, by (i) describing the types of contracts to which the Principles apply, and (ii) expressly excluding consumer and employment contracts.

1.6 In some States, consumer contracts are characterised as commercial contracts, since one of the parties is a professional. The Principles do not adopt this characterisation. Rather, Article 1(1) describes as falling within the scope of the Principles those contracts in which "*… each party* is acting in the exercise of its trade or profession". For the Principles to be applied, both (or all) parties must be acting in the course of their respective trade or profession. This definition is important because it introduces an autonomous concept of commercial contracts for the purpose of the Principles. This definition does not necessarily mirror the traditional distinction in some States between civil and commercial transactions. The formulation above is inspired by the Rome I Regulation (Art. 6(1)), which defines a consumer as a natural person acting for a purpose which can be regarded as being outside his or her trade or profession. The definition of Article 1(1) is the converse, in the sense that it affirmatively describes commercial contracts as those in which each party is acting in the exercise of its trade or profession.

1.7 As used in Article 1(1) and throughout the Principles, the term "party" includes any natural or legal person; for example: independent contractors, companies, foundations, partnerships, unincorporated bodies or publicly owned entities. Parties are not required to have extensive experience or skill in their specific trade or profession. Moreover, the use of the terms "trade or profession" makes it clear that the definition includes both commercial activities of merchants, manufacturers or craftsmen (trade transactions) and commercial activities of professionals, such as lawyers or architects (professional services). Insurance contracts and contracts transferring or licensing intellectual property rights between professionals fall within the scope of the Principles, as do agency or franchise contracts.

1.8 Whether a party "… is acting in the exercise of its trade or profession" depends on the circumstances of the contract, not on the mere status of the parties. Hence, the same person may act as a trader or professional in relation to certain transactions and as a consumer in relation to others.

> ***Illustration 1-1****. Party A is a practising lawyer. When Party A concludes a legal service contract with Party B, a company, Party A is acting in the exercise of his or her profession. However, when Party A concludes a rental contract for an apartment in which to spend his or her vacation, Party A is acting outside the exercise of his or her profession.*

1.9 If the contract is commercial, the Principles apply irrespective of the means through which it was concluded. Thus, the Principles apply, for example, to e-commerce

transactions and any type of contract concluded by electronic means, as long as the parties are acting in the exercise of their trade or profession.

Exclusion of consumer and employment contracts

1.10 Non-commercial contracts are excluded from the scope of application of the Principles. In particular, and to avoid any doubt, Article 1(1) explicitly excludes consumer and employment contracts. This exclusion encompasses both individual and collective contracts of employment. This exclusion is justified by the fact that the substantive law of many States subjects consumer and employment contracts to special protective rules from which the parties may not derogate by contract. These rules are aimed at protecting the weaker party – consumer or employee – from an abuse of the freedom of contract and this protection extends to private international law where it appears as an exclusion or limitation on party autonomy. However, the exclusion of consumer and employment contracts under Article 1(1) is merely illustrative of the type of non-commercial contracts to which the Principles do not apply. Other non-commercial contracts, such as a contract concluded between two consumers, are also outside the scope of application of the Principles.

1.11 The fact that the Principles, by their terms, apply only to contracts in which each party is acting in the exercise of its trade or profession should not lead to a negative inference that party autonomy is not available in non-commercial contracts. The Principles do not provide private international law rules for such contracts.

1.12 Article 1(1) describes the contracts to which the Principles apply in general terms, in keeping with the nature of the instrument as a set of non-binding general principles. With regard, in particular, to consumer contracts, the Principles do not explicitly address the characterisation of the so-called "dual-purpose contracts", *i.e.*, contracts intended for purposes that fall partially within and partially outside a party's trade or profession. Likewise, the Principles are silent with regard to the perspective from which the purpose of the contract is to be evaluated, *i.e.*, whether it is necessary for the professional to have been aware of the purpose of the contract (see Art. 2(a) CISG).

Article 1(2)

Internationality

1.13 To fall within the scope of the Principles, the contract must qualify as an "international" contract. This requirement is consistent with the traditional understanding that private international law applies only to international cases. The definition of "internationality" varies considerably among national and international instruments (see para. 1.15).

1.14 For the purpose of the Principles, the notion of an international contract is defined in Article 1(2). Pursuant to this provision, the only contracts that are excluded as lacking internationality are those in which "each party has its establishment in the same State and the relationship of the parties and all other relevant elements, regardless of the chosen law, are connected only with that State". This negative definition excludes only purely domestic situations, aiming to confer the broadest possible scope of interpretation to the term "international". This provision is primarily inspired by the 2005 Hague Choice of Court Convention (Art. 1(2)).

1.15 Article 1(2) of the Principles does not adopt a positive definition of internationality of the contract as found in some other instruments (see, *e.g.,* Art. 1 *a)-b)* 1986 Hague Sales Convention). Nor does Article 1(2) take a broader approach of referring to all cases involving a "conflict of laws", or a "choice between the laws of different States" whereby

the parties' choice of law alone may constitute a relevant element (see, *e.g.,* Art. 3 2006 Hague Securities Convention).

Ascertainment of internationality

1.16 The ascertainment of internationality of the contract proceeds from the following two steps.

1.17 First, Article 1(2) refers to the establishments of the parties as a relevant element. When the parties' establishments are located in different States, the contract is international and the Principles apply. This is a simple test that facilitates the ascertainment of internationality without having to refer to other relevant factors. If a party has more than one establishment, the relevant establishment is the one that has the closest relationship to the contract at the time of its conclusion (see Art. 12).

> ***Illustration 1-2.*** *Party A (which has its main establishment in State X but whose establishment that has the closest connection to the contract in the sense of Article 12 is in State Y) signs a contract through its establishment in State Y with Party B, which also has its main establishment in State X and is acting through its main establishment in State X. Because the parties acted through establishments located in different States (State Y for Party A and State X for Party B), the contract is international and thus is governed by the Principles.*

1.18 Second, even if the first test does not apply, a contract still qualifies as international unless "all other relevant elements" are located in the same State. These relevant elements may be, for example, the place of conclusion of the contract, the place of performance, a party's nationality, and a party's place of incorporation or establishment. If a party has more than one establishment involved in the transaction, subordinate establishments that have been disregarded in the first step pursuant to Article 12 (see para. 1.17) may still be taken into consideration.

1.19 The ascertainment of internationality may require a careful case-by-case analysis. For example, the sale of land located in State X between parties who have their establishments in State Y satisfies the requirement of internationality of the contract because of the location of the land abroad. However, the same considerations do not apply with regard to a domestic sale of tangible goods in State X that are produced abroad, *i.e.*, in State Y (or several States). This is because, at all times germane to the sale, all relevant elements are located in State X. Similarly, the fact that pre-contractual negotiations took place abroad, or that a particular language is used in the contract, without more does not fulfill the requirement of internationality.

1.20 The contract qualifies as international and falls within the scope of the Principles unless there is no relevant element establishing internationality. This interpretation derives from the negative definition of internationality provided in Article 1(2).

Irrelevant factors

1.21 The phrase "regardless of the chosen law" in Article 1(2) means that the parties' choice of law is not a relevant element for determining internationality. In other words, the parties may not establish internationality of the contract solely by selecting a foreign law, even if the choice is accompanied by a foreign choice of court or arbitral tribunal, when all the relevant objective elements are centred in one State (see Art. 1 *b)*

1986 Hague Sales Convention). This definition of internationality differs from that of the 2006 Hague Securities Convention (Art. 3) and the Rome I Regulation (Art. 1(1)).

1.22 The Principles do not address conflicts of laws among different territorial units within one State, for example, within Australia, Canada, Nigeria, Spain, the United Kingdom or the United States of America. Hence, the fact that one of the relevant elements is located in a different territorial unit within one State does not constitute internationality of the contract in the sense of Article 1(2). However, the Principles do not prevent lawmakers or other users from extending the scope of application of the Principles to intra-State conflicts of laws.

Article 1(3)

1.23 The Principles apply to choice of law agreements for *contracts*. Following the approach of other international instruments, the Principles do not provide a definition of the term "contract". Nevertheless, in order to facilitate the application of the Principles, Article 1(3) excludes from their scope certain matters for which there is no wide consensus on (a) whether they qualify as contractual, or (b) whether, in any event, they should be subject to party autonomy. The list of exclusions includes six items: (i) capacity of natural persons; (ii) arbitration agreements and agreements on choice of court; (iii) companies or other collective bodies and trusts; (iv) insolvency; (v) proprietary effects of contracts; and (vi) the issue of whether an agent is able to bind a principal to a third party. This list is inspired by, among others, the 1986 Hague Sales Convention (Art. 5), the Rome I Regulation (Art. 1(2)) and the Mexico City Convention (Art. 5).

1.24 The reasons for Article 1(3) are twofold: the legal nature of the enumerated issues, and the lack of consensus on whether to characterise them as contractual issues or on whether to subject them to party autonomy. However, the existence of a list of exclusions should not be interpreted as a policy decision against party autonomy in respect of the matters excluded. The Principles are neutral on this point and, therefore, do not preclude lawmakers or other users from extending party autonomy to some or all of the excluded matters.

1.25 *First*, the Principles do not address the law governing *the capacity of natural persons.* In this context, capacity means the ability of natural persons to act and enter into contracts independently. It does not include the authority of agents or organs to represent a principal or entity (see Art. 5 *b)* 1986 Hague Sales Convention). Capacity is a matter that may appear as an incidental question to the validity of the contract, including the choice of law agreement itself. The lack of capacity entails a restriction on party autonomy because of the need to protect the person due to, for example, his or her age (a minor) or mental state. In some States, legal capacity is regarded as a matter of status and does not qualify as contractual. The determination of the law applicable to this question is excluded from the scope of the Principles. The exclusion means that the Principles determine neither the law governing the capacity of natural persons, nor the legal or judicial mechanisms of authorisation, nor the effects of a lack of capacity on the validity of the choice of law agreement (see paras 39-40 Explanatory Report to the 1986 Hague Sales Convention).

1.26 *Secondly*, the Principles do not address the law governing *arbitration agreements and agreements on choice of court.* This exception mainly refers to the *material validity* of such agreements, *i.e.*, to the contractual aspects of those jurisdictional clauses, and includes questions such as fraud, mistake, misrepresentation or duress (see also para. 126 Explanatory Report to the 2005 Hague Choice of Court Convention). In some States, these questions are considered procedural and are therefore governed by the *lex fori* or *lex arbitri.* In other States, these questions are characterised as substantive issues to be governed by the law applicable to the arbitration or choice of court agreement

itself. The Principles do not take a stance among these different views. Rather, Article 1(3) *b)* excludes these issues from the scope of the Principles.

1.27 *Thirdly,* the Principles do not address the law governing *companies or other collective bodies and trusts.* The term "collective bodies" is used in a broad sense so as to encompass both corporate and unincorporated bodies, such as partnerships or associations.

1.28 The exclusion under Article 1(3) *c)* encompasses the constitution and organisation of companies or other collective bodies and trusts. The excluded issues are, in general, the creation, membership, legal capacity, internal organisation, decision-making processes, dissolution and winding-up of companies and other collective bodies. The same exclusion applies to issues concerning the internal administration of trusts. In many States, these issues are subject to specific private international law rules pointing to the law of companies (in general, the law of the place of incorporation or central administration) or the law of other collective bodies or trusts.

1.29 The exclusion in Article 1(3) *c)* is confined to matters involving the internal organisation and administration of companies or other collective bodies and trusts and does not extend to contracts that they conclude with third parties. The Principles also apply to commercial contracts entered into between the members of a company (shareholder agreements).

1.30 *Fourthly,* the Principles do not address the law governing *insolvency*. This exclusion refers to the effects that the opening of insolvency proceedings may have on contracts. Insolvency proceedings may interfere with the general principles of contract law, for example, by invalidating a contract pursuant to claw-back rules, staying a termination right of the party *in bonis,* or giving the insolvency administrator the power to reject the performance of a pending contract or to assign it to a third party. The exclusion of insolvency in Article 1(3) *d)* relates to these questions. In general, the Principles do not determine the law applicable to the question of how contracts are to be treated in insolvency; nor do they address the legal capacity of the insolvency administrator to enter into new contracts on behalf of the insolvent estate. The term insolvency is used here in a broad sense, encompassing liquidation, reorganisation, restructuring or administration proceedings.

1.31 *Fifthly*, the Principles do not address the law governing *the proprietary effects of contracts.* The Principles allow the parties to choose the law applicable to their contractual obligations, but they do not address the establishment and effects of rights *in rem* created by the contract. In other words, the Principles only determine the law governing the mutual rights and obligations of the parties, but not the law governing rights *in rem*. For example, in a contract for the sale of an asset, movable or immovable, tangible or intangible, the Principles apply to the seller's personal obligation to transfer and the buyer's personal obligation to pay, but not to questions such as whether the transfer actually conveys property rights without further action, or whether the buyer acquires ownership free of the rights or claims of third parties.

1.32 Finally, the Principles do not address the law governing the issue of *whether an agent is able to bind a principal to a third party*. This exclusion refers to the *external* aspects of the agency relationship, *i.e.*, to issues such as whether the principal is bound on the grounds of an implied or apparent authority or on the grounds of negligence, or whether and to what extent the principal can *ex post* ratify an *ultra vires* act of the agent (see Art. 11 1978 Hague Agency Convention). By contrast, the Principles apply to the internal aspects of an agency, *i.e.*, the agency or mandate relationship between the principal and the agent, if it otherwise qualifies as a commercial contract.