XIV.2 - Law applicable to international contracts

(a) A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to only part of the contract. The parties may at any time agree to subject the contract to a law other than that which previously governed it.

(b) Absent a choice of law by the parties, a contract is governed by the law with which the contract is most closely connected ("centre of gravity test"; "engster Zusammenhang"; "liens les plus étroits").

(c) Contracts are most closely connected with the law of the country where the party required to effect the characteristic performance has its habitual residence, seat or place of business.

(d) Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs (b) or (c), the law of that other country shall apply.

(e) The law applicable to a contract by virtue of this Principle shall govern in particular:

i) interpretation;
ii) performance;
iii) the consequences of a total or partial breach of obligations, including the assessment of damages in so far as it is governed by rules of law;
iv) the various ways of extinguishing obligations, and prescription and limitation of actions;
v) the consequences of nullity of the contract.

Commentary:

1 The closest connection test in Subsection (a) goes back to the famous German law professor and Prussian minister for legislation, Friedrich Carl von Savigny. In Vol. 8 of his major treatise "System des heutigen Römischen Rechts" published in the 19th century, Savigny argued that it is the task of conflict of laws to determine the "seat" of a legal relationship, i.e., the legal system with which this legal relationship has the closest territorial connection. Today, the closest connection test has a functional instead of a purely territorial meaning. It is reflected, e.g., in Art. 4 of the Rome I Regulation of the EU, s. 1051 (2) of the German Arbitration Act and Art. 187 (1) of the Swiss arbitration law contained in the Swiss Federal Law on Private International Law.

2 The rule in Subsection (b) is based on the idea that it is not the party who pays but the party who performs in kind - often in a professional context - that provides the characteristic performance within a contractual relationship. It is this performance which determines the type of contract one is dealing with. This relatively easy and straightforward approach provides legal certainty and ensures a uniform approach to the determination of the law applicable to a contractual relationship, no matter before which court or arbitral tribunal the issue is to be decided.

3 This means that, absent an express or implied choice of law by the parties (which always prevails over any objective connection of the contract to a domestic legal system unless the parties' choice of law agreement is invalid), the determination of the law applicable to a contract is based on a typology of contracts:

- a contract for the sale of goods is governed by the law of the country where the seller has his habitual residence, seat or principal place of business (unless the contract is governed by the UN Sales Convention (CISG), but note Art. 4 CISG for the limited scope of the Convention, issues outside the Convention's scope must be determined under the applicable domestic law!),
- a contract for the provision of services is governed by the law of the country where the service provider has his
habitual residence, seat or principal place of business, a contract of carriage is governed by the law of the country of habitual residence, seat or principal place of business of the carrier,

- a **franchise contract** is governed by the law of the country where the franchisee has his habitual residence, seat or principal place of business,
- a **contract for the performance of a certain work** (e.g. a construction contract) is governed by the law of the country where the contractor has his habitual residence, seat or principal place of business,
- a **consultancy contract** is governed by the law of the country where the consultant has his habitual residence, seat or place of business,
- a **distribution contract** is governed by the law of the country where the distributor has his habitual residence, seat or principal place of business,
- a **licensing contract** is governed by the law of the country where the licensor has his habitual residence, seat or place of business,
- a **research and development contract** is governed by the law of the country where the researcher/developer has his habitual residence, seat or principal place of business,
- a **contract in banking and finance** (e.g. a loan agreement) is governed by the law of the country where the bank has its seat,
- an **employment contract** is governed by the law of the country in which or, failing that, from which the employee habitually carries out his work in performance of the contract.

4 A **mixed contract** which combines elements of a number of the types of contracts listed above is governed by the law of the country where the party that does not pay has his habitual residence, seat of place of business.

5 Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in para. 3 above, the law of that other country shall apply.

6 If the contract is connected to a number of legal systems but is not most closely connected to either of them, the **lex validitatis Principle** may provide a way to connect the contract to one of those legal systems.