How Choice of Law Impacts Contractual Obligations

By Maggy Baccinelli (baccinelli@acc.com), ACC

Sara Biro is senior European counsel for Fitch Ratings, based in London. She is an American who has lived and practiced law abroad for almost 18 years. Biro is passionate about sharing her knowledge of international law and practice, and about helping in-house counsel become better international lawyers. As immediate past chair of ACC’s International Legal Affairs Committee, she said she first became active in ACC because, “I saw people not doing as well as they could be doing if they had a bit more information. I really want to help inform other in-house lawyers so that, when they are doing business around the world, they can make more friends and annoy fewer people.”

It is with this sense of humor that Biro delivered her presentation at ACC’s 2012 Annual Meeting in Orlando. As one of the panelists of a session on drafting considerations for international contracts, Biro focused her discussion on how understanding choice of law can help in-house counsel minimize risk when negotiating contracts that are governed by the law of a civil law country.

Biro talked about choice of law with the energy of an enthusiastic history teacher. During her session, she explained that there are three core “families” of civil law — French, German and Nordic — but that she would be focusing on French and German civil law because they have the most comprehensive legislative codifications. She went on to say that the French Code comes from the Napoleonic Code, which was adopted in 1804. “Napoleon viewed it as his biggest accomplishment. He said, ‘People will forget about the battles but they’ll remember this.’ And they do.”

We know they do, said Biro, because the French Civil Code has affected legal systems in many Western European countries and, through influencing the legal systems of those countries, has affected the legal systems of the countries of South America and Africa, too. Similarly,
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the German Civil Code has influenced the legal systems of countries in the Far East, including Japan, China, Mongolia and Taiwan.

“So, once you get a basic understanding of the French and German civil codes in the area of contracts, it can be very helpful to you wherever you are in the world,” said Biro. “But having that information should also make you very aware that you need to talk to a local lawyer in the country whose law will govern your contract to ensure that your contract will have the terms and conditions that you intend it to have.”

Biro said this is one of two points she hopes her audience took away from her session. Civil law characterizes contracts by type of contract. The characterization of the contract means that certain contractual terms will automatically apply to that contract. Some of these terms are mandatory and cannot be excluded from the contract; if they are not mandatory, then counsel must expressly “dis-apply” them to keep them from becoming part of the contract.

“And these can be significant terms — I’m talking about major modifications to the deal you thought you had,” said Biro. “You need to talk to your local lawyer about what type of contract you are dealing with, what terms apply to your contract and what you can do about the terms that apply. Do you accept some of them? Can you exclude some of them? What do you do about the mandatory contract terms that apply to your contract?”

Her other main point was the importance of good translation. “I don’t think people think about it sufficiently,” she said. “People spend a lot of time negotiating contracts, but then don’t pay much attention to who is translating the contract.” Biro emphasizes hiring legal translators with experience in the particular subject matter of the contract. “It’s difficult to find the right people, but if you don’t, you may as well not have spent any time negotiating the contract, because, if it’s not translated properly, your hard work will go out the window.”

Biro also reminded her audience of the different bases of the civil law on contracts and the common law of contracts: The basis of civil law contracts is consent, not a “caveat emptor” bargain. In civil law countries, the parties negotiating the contract have a duty to act in good faith, not just when negotiating the contract, but throughout the life of the contract. As a result, civil codes may impose information disclosure requirements on the parties who are negotiating a contract and/or restrict a party’s freedom to withdraw from negotiations. “Negotiating a contract which is governed by civil law is a whole different ballgame,” said Biro.

Another misconception of in-house counsel in common law jurisdictions regards the concept of consideration in civil law contracts. Biro said that some lawyers think consideration is not required in civil law jurisdictions. Under the French Civil Code, however, the parties must have both an objective and subjective “causa” for the contract to be effective. The objective cause is what each party is getting out of the contract. “So, in France, as a general rule, someone could not sell a thriving business for one dollar because that’s not a sufficient objective cause from the standpoint of the party that is selling the business,” said Biro. In the United States and United Kingdom, however, it would be possible to sell a thriving business for one dollar because contracts can be formed based on an exchange of nominal consideration.

In Germany, Biro distinguished, consideration is not required, but not having it may change the characterization of the contract, and as a result, the applicable contractual terms. “If consideration is not given by each party to the contract, your contract could become a contract for gift. Unlike in common law countries where, as a general rule, people can’t enforce a promise to give a gift, promises to give a gift can be enforceable contracts in civil law countries,” she explained.
In terms of contract format, Biro said civil law contracts tend to be shorter and simpler than common law contracts because certain contractual terms apply automatically under the relevant civil code, “so you don’t have to spell everything out.” However, if a complex contract governed by civil law involves extensive negotiations, she said the document can be as long and detailed as a complex contract that is governed by the law of a common law jurisdiction. Here, she gave her warning again, “But what the common law lawyer needs to keep in mind is that, however long and detailed your contract is, if you’ve elected the law of a civil law country as the governing law of your contract, additional contractual terms will apply to your contract that may conflict with some of your carefully negotiated contractual provisions or that may significantly modify the deal you think you’ve struck.”

As for negotiating styles, Biro said, “The European negotiating style is much less direct. People often discuss a number of topics unrelated to the transaction before they get down to negotiations. In contrast, Americans are well known for going straight to the point in negotiations.”