Arbitration-Favored Policy Has its Boundary: Case Study and Takeaways for China

(This post is written by Chen Zhi, a Ph.D. candidate at the University of Macau, a trainee lawyer in Mainland China)

The arbitration-favored policy has been adopted by many jurisdictions across the world in recent years, as the support of arbitration by local judiciaries has been viewed as an important standard for gauging the business environment of a jurisdiction. While the decision of Morgan v. Sundance Inc. rendered in May 2022 by the Supreme Court of the USA illustrates that arbitration-favored policy has its boundary, this seems a trend emerging from the laws and legal trends in other jurisdictions.

Summary of the Fact

This case concerned a class action initiated by a former employee, Morgan against Sundance Incorporate (the owner of a Taco Bell franchise restaurant, hereinafter "Company") regarding the arrear of overtime payment in the context of Federal law of the USA.

Albeit there was an arbitration agreement incorporated in the contract between Morgan and the Company, the Company failed to raise any motion about the arbitration agreement at the outset and defended as if the arbitration agreement did not exist.

Nearly 8 months after the commencement of the litigation, the company raised jurisdictional objection by invoking the omitted arbitration agreement and filed the motion to compel arbitration under the 1925 Federal Arbitration Act (hereinafter "FAA"). Morgan argued that the Company had waived the right to arbitrate. By measuring the case against the standard for the waiver as set out in the precedent of the Court of Appeal of Eighth Circuit, the court of first instance ruled in favor of Morgan and rejected to refer the case to arbitration.

Nonetheless, the Court of Appeal of the Eighth Circuit had adopted the

requirement for waiver based on the “federal policy favoring arbitration”. Under the new requirement, Morgan shall furnish the proof showing prejudice incurred by the delay, and overturns the trial court’s decision thereby.[i] The case was subsequently appealed before the Supreme Court of the USA.

Supreme Court’s Decision

It is not surprising that lower courts in the USA have been consistently adopting specific rules for arbitration in the name of the arbitration-favored policy, which is contradictory to the proposition of the Supreme Court.[ii]

In the Morgan case, the Supreme Court holds that the Appeal Court of the Eighth Circuit has erred in inventing a novel rule tailored for the arbitration agreement, and reiterates that the arbitration agreement shall be placed on the same footing as other contracts. In the unanimous opinion delivered by Justice Kagan, the Supreme Court explicitly states that:

“*Accordingly, a court must hold a party to its arbitration contract just as the court would to any other kind. But a court may not devise novel rules to favor arbitration over litigation.*” [iii]

In this regard, the arbitration agreement shall not be distinguished from other types of contracts in the context of Federal Law, under which the prejudice will generally not be asked about in the assessment of waiver. By Stripping off the requirement of prejudice, the Supreme Court remands the case to the Court of Eighth Circuit for reconsideration.

The Supreme Court does not delve into the jurisprudence behind arbitration-favored policy but simply states that the purpose of this policy is to make arbitration agreements as enforceable as other contracts, but not more. [iv]

The Main Concern of Morgan v. Sundance Inc.

In the context of American law, the grounds for equal treatment emerges from Section 2 of the 1925 Federal Arbitration Act, which stipulates that an arbitration agreement is valid and enforceable unless the grounds for revocation of any contract as set out in law or equity were found. Against this backdrop and in collaboration with the drafting history of the enactment of the Federal Arbitration Act, the Supreme Court has set out the basic principle that the arbitration

agreement shall be placed on the same footing as other contracts, by which the arbitration-favored policy does entitle a higher protecting standard for arbitration agreement, as stated in Granite Rock Co. v. Teamsters:

"[…]the *'policy' is merely an acknowledgment of the FAA's commitment to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate and to place such agreements upon the same footing as other contracts.*"[v]

Through the decision in the Morgan case, the equal treatment principle is recapped and stressed, by which the arbitration-favored policy creates no new rules tailored for waiver of arbitration clauses under the legal framework of the USA.

The Complexity of Arbitration-favored Policy and the Boundary

Recent years have witnessed state courts' preference to embrace the notion of "arbitration-favored policy" or "pro-arbitration policy". Nonetheless, the arbitration-favored policy is a sophisticated and vague concept without an agreed definition worldwide. In principle, this policy flows from the well-recognized characteristics of international commercial arbitration such as autonomy, expediency, efficiency, and enforceability across the world. As per the analysis of Prof. Bremann, there are at least 12 criteria for gauging the arbitration-friendliness policy.[vi]

Likewise, Justice Mimmie Chan at the Court of the Instance of Hong Kong SAR fortifies 10 pro-arbitration principles employed by courts in Hong Kong towards enforcement of arbitration awards in the case of KB v S and Others, which sets up relatively high thresholds for parties to challenge arbitral awards in the enforcement stage, as the Chan J. highlights: (1) the courts' reluctancy to looking to the merits of the case, (2) challenger's duty to make a prompt objection against any alleged irregularities under the bona fide principle and, (3) the court's residual discretion to enforce the award albeit the statutory grounds of rejection has been made out.[vii] Similar principles can also be extracted from decisions by courts in other jurisdictions like Singapore. [viii]

In the author's view, these considerations for arbitration-favored policy can be distilled as the following four limbs:

(1) adherence to the parties' autonomy to the largest extent,

(2) promoting the fairness and efficiency of commercial arbitration,

(3) minimizing the judicial interference throughout the arbitration proceedings, including the stages before and after the issuance of the arbitral award, among others, refraining from conducting the review on the merits issue of the case unless in exceptional circumstances and nullifying arbitral award based on trivial errors,

(4) providing legal assistance to arbitration proceedings for the promotion of fairness, expediency and efficiency (i.e., auxiliary proceedings for the enforcement of arbitration agreement and award, issuance, and execution of interim reliefs, taking of evidences).

As to the field of arbitral jurisdiction, the arbitration-favored policy always takes the form of the validation principle, where at least four scenarios are present in legal practice:

First, when confronted with the issue of the law governing arbitration agreement, and more than one laws are relevant, courts are required to apply laws that are in favor of the effectiveness of the arbitration agreement, either by virtue of statutory regulations[ix] or provided as one of the considerations in judicial practice.[x]

Second, courts are declined to intervene in the dispute over arbitral jurisdiction before the decision of the arbitration tribunal is rendered, as a result of the negative effect of the *competence – competence* principle to ensure the integrity and efficiency of arbitration proceedings.[xi]

Third, the invalidity of the matrix contract does not necessarily negate the arbitration agreement incorporated therein as per the widely-accepted separability doctrine.[xii]

Fourth, the courts will interpret in a manner that is likely to give effect to the arbitration agreement, particularly where the arbitration agreement is pathological in form or substance.[xiii]

At least one of the aforesaid scenarios emerges from legislation or judicial practices in jurisdictions featuring or advocating arbitration-favored policy, in which courts are always inclined to refer the case to arbitration. Nonetheless, the

arbitration-favored policy does not mean that the court will give effect to the arbitration agreement unconditionally. The aforesaid Morgan case demonstrates that arbitration-favored policy has boundaries in the context of American law, taking the form of the equal treatment principle.

The boundary of arbitration-favored policy also emerges from laws and legal practices in other jurisdictions, as representative examples, the BNA case by the Court of Appeal of Singapore, the Kabab-Ji case by the Supreme Court of the UK, and the Uber case by the Supreme Court of Canada will be further illustrated below:

BNA Case

In this case, at issue before Singaporean courts was the law governing arbitration agreement, where the parties had designated PRC law as the governing law of the contract and expressly set out the term "arbitration in Shanghai" in the arbitration clause. The plaintiff objected to arbitral jurisdiction after the commencement of arbitration proceedings before the tribunal and subsequently resorted to courts in Singapore for recourse against the tribunal's decision ruling that the arbitration agreement was valid under the laws of Singapore.

The plaintiff contended that the laws of China shall be applied, while the respondent argued that the arbitration clause in dispute was alleged to be invalid under PRC law, and submitted that the Singaporean court shall apply laws that are more in favor of the effectiveness of the arbitration agreement under validation principle hence the governing law shall be the laws of Singapore. The Singapore High Court applied Singaporean law and the dispute was filed before the Court of Appeal of Singapore.

The Court of Appeal opines that the validation principle can only be taken into consideration when there are other laws that can compete with PRC law to be the governing law of arbitration clause,[xiv] as all factors point to China as the proper law and Singapore was not the seat in the context of Article 10 of International Arbitration Act, this case shall be given to Chinese courts to decide.[xv] Therefore, the Appeal Court overturned the controversial decision by the Singapore High Court which determined Singapore as the seat by twisting the meaning of arbitral seat.[xvi]

Per the decision in the BNA case, the validation principle is only applicable where

some prerequisites are met. While parties expressly reach an intention likely to negate the arbitration agreement without other competing factors, the court shall not rewrite the contract to nakedly validate the arbitration agreement.

Kabab-Ji Case

In this case, a Paris seated tribunal decided to extend the arbitration agreement to Kout, the parent company to the signatory which had been actively engaging in performance and re-negotiation of the contract in dispute, while not being a signatory to the contract. The tribunal's decision was under the scrutiny of judiciaries in the UK at the enforcement stage.

Unlike the scenario in the BNA case, there were two competing factors regarding the determination of the proper law of arbitration agreement in Kabab-Ji: laws of England as the designated laws governing the main contract and the laws of France as the *lex arbitri* fixed in the contract. While the French laws turn out to be more in favor of the effectiveness of the arbitration clause, the Supreme Court of the UK rejected enforcing the arbitral award for lack of valid arbitration agreement via the application of English law as the proper law of arbitration clause. The court stresses in the decision that the validation principle does not apply to issues concerning the formation of a contract, and hence this principle was not relevant in deciding the issue of non-signatory.[xvii] And departing from the validation principle as set out in its precedent.

Per the decision of the Supreme Court of the UK, the extension of the arbitration agreement to non-signatory pertains to the formation of an arbitration agreement rather than the interpretation of the contract, which is contrary to the approach employed by French courts over the same case scenario. The decision in the Kabab-Ji case has given rise to controversies, as a commentator pointed out, the English court may be criticized for stepping over the line.[xviii] Nonetheless, the decision of Kabab-Ji is to some extent in line with the stringent attitude toward the non-signatory issue of arbitration agreement that judiciaries in England have consistently taken.[xix]

Uber Case

The dispute arose out of the putative employment relationship between Heller, a delivery driver, and UberEATS, a Toronto-based subsidiary of Uber. During the litigation, UberEATS filed a motion to compel arbitration by invoking the

arbitration clause embedded in the boilerplate service agreement between Uber and all drivers who sign in for service of Uber.

The Supreme Court of Canada finds the arbitration clause unconscionable based on two main findings: (1) inequality of bargaining power between Heller and Uber, (2) improvidence produced by the underlying arbitration clause. The court stresses the fact that according to the arbitration clause, arbitration proceedings shall be administered under the Rules of Arbitration of the International Chamber of Commerce, which requires US$14,500 in up-front administrative fees for the commencement of the putative arbitration proceedings. Also, Amsterdam shall be the place of arbitration per the arbitration clause, hence further fees for traveling and accommodation will be incurred thereby. The court ruled that the arbitration clause was invalid and rejected to compel arbitration.[xx]

The judgment also discusses the arbitration-favored policy contention, stating that arbitration is respected based on it being a cost-effective and efficient method of resolving disputes.[xxi] By this logic, arbitration clauses creating a hurdle toward cost-effective and efficient resolution of disputes will not be safeguarded albeit the arbitration-favored policy is applicable.

The Uber case illustrates that different values may at odds with each other in the application of arbitration-favored policy, hence trade-offs will be presented before decision-makers. As discussed by Prof. Bremann, one given policy or practice may be pro-arbitration in some respects while anti-arbitration in other respects, further, the implication of arbitration-favored policy may also be detrimental to policies extrinsic to arbitration.[xxii] In the Uber case, two kinds of conflict are present simultaneously, first, upholding the effectiveness of the underlying arbitration clause may be detrimental to the policy for the protection of those who are vulnerable(trade-off between arbitration-friendly policy and extrinsic policies), second the enforcement of alleged parties' autonomy taking the form of "arbitration administered by ICC in Netherland" is likely to be detrimental to the expediency and efficiency nature of arbitration(trade-off between arbitration-favored policy and extrinsic).

The answer to the said trade-offs remains unresolved, as there is no agreed standard by far, and courts in different jurisdictions can be divergent on this issue. As a prime example, while there is a discrepancy regarding the number of tribunal members between the rules of the arbitration institution and the

arbitration clause, where the former provides a mandatory sole-arbitrator regulation for consideration of expedition and efficiency, the latter had designated a three-member-tribunal, the court of Singapore upheld the preemption of arbitration rules over the arbitration clause,[xxiii] while Chinese court once ruled in favor of the arbitration clause and rejected to enforce the award rendered by the sole arbitrator.[xxiv]

Takeaways for China

The arbitration-favored policy is a complicated notion that includes a myriad of separate and to some extent, conflicting considerations. In a general sense, courts embracing arbitration-favored policy are reluctant to negate the arbitration agreement. However, there are some exceptional instances where:

(1) the vindication of the arbitration agreement will produce prejudice to other values that are extrinsic to arbitration, such as the rule of law principle, the consistency of legal practice, policies for the protection of vulnerable parties, etc., like the situations in Morgan case and Uber case, and,

(2) the interpretation or implementation of the arbitration clause will undermine other considerations among the arbitration-favored policy, for instance, while the enforcement of the arbitration clause can be low-efficient and costly, or the validation principle may be contrary to the parties' true intention, like the situations in BNA case and Kabab-Ji case.

Therefore, every jurisdiction shall tailor the arbitration-favored policy for its legal system and meet its own needs, instead of employing a dogmatic understanding of the policy.

Like other rising economic bodies like India,[xxv] China is also moving toward a jurisdiction that is "arbitration-favored" under the Belt and Road imitative and the blueprint for the construction of the Guangdong- Hong Kong- Macao Greater Bay Area. Against this backdrop, judiciaries are taking more liberal approaches that are tended to give effect to arbitration agreements that are likely to be considered invalid previously, particularly in disputes regarding the choice of law issue and the substance of the arbitration agreement. [xxvi]As to the formal requirement of arbitration agreement, the Supreme People's Court also made a great leap in dispensing with the stringent approach by acknowledging the effectiveness of an arbitration clause as set out in a draft contract not being

signed by neither party, based on the findings that the parties have discussed and finalized the arbitration clause in the draft of the contract during the negotiating phase.[xxvii]

Moreover, the Draft Revised Arbitration Law released in late July 2021 provides more liberal approaches for the validity of arbitration agreements, which includes:

(1) the recognition of *ad hoc* arbitration agreement in foreign-related disputes,

(2) the relaxing requirement for a valid arbitration agreement, where parties' failure to designate a sole arbitration institution does not negate the arbitration agreement,

(3) the promulgation of extension of the arbitration agreement to non-signatories in some types of disputes, and

(4) the adoption of a new framework of *competence-competence* principle that is more in line with the international framework as set out in UNCITRAL Model Law.[xxviii]

These attempts have been heatedly debated and are by and large arbitration-favored and laudable by lifting the unreasonable hurdles for the autonomy, expediency, and efficiency of arbitration. Nonetheless, recognizing the validity of arbitration agreement is not the sole consideration, lawmakers, judiciaries, and other participants in commercial arbitration of Mainland China will confront trade-offs during the law-making and implementation of the rules under the arbitration-favored policy. As a corollary, an arbitration agreement can be safeguarded to the extent it is in line with the basic principles that are placed at a higher level.

[i] Morgan v. Sundance, Inc. 596 U. S. ____ (2022) (Supreme Court of USA, decided on 23 May 2022).

[ii] Amicus brief of Law Professors in Morgan v. Sundance, Inc., 596 U.S. ___ (2022), pp. 11-12, available at https://www.supremecourt.gov/DocketPDF/21/21-328/207550/20220106140817376_Morgan%20amicus%20brief%20final.pdf last visited on 21 November 2022.

[iii] Morgan v. Sundance, Inc. 596 U. S. ____ (2022) (Supreme Court of USA,

decided on 23 May 2022).

[iv] *Ibid.*

[v] Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U. S. 487(1989), as quoted in Granite Rock Co. v. Teamsters, 561 U. S. 287, 302 (2010) (Supreme Court of USA, decided on 24 June 2010).

5 These considerations are: (1) to what extent does it render international arbitration economical in term of time or cost? (2) to what extent does it ensure consent to arbitrate and enhance the scope for party autonomy? (3) to what extent does it effectuate the likely intentions or expectations of the parties? (4) to what extent is it consistent with the *lex arbitri* or the institutional rules chosen by the parties? (5) to what extent does it, consistent with party intent, enable the tribunal to exercise sound discretion and flexibility on matters of arbitral procedure? (6) to what extent does it ensure the independence and impartiality of arbitrators? (7) to what extent does it protect a party's right to be heard? (8) to what extent does it promote accuracy in the administration of justice? (9) to what extent does it minimize, to the fullest extent reasonably possible, the intervention of national courts in the arbitral process? (10) to what extent does it help ensure that the resulting award will be an effective one? (11) to what extent does it enable the resulting award to withstand challenges in an annulment or enforcement action? (12) to what extent does it expand the categories of legal claims treated as arbitrable? See George A. Bermann, *What Does it Mean to be 'Pro-Arbitration'?,* Arbitration International, Volume 34 (2018), p. 343.

[vii] KB v S. and Others, [2015] HKCFI 1787, para.1(Hong Kong Court of First Instance, decided on 15 September 2015).

[viii] China Machine New Energy Corporation v Jaguar Energy Guatemala LLC, [2020] SGCA 12, para. 87(The threshold for the finding of breach of natural breach for the purpose of vacating arbitral award is a high one and can only be crossed in exceptional cases.) (Appeal Court of Singapore, decided on 28 February 2020).

[ix] See Article 178 (2) of Private International Law of Switzerland ("As regards its substance, the arbitration agreement shall be valid if it conforms to the law chosen by the parties, or to the law applicable to the dispute, in particular the law governing the main contract, or to Swiss law.").

[x] Enka Insaat Ve Sanayi AS v. OOO Insurance Company Chubb, [2020] UKSC 38, para. 97 (Where the clause in question is an arbitration clause, because of its severable character its putative invalidity may support an inference that it was intended to be governed by a different law from the other provisions of the contract […]) (Supreme Court of the UK, decided on 9 October 2020). See also BCY v. BCZ, [2016] SGHC 249, para. 74 ("[…] governing law of the main contract should only be displaced if the consequences of choosing it as the governing law of the arbitration agreement would negate the arbitration agreement even though the parties have themselves evinced a clear intention to be bound to arbitrate their disputes.") (Singapore High Court, decided on 9 November 2016).

[xi]Article 16(1) of UNCITRAL Model Law on International Commercial Arbitration("[…] an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract.")

[xii] Tomolugen Holdings Ltd and Another v. Silica Investors Ltd and other appeals, [2015] SGCA, para. 60 (Singapore court should adopt a *prima facie* standard of review when hearing a stay application) (Court of Appeal of Singapore, decided on 26 October 2015). Fiona Trust & Holding Corp. v. Privalov [2007] UKHL 40 para. 13, (Arbitration clause shall be construed in accordance with the presumption that parties are likely to have intended any dispute arising out of the underlying contract to be decided by the same body.) (House of Lords of the UK, decided on 17 October 2007).

[xiii] "[W]here the parties have evinced a clear intention to settle any dispute by arbitration, the court should give effect to such intention, even if certain aspects of the agreement may be ambiguous, inconsistent, incomplete or lacking in certain particulars…" Insigma Technology Co Ltd v Alstom Technology Ltd [2009] 3 SLR(R) 936, para. 31, as quoted in HKL Group Co Ltd v Rizq International Holdings Pte Ltd, [2013] SGHCR 5, para. 13 (Singapore High Court, decided on 19 February 2013). See also ?????? and ??? v. Ace Lead Profits Ltd and another, [2022] HKCFI 3342? para. 53 (Arbitration clause is not nullified by the non-existence of putative arbitration institution) (Hong Kong Court of First Instance, decided on 4 November 2022).

[xiv] BNA v. BNB and another, [2019] SGCA 84, para. 95. (Court of Appeal of Singapore, decided on 27 December 2019).

[xv] *Ibid*., at para. 102.

[xvi] See BNA v. BNB, [2019] SGHC 142, para. 101(agreement referring to Shanghai instead of PRC is not a reference to seat) (Singapore High Court, decided on1 July 2019). Ironically, contrary to the plaintiff's assertion and the Singapore court's wariness, the validity arbitration clause at issue was subsequently confirmed by the Chinese court following the conclusion of judicial review proceedings before the Singapore Court of Appeal, as set out in Daesung Industrial Gases Co Ltd v. Praxair (China) Investment Co Ltd (2020) Hu 01 Min Te No.83 (Shanghai No.1 Intermediate People's Court, decided on 29 June 2020). See also José-Antonio Maurellet, Helen Shi, et al., *PRC Court Confirms Validity of "SIAC-Shanghai" Clause*, available at https://dvc.hk/en/news/cases-detail/prc-court-confirms-validity-of-siac-shanghai-clause/ last visited on 21 November 2022.

[xvii] Kabab-Ji SAL v. Kout Food Group, [2021] UKSC 48, para. 51 ([Validation principle] is not a principle relating to the formation of contracts which can be invoked to create an agreement which would not otherwise exist.) (Supreme Court of UK, decided on 27 October 2021).

[xviii] Andrew Tweeddale, *The Validation Principle and Arbitration Agreements: Difficult Cases Make Bad Law*, The International Journal of Arbitration, Mediation and Dispute Management, Volume 88, Issue 2 (2022), p. 248.

[xix] The restrictive approach emerges from the Peterson Farms v. CM Farming Ltd., [2004] EWHC 121, as cited in Andrea Marco Steingruber, Consent in International Arbitration (UK: Oxford University Press, 2012), p. 156.

[xx] Uber Technologies Inc. v. Heller, 2020 SCC 16, paras. 93 – 94(Federal Supreme Court of Canada, decided on 26 June, 2020).

[xxi] *Ibid*., at para. 97.

[xxii] George A. Bermann, *What Does it Mean to be 'Pro-Arbitration'?,* Arbitration International, Volume 34 (2018), pp. 343-353.

[xxiii] AQZ v. ARA, [2015] SGHC 49 (2015) (Singapore High Court, decided on 13 February 2015).

[xxiv] Noble Resources International Pte Ltd v. Good Credit International Trade

Co Ltd, (2016) Hu 01 Xie Wai Ren No. 1 (Shanghai No.1 Intermediate People's Court, decided on 11 August 2017).

[xxv] Like India, see Aditya Singh Chauhan and Aryan Yashpal, *Change to Improve, Not to Unhinge—A Critique of the Indian Approach to International Arbitration*, Indian Journal of Arbitration Law, Volume X, Issue 2 (2021), pp. 1-11.

[xxvi] See Helen Shi, *Have Chinese Courts Adopted an Arbitration- Friendly Approach Towards International Arbitration?*, in Neil Kaplan, Michael Pryles, et al. (eds), International Arbitration: When East Meets West: Liber Amicorum Michael Moser(Netherlands: Kluwer Law International, 2020), pp. 235-244.

[xxvii] Luck Treat Limited v. Zhongyuancheng Co, Ltd, 2019 Zui Gao Fa Min Te No.1(Supreme People's Court of China, decided on 18 September 2019).

[xxviii] Terence Wong et al, *China: Draft Revised Arbitration Law of PRC Published for Comments*, available at https://www.mondaq.com/china/arbitration-dispute-resolution/1104356/draft-revised-arbitration-law-of-prc-published-for-comments- last visited on 4 December 2022. See also Weina Ye et al, *Key Changes under Revised Draft of PRC Arbitration Law*, available at https://hsfnotes.com/arbitration/2021/08/11/key-changes-under-revised-draft-of-pcr-arbitration-law/, last visited on 4 December 2022.

European Commission Proposal for a Regulation on Private International Law Rules Relating to Parenthood

This piece was written by Helga Luku, PhD researcher at the University of Antwerp

On 7 December 2022, the European Commission adopted a Proposal for a Regulation which aims to harmonize at the EU level the rules of private international law with regard to parenthood. This proposal aims to provide legal certainty and predictability for families in cross-border situations. They currently face administrative burdens when they travel, move or reside in another Member State (for family or professional reasons), and seek to have parenthood recognised in this other Member State. The proposal follows on a declaration two years ago by the Commission President von der Leyen in her State of the Union address that **"If you are a parent in one country, you are a parent in every country".**

How will this proposal change the current situation?

In line with the case law of the Court of Justice of the EU, Member States are required to recognise parenthood for the purpose of the rights that the child derives from Union law, permitting a child who is a Union citizen, to exercise without impediment, with each parent, the right to move and reside freely within the territory of Member States. Thus, parenthood established in one Member State should be recognised in other Member States for some (limited) purposes. There is currently no specific EU legislation that requires Member States to recognise parenthood established in other Member States for all purposes.

Different substantive and conflict-of-law rules of Member States on the establishment and recognition of parenthood can lead to a denial of the rights that children derive from national law, such as their succession or maintenance rights, or their right to have any one of their parents act as their legal representative in another Member State on matters such as medical treatment or schooling. Thus, the proposal aims to protect the fundamental rights of children and as it is claimed by the Commission, to be in full compliance with the UN Convention on the Rights of the Child. Through the proposed Regulation, the Commission intends to enable children, who move within the Union to benefit from the rights that derive from national law, **regardless of**:

- **the nationality of the children or the parents** (on the condition that the document that establishes or proves the parenthood is issued in a Member State);
- **how the child was conceived or born** (thus including conception with assisted reproductive technology);

- **the type of family of the child** (including e.g. the recognition of same-sex parenthood or parenthood established through adoption).

In principle, the proposal does not interfere with substantive national law in matters related to parenthood, which are and will remain under the competence of Member States. However, by putting the children's rights and best interests in the spotlight of the proposal, the Commission is requiring Member States to disregard their reluctance toward the recognition of some types of parenthood.

As the Union aspires an area of freedom and justice, in which the free movement of persons, access to justice and full respect of fundamental rights are guaranteed, the Commission proposes the adoption of Union rules on international jurisdiction and applicable law in order to facilitate the recognition of parenthood among the Member States. It covers not only the recognition of judgments but also the recognition and acceptance of authentic instruments. In this sense, the proposal covers the three main pillars of private international law and it will also introduce a European Certificate on Parenthood.

The main aspects of this proposal include:

- **Jurisdiction**: jurisdiction shall lie alternatively with the Member State of habitual residence of the child, of the nationality of the child, of the habitual residence of the respondent (e.g. the person in respect of whom the child claims parenthood), of the habitual residence of any one of the parents, of the nationality of any one of the parents, or of the birth of the child. Party autonomy is excluded. (Chapter II, articles 6-15)
- **The applicable law**: as a rule, the law applicable to the establishment of parenthood should be the law of the State of the habitual residence of the person giving birth. If the habitual residence of the person giving birth cannot be established, then the law of the State of the birth of the child should apply. Exceptions are foreseen for the situation where the parenthood of a second person cannot be established under the applicable law. (Chapter III, articles 16-23).
- **Recognition**: the proposal provides for the recognition of court decisions and authentic instruments with binding legal effects, which establish parenthood, without any special procedure being required. However, if one of the limited grounds for refusal is found to exist, competent authorities of Member States can refuse the recognition of parenthood

established by a court decision or an authentic instrument with binding effects. (Chapter IV, articles 24-43)

- **Acceptance:** the proposal also provides for the acceptance of authentic instruments with no binding legal effect. These instruments do not have a binding legal effect because they do not establish parenthood, but they refer to its prior establishment by other means or to other facts, thereby having only evidentiary effects. It may be a birth certificate, a parenthood certificate, an extract of birth from the register or any other form. The acceptance of these instruments with evidentiary effects can be refused only on public policy grounds. (Chapter V, articles 44-45)
- **Creation of a European Certificate of Parenthood**: children or their legal representatives can request it from the Member State in which the parenthood was established. This Certificate will be issued in a uniform standard form and will be available in all Union languages. It is not mandatory but children or their legal representatives have the right to request it and have it recognised in all Member States (chapter VI, articles 46-57).

What is next?

Since the current proposal concerns family law issues with cross-border implications, under Article 81(3) of the Treaty on the Functioning of the European Union, the Council shall act unanimously via a special legislative procedure after consulting the European Parliament. Besides the sensitive area the proposal regulates, it also adopts a pro-diversity and non-discrimination policy, including the recognition of same-sex parenthood and surrogacy. Thus, considering the different approaches and national identities of Member States, often associated with their more conservative or liberal convictions, unanimity will not be easy to reach. However, if unanimity cannot be reached, a number of Member States can still adopt the proposal in enhanced cooperation (see: Article 20 Treaty on European Union). This is not an uncommon procedure for Member States when they have to adopt legislation that concerns family law issues, e.g. Regulation 1259/2010 on the law applicable to divorce and legal separation (Rome III) and Regulation 2016/1103 on jurisdiction, applicable law and the recognition and enforcement of decisions in matters of matrimonial property regimes. However, if it happens that the proposal is adopted in enhanced cooperation, it is doubtful whether its objective to provide the same rights for all children is truly achieved.

Additionally, the participating Member States will probably include those that did not impose very restrictive requirements with regard to the recognition of parenthood in their national laws, even before the adoption of the Regulation in enhanced cooperation.

First strike in a Dutch TikTok class action on privacy violation: court accepts international jurisdiction

Written by Eduardo Silva de Freitas (Erasmus University Rotterdam) & Xandra Kramer (Erasmus University Rotterdam/Utrecht University), members of the Vici project Affordable Access to Justice, financed by the Dutch Research Council (NWO), www.euciviljustice.eu.

Introduction

On 9 November 2022 the District Court Amsterdam accepted international jurisdiction in an interim judgment in a collective action brought against TikTok (DC Amsterdam, 9 November 2022, ECLI:NL:RBAMS:2022:6488; *in Dutch*). The claim is brought by three Dutch-based representative organisations; the Foundation for Market Information Research (*Stichting Onderzoek Marktinformatie*, SOMI), the Foundation Take Back Your Privacy (TBYP) and the *Stichting Massaschade en Consument* (Foundation on Mass Damage and Consumers). It concerns a collective action brought under the Dutch collective action act (WAMCA) for the infringement of privacy rights of children (all foundations) and adults and children (Foundation on Mass Damage and Consumers). In total, seven TikTok entities are sued, located in Ireland, the United Kingdom, California, Singapore, the Cayman Islands and China. The claims are for the court to order that an effective system is implemented for age

registration, parental permission and control, and measures to ensure that commercial communication can be identified and that TikTok complies with the Code of Conduct of the Dutch Media Act and the GDPR.

After an overview of the application of the WAMCA, which has been introduced in a different context on this blog earlier, we will discuss how the Court assessed the question of international jurisdiction.

The class action under the Dutch WAMCA

Following case law of the Dutch Supreme Court in the 1980s concerning legal standing of representative organisations, the possibility to start a collective action was laid down in Article 3:305a of the Dutch Civil Code (DCC) in 1994. However, this was limited to declaratory and injunctive relief. Redress for compensation in mass damage cases was only introduced in 2005 with the enactment of the Collective Settlement of Mass Claims Act (*Wet collectieve afwikkeling massaschade*, WCAM). This collective settlement scheme enables parties to jointly request the Amsterdam Court of Appeal to declare a settlement agreement binding on an opt-out basis. The legislative gap remained as a collective action for compensation was not possible and such mass settlement agreement relies on the willingness of an allegedly liable party to settle.

This gap was closed when in 2019, after a lengthy legislative process, the Act on Redress of Mass Damages in a Collective Action (*Wet afwikkeling massaschade in collectieve actie*, WAMCA) was adopted. The WAMCA entered into force on 1 January 2020 and applies to mass events that occurred on or after 15 November 2016. The WAMCA expanded the collective action contained in Article 3:305a DCC to include actions for compensation of damage (Tillema, 2022; Tzankova and Kramer, 2021). While the WAMCA Act generally operates on an opt-out basis for beneficiaries represented by the representative organisation(s), there are exemptions, including for parties domiciled or habitually resident outside the Netherlands. In addition, the standing and admissibility requirements are relatively strict, and also include a scope rule requiring a close connection to the Netherlands. Collective actions are registered in a central register (the WAMCA register) and from the time of registration a three-months period starts to run (to be extended to maximum six months), enabling other claim organisations to bring a claim, as only one representative action can be brought for the same event(s). If no settlement is reached, an exclusive representative will be appointed by the

court. Since its applicability as of 1 January 2020, 61 collective actions have been registered out of which 8 cases have been concluded to date; only a very few cases have been successful so far. These collective actions involve different cases, including consumer cases, privacy violations, environmental and human rights cases, intellectual property rights, and cases against the government. Over one-third of the cases are cross-border cases and thus raise questions of international jurisdiction and the applicable law.

As mentioned above, in the TikTok case eventually three Dutch representative foundations initiated a collective action against, in total, seven TikTok entities, including parent company Bytedance Ltd. (in the first action, the claim is only brought against the Irish entity; in the other two actions, respectively, six and seven entities are defendants). These are TikTok Technology Limited (Ireland), TikTok Information Technology Limited (UK), TikTok Inc. (California), TikTok PTE Limited (Singapore), Bytedance Ltd. (Cayman Islands), Beijng Bytedance Technology Co. Ltd. (China) and TikTok Ltd. (also Cayman Islands). The claim is, in essence, that these entities are responsible for the violation of fundamental rights of children and adults. The way in which the personal data of TikTok users is processed and shared with third parties violates the GDPR as well as the Dutch Telecommunications Act and Media Act. It is also claimed that TikTok's terms and conditions violate the Unfair Contract Terms Directive (UCTD – 93/13/EEC) and the relevant provisions of the Dutch Civil Code.

International jurisdiction of the Amsterdam District Court

The first stage of the proceedings, leading up to this interim judgment, deals with the international jurisdiction of the District Court of Amsterdam, as the TikTok entities challenge its international jurisdiction. TikTok requested the Court to refer preliminary questions to the CJEU but the Court refused this request, stating that the questions on (a) how the GDPR and Brussels I-bis Regulation regimes interact and (b) the applicability of Article 79(2) GDPR were deemed resolved.

Relevant jurisdiction rules

Considering the domicile of the defendant(s) and the alleged violation of the GDPR, both EU and Dutch domestic jurisdiction rules come into the picture. TikTok alleges that the Dutch courts do not have jurisdiction over this case under

Article 79(2) GDPR. Moreover, TikTok alleges that, since Article 79(2) GDPR is a *lex specialis* in relation to the Brussels I-bis Regulation, the latter cannot be applied to override the jurisdictional rules set out in the GDPR. The three representative organisations argue that the Dutch courts have jurisdiction under both EU private international law rules and the Dutch Code of Civil Procedure (DCCP). Before delving into how the District Court of Amsterdam construed the interaction between the legislations concerned, we will describe the applicable rules on international jurisdiction for privacy violations. The alleged violations occurred, or the claims relate to violations occurring, after 25 May 2018, that is, after the entry into force of the GDPR. TikTok Ireland is a data controller subject to the GDPR. Under Article 79(2) GDPR the "data subjects" (those whose rights are protected by the GDPR) shall bring an action for the violation of their rights in either the courts of the Member State in which the data controller or processor is established or of the Member State in which the data subject has its habitual residence. Furthermore, Article 80(1) GDPR provides for the possibility of data subjects to mandate a representative body which has been properly constituted under the law of that Member State, has statutory objectives which are in the public interest, and is active in the field of the protection of data subjects' rights and freedoms to file actions on their behalf under Article 79 GDPR.

The case also deals with non-GDPR-related claims, which triggers the application of the Brussels I-bis Regulation, at least as far as the entities domiciled in the EU are concerned. Article 7(1)(a) Brussels I-bis states that, for contractual matters, jurisdiction is vested in the Member State in which the contract is to be performed. More importantly for this case, with regards to torts, Article 7(2) provides jurisdiction for the courts of the place where the harmful event occurred or may occur. Finally, in relation to the TikTok entities that are not domiciled in the EU, the international jurisdiction rules of the Dutch Code of Civil Procedure (Articles 1-14 DCCP) apply. This is the case regarding both GDPR and non-GDPR-related claims. These Dutch rules are largely based on those of the Brussels I-bis Regulation and also include a rule on multiple defendants in Article 7 DCCP.

The claims against TikTok Ireland

The Amsterdam District Court starts its reasoning by addressing whether it has jurisdiction over TikTok Technology Limited, domiciled in Ireland, the entity that is sued by all three representative organisations. The Court states that Article 80(1) GDPR does not distinguish between substantive and procedural rights in

granting the possibility for data subjects to mandate a representative body to file actions on their behalf under Article 79 GDPR. Therefore, actions brought under Article 80(1) GDPR can rely on the jurisdictional rule set out in Article 79(2) GDPR which allows for the bringing of actions before the courts of the Member State in which the data subject has its habitual residence. The Court further reasons that the word 'choice' enshrined in Recital 145 GDPR, when mentioning actions for redress, allows for the interpretation that it is up to the data subject to decide where she prefers to file her claim. In the case at hand, since the data subjects concerned reside in the Netherlands, they can mandate a representative body to file claims before the Dutch courts.

As to the non-GDPR-related claims and GDPR violations that also qualify as tortious conduct, the District Court considered first whether the case concerned contractual matters, to decide whether Article 7(1) or Article 7(2) Brussels I-bis Regulation applies. For this purpose, the District Court relied on the rule established by the CJEU in *Wikingerhof* v. *Booking.com* (Case C-59/19, ECLI:EU:C:2020:95), according to which a claim comes under Article 7(2) when contractual terms as such and their interpretation are not at stake, but rather the application of legal rules triggered by the commercial practices concerned – or, in other words, contractual "interpretation being necessary, at most, in order to establish that those practices actually occur". Given that, in this case, the question is whether TikTok's terms and conditions are abusive under both the UCTD and the DCC, the claim was deemed to fall under Article 7(2) Brussels I-bis Regulation.

Next, the District Court assesses whether the criteria for establishing jurisdiction under Article 7(2) are met. For this purpose it refers to the CJEU ruling in *eDate Advertising and Others* (Case C-509/09, ECLI:EU:C:2011:685). In this case the CJEU ruled that, when it comes to "publication of information on the internet" that triggers an "adverse effect on personality rights", the habitual residence of the victim being his centre of interests can be regarded as the place in which the damage occurred. The District Court rightfully ruled that since the rights of TikTok users that have their habitual residence in the Netherlands had been violated through online means, the Netherlands can be regarded as the place in which the damage occurred.

The Court confronts TikTok's argument that, since Article 79(2) GDPR is a *lex specialis* in relation to the Brussels I-bis Regulation, the latter cannot be applied

to override the jurisdictional rules set out in the GDPR. As per the Court, the rules on conflict of jurisdiction established by the Brussels I-bis Regulation are general in nature and, as such, cannot be derogated from other than by explicit rules. Hence, the Court interprets Recital 147 GDPR – which states that the application of the Brussels I-bis Regulation should be without prejudice to the application of the GDPR – as being unable to strip away the applicability of the Brussels I-bis Regulation. In the Court's understanding, Recital 147 GDPR points to the complementarity of the GDPR in relation to the Brussels I-bis Regulation, and both regimes coexist without hierarchy. Therefore, according to the Court, the GDPR is not a *lex specialis* in relation to the Brussels I-bis Regulation. Furthermore, the Court notes that, under Article 67 Brussels I-bis Regulation, its regime is without prejudice to specific jurisdictional rules contained in EU legislation on specific matters. While the relationship between the jurisdiction rules of the GDPR and the Brussels I-bis Regulation is not wholly undisputed, in the present case the provisions do not contradict each other, while at the same time in this case also non-GDPR issues are at stake.

The claims against non-EU based TikTok entities

Having established international jurisdiction in the case against TikTok Ireland, the Amsterdam District Court rules on its international jurisdiction in relation to the other TikTok entities sued by two of the foundations. As no EU rules or international convention applies, the Dutch jurisdiction rules laid down in Articles 1-14 DCCP apply. Article 7(1) DCCP contains a rule for multiple defendants and connected claims similar to that in Article 8(1) Brussels I-bis. The Court considers that both legal and factual aspects are closely intertwined in this case. The claims concern several different services, not only the processing of data, and all defendants are involved in the provision of these services. The claims are therefore so closely connected that it is expedient that they are dealt with in the same proceedings.

Outlook

TikTok attempted to appeal this interim judgment on international jurisdiction. Under Article 337(2) DCCP, it is at the court's discretion to grant leave to appeal interim decisions when the appeal is not filed against the final judgment at the same time. In this case, the Court did not find sufficient reasons to allow for such appeal. The case will now proceed on other preliminary matters, including the

admissibility of the claim under the WAMCA, and (if admissible) the appointment of the exclusive representative. For this purpose, at the end of its judgment the Court orders parties to provide security as to the financing of the case, which requires submitting to the Court a finance agreement with the third-party financer. After that, assuming that no settlement will be reached, the case will proceed on the merits. It may well be that either of the parties will appeal the final judgment, and that on that occasion TikTok will raise the jurisdictional question again.

To be continued.

GEDIP's Reccommendation on the Proposal for a Directive on Corporate Sustainability Due Diligence

Written by Hans van Loon, former Secretary General of the HCCH and Honorary Professor of the University of Edinburgh Law School

As reported in this blog before (see CSDD and PIL: Some Remarks on the Directive Proposal), the European Commission on 23 February 2022 adopted a proposal for a Directive on corporate sustainability due diligence.

Earlier, at its annual meeting in 2021, the European Group for Private International Law (GEDIP) had adopted a Recommendation to the EU Commission concerning the PIL aspects of corporate due diligence and corporate accountability, and this blog reported on this Recommendation too, see GEDIP Recommendation to the European Commission on the private international law aspects of the future EU instrument on corporate due diligence and accountability.

While some of the recommendations proposed by GEDIP last year are reflected in the Draft Directive, the Draft fails to follow up on several crucial recommendations concerning judicial jurisdiction and applicable law. This will detract from its effectiveness.

In particular:

- The Proposal, while extending to third country companies lacks a provision on judicial jurisdiction in respect of such companies;
- The Proposal, while extending a company's liability to the activities of its subsidiaries and to value chain co-operations carried out by entities "with which the company has a well-established business relationship", lacks a provision dealing with the limitation of the provision on co-defendants in the Brussels I bis Regulation (Article 8(1)) to those domiciled in the EU;
- The Proposal lacks a provision allowing a victim of a violation of human rights to also invoke, similar to a victim of environmental damage under Article 7 of Regulation 864/2007 (Rome II), the law of the country in which the event giving rise to the damage occurred, and does not prevent companies from invoking a less strict rule of safety or conduct within the meaning of Article 17 of Rome II;
- The provision of the Proposal on the mandatory nature of the provisions of national law transposing the Directive (Article 22 (5)) is insufficient because (i) the words "in cases where the law applicable to actions for damages to this effect is not that of a Member State" are redundant and (ii) allthese provisions of national law transposing the Directive should apply irrespective of the law applicable to companies, contractual obligations or non-contractual obligations.

GEDIP therefore, on the occasion of its meeting in Oslo, 9-11 September 2022 adopted a Recommendation concerning the Proposal for a directive of 23 February 2022 on Corporate Sustainability Due Diligence, following up on its Recommendation to the Commission of 8 October 2021. The text of the Recommendation can be found here.

[This post is cross-posted at the EAPIL blog]

Chinese Case Law Collection Adds to the CISG's Jurisconsultorium: Reflections on the United Nations Convention on Contracts for the International Sale of Goods and its Domestic Implementations

Dr Benjamin Hayward*

The *United Nations Convention on Contracts for the International Sale of Goods* ('*CISG*'), currently adopted by 95 States, is a treaty intended to harmonise the laws governing cross-border goods trade: and thereby promote trade itself. So much is made clear in its Preamble:

> *The States Parties to this Convention, …*
>
> *Being of the opinion that the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade,*
>
> *Have agreed as follows: …*

Art. 7(1) *CISG's* instruction for interpreters to have regard 'to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade' establishes a requirement of autonomous interpretation. This, in turn, facilitates the *CISG's* global jurisconsultorium: whereby courts, arbitrators, lawyers, academics, and other interested stakeholders can influence and receive influence in relation to the *CISG's* uniform interpretation. A recent publication edited by Peng Guo, Haicong

Zuo and Shu Zhang, titled *Selected Chinese Cases on the UN Sales Convention (CISG) Vol 1*, makes an important contribution to this interpretative framework: presenting abstracts and commentaries addressing 48 Chinese *CISG* cases spanning 1993 to 2005, that may previously have been less accessible to wider international audiences.

A review of this case law collection discloses an interesting phenomenon affecting the *CISG's* Chinese application: at least, until very recently. Pursuant to Art. 142(2) *General Principles of the Civil Law* (which was effective in the People's Republic of China until repealed as of 1 January 2021):

> *[I]f any international treaty concluded or acceded to by the People's Republic of China contains provisions differing from those in the civil laws of the People's Republic of China, the provisions of the international treaty shall apply, unless the provisions are ones on which the People's Republic of China has announced reservations.*

(Translation via Jie Luo.)

Numerous contributions to Guo, Zuo and Zhang's volume – including by Wang, Guo and Zhang; Luo; Luo again; Wang; and Xu and Li – observe that some Chinese courts have interpreted this provision to require the *CISG's* application only where it is inconsistent with non-harmonised Chinese law. Whilst this approach to the *CISG's* application is noteworthy for its inconsistency with international understandings of the treaty, it is arguably more noteworthy for highlighting that national law itself is often 'where the relationship between the convention and national law is regulated'.[1] Scholarship has given much attention to the success (or otherwise) of Art. 7(1) *CISG* in securing the treaty's autonomous interpretation. However, machinery provisions giving the *CISG* local effect in any given legal system (themselves being matters of 'local legislative judgment') have an apparently-underappreciated role to play, too.

Wang's contribution quotes Han as writing that the Chinese inconsistency concept's effective implementation of a reverse burden of proof in establishing the *CISG's* application is a situation that 'I am afraid … is unique in the world'. On the contrary, and not unlike China's former Art. 142(2) *General Principles of the Civil Law*, Australia's *CISG* implementing Acts still ostensibly frame the treaty's local application in terms of inconsistency. The *Sale of Goods (Vienna*

Convention) Act 1986 (NSW) s 6 is representative of provisions found across the Australian state and territory jurisdictions: '[t]he provisions of the *Convention* prevail over any other law in force in New South Wales to the extent of any inconsistency'. Case law from Victoria and from Western Australia has read those jurisdictions' equivalent inconsistency provisions as implying the *CISG's* piecemeal application, only where particular provisions are inconsistent with local law. Looking even further afield, Australia's own use of the *inconsistency* device is far from unique. Singaporean and Canadian legislation make use of the inconsistency concept, as does Hong Kong's recently-promulgated *CISG* Ordinance. In the latter case, the statutory interpretation risks associated with the adoption of an inconsistency provision were drawn to the Hong Kong Department of Justice's attention. However, Australia's statutory model prevailed, perhaps in part because it has previously been put forward as a model for Commonwealth jurisdictions looking to implement the *CISG*.

At the risk of being slightly controversial, at least some scholarship addressing the failings of national *CISG* interpretations may have been asking the wrong question: or at least, missing an important additional question. Instead of asking why any given court has failed to apply and respect Art. 7(1) *CISG's* interpretative directive, we might instead (or also) usefully ask whether that given State's *CISG* implementation legislation has been drafted so as to invite the local law comparisons that have then been made. Some responsibility for problematic *CISG* interpretations might lie with the legislature, in addition to the judiciary.

In Australia, the *Playcorp* decision – Victoria's inconsistency case referred to above – has been taken by subsequent cases in both the Federal Court and in the Full Federal Court of Australia as authority for the proposition that Art. 35 *CISG's* conformity requirements equate to the implied terms contained in the non-harmonised *Goods Act 1958* (Vic) s 19. The Federal Court's first-instance decision was itself then cited in New South Wales for that same proposition: leading to a problematic *CISG* interpretation that is now entrenched under multiple layers of precedent. Whilst the equation being made here is rightly criticised in itself, it has Australia's inconsistency provisions – *in addition to* our courts' failures to apply Art. 7(1) *CISG* – resting at its core.

Guo, Zuo and Zhang's *Selected Chinese Cases on the UN Sales Convention (CISG) Vol 1* thereby makes a valuable contribution to the *Convention's* jurisconsultorium: first, by virtue of its very existence, but secondly, by its

additional disclosure of China's former inconsistency struggles to the wider scholarly community.

[1] Bruno Zeller, 'The *CISG* in Australasia: An Overview' in Franco Ferrari (ed), *Quo Vadis CISG? Celebrating the 25th Anniversary of the United Nations Convention on Contracts for the International Sale of Goods* (Bruylant, 2005) 293, 299.

* Senior Lecturer, Department of Business Law and Taxation, Monash Business School

Twitter: @LawGuyPI

International Trade and International Commercial Law research group: @MonashITICL

Disclosure: The author is a confirmed contributor to the forthcoming *Selected Chinese Cases on the UN Sales Convention (CISG) Vol 3*.

Special Commission on the Hague Adults Convention: Five Takeaways from its First Meeting

This post was written by Pietro Franzina and Thalia Kruger, and is being published simultaneously on Conflictoflaws.net and on the EAPIL blog.

The delegations of more than thirty Member States of the Hague Conference on Private International Law attended the first meeting of the Special Commission charged with reviewing the operation of the Hague Hague Convention of 13 January 2000 on the international protection of adults of 13 January 2000 on the international protection of adults. The meeting

took place in The Hague and online from 9 to 11 November 2022 (for a presentation of the meeting, see this post on Conflictsoflaw.net and this one on the EAPIL blog). A dozen organisations, governmental and non-governmental (including the Council of the Notariats of the European Union, the Groupe Européen de Droit International Privé and the European Association of Private International Law), were also in attendance.

The discussion covered a broad range of topics, leading to the conclusions and recommendations that can be found on the website of the Hague Conference. The main takeaways from the meeting, as the authors of this post see them, are as follows.

The Hague Adults Convention Works Well in Practice

To begin with, the Special Commission affirmed that the Convention works well in practice. No major difficulties have been reported either by central authorities instituted under the Convention itself or by practitioners.

Doubts occasionally appear with respect to some provisions. Article 22 for example provides that measures of protection taken by the authorities of a Contracting State "shall be recognised by operation of law in all other Contracting States", unless a ground for refusal among those listed in the same provisions arises. A declaration of enforceability, as stipulated in Article 25, is only necessary where measures "require enforcement" in a Contracting State other than the State of origin.

Apparently, some authorities and private entities (e.g., banks) are reluctant to give effect to measures of protection that clearly do not require enforcement, such as a judicial measure under which a person is appointed to assist and represent the adult, unless that measure has been declared enforceable in the State where the powers of the appointed person are relied upon. The Special Commission's conclusions and recommendations address some of these hesitations, so that they should now prove easier to overcome. Regarding *exequatur*, see para. 33, noting that "measures for the protection of an adult only exceptionally require enforcement under Article 25", adding that this may occur, for instance, "where a decision is taken by a competent authority to place the adult in an establishment or to authorise a specific intervention by health care practitioners or medical staff", such as tests or treatments. Other

doubts are dealt with in the practical handbook prepared by the Working Group created within the Hague Conference in view of the meeting of the Special Commission. The draft handbook (first version publicly available), which the Special Commission has approved "in principle", will be reviewed in the coming weeks in light of the exchanges that occurred at the meeting, and submitted to the Council on the General Affairs and Policy of the Conference for endorsement in March 2023).

Situations Exist in the Field of Adults' Protection that Are Not (Fully) Regulated by the Convention

The Convention deals with measures of protection taken by judicial and administrative authorities, and with powers of representation conferred by an adult, either by contract or by a unilateral act, in contemplation of incapacity. By contrast, nothing is said in the Convention concerning *ex lege* powers of representation. These are powers of representation that the law of some States (Germany, Austria and Switzerland, for example) confers on the spouse of the adult or a close relative or family member, for the purpose of protecting the adult. Their operation is generally confined to situations for which no measures have been taken and no powers of representation have been conferred by the adult.

The Special Commission acknowledged that *ex lege* powers of representation fall under the general scope of the Convention, but noted that no provision is found in the Convention that deals specifically with such powers. In practice, *ex lege* powers of representation may be the subject of cooperation between the authorities of Contracting Parties (notably as provided for under Chapter V), but, where the issue arises of the existence, the extent and the exercise of such powers, the courts and other authorities of Contracting States will rely on their own law, including, where appropriate, their conflict-of-laws rules.

There is yet another gap that the Special Commission discussed. The Commission observed that instructions given and wishes made by an adult in anticipation of a future impairment of their personal faculties (e.g., in the form of advance directives), similarly fall within the general scope of the Convention and are subject, as such, to the cooperation provisions in Chapter V. Whether or not a particular anticipatory act constitutes a power of representation for the purposes of Articles 15 and 16, on powers of representation conferred by the adult, is to be determined on a case-by-case basis. Some unilateral acts plainly come within the

purview of Articles 15 and 16, as they actually include a conferral of powers on other persons. Others do not, and may accordingly be dealt with by each Contracting State in conformity with their own law.

States Do Not Currently See an Interest in Modifying the Convention

The question has been raised in preparation of the Special Commission whether the Convention ought to be amended, namely by a protocol to be negotiated and adopted in the framework of the Hague Conference on Private International Law. In principle, a protocol would have provided the States with the opportunity to fill the gaps described above, and address other concerns. However, under international law only those Contracting States that ratify the protocol would be bound by the modifications.

The Special Commission witnessed that, at this stage, no State appears to see an amendment as necessary.

Only one issue remains to be decided in this respect, namely whether the Convention should be modified in such a way as to include a REIO clause, that is, a clause aimed at enabling organisations of regional economic integration, such as the European Union, to join the Convention in their own right. The matter will be discussed at the Council on the General Affairs and Policy of the Conference of March 2023.

The decision lies, in fact, in the hands of the Union and its Member States, as this is currently the only Regional Economic Integration Organisation concerned by such a clause. Their decision will likely be affected by the approach that should be taken in the coming weeks concerning the proposal for a regulation on the protection of adults that the Commission is expected to present in the first half of 2023.

Efforts Should Now Be Deployed Towards Increasing the Number of Contracting Parties

The main problem with the Convention lies in the fact that only relatively few States (fourteen, to be precise) have joined it, so far. Several States stressed the importance of further promoting ratification of, or accession to, the Convention.

It is worth emphasising in this respect that the Hague Adults Convention builds,

to a very large extent, on cooperation between Contracting States. This means that a State cannot fully benefit from the advantages of the Convention by simply copying the rules of the Convention into its own legislation, or by relying on such rules on grounds of judicial discretion (as it occurs in the Netherlands and to a large extent in England and Wales), but should rather become a party to it.

Various States expressed an interest in the Convention. The responses to the questionnaires circulated in preparation of the meeting of the Special Commission suggest that at least five States are actively contemplating ratification (Hungary, Italy, Luxembourg, Mexico and Sweden), and that others have considered ratification (Slovakia) or are considering it (Argentina). For its part, Malta signed the Convention on the occasion of the meeting of the Special Commission, and will likely ratify it in the not too distant future.

Tools to Enhance the Successful Operation of the Convention

Some of the practitioners present drew the participants' attention to practical difficulties in the cross-border protection of adults. To minimise practical difficulties, the Permanent Bureau, in some instances together with the Working Group on the Adults Convention, developed a number of tools.

The first is an extensive country profile, to be completed by Contracting States and made available on the website of the Hague Conference. This profile includes various matters of national law, such as names and content of measures of protection, jurisdiction of courts or other authorities to issue these measures, transfer of jurisdiction, and names, forms and extent of powers of representation.

The second is a toolkit on powers of representation, which contains detailed information about the national laws of States that provided responses, on for instance who can be granted powers of representation, how this granting must take place, and the permitted extent of the representation.

Concluding remarks

All in all, the issue of the cross-border protection of Adults has rightly gained attention over the past ten years. While States amend their domestic legislation to be in conformity with the UN Convention on the Rights of Persons with Disabilities, they seem to be increasingly aware of the importance of ensuring cross-border continuity. This includes continuity of measures of protection issued

by authorities such as courts, as well as the powers of representation granted by adults themselves. These matters of private international law require dialogue on the international and European Union level, more States to join the Convention, and tools to assist practice.

Report from the 2022 Hague Academy Summer Course in PIL

Written by Martina Ticic, University of Rijeka, Faculty of Law; Croatian Science Foundation (HRZZ) doctoral student

For anyone interested in the area of private international law, the Hague Academy of International Law and its Summer Courses on Private International Law have been one of the must-do's ever since the Academy opened its doors in 1923. Each year, hundreds of students, academics and practitioners attend the courses given by renowned lecturers, while the Academy also offers multiple social and embassy visits, an access to the famous Peace Palace Library, as well as ample opportunities for discussion between the attendees who all come from different backgrounds. It seems that this report comes in quite timely as the programme for the 2023 Summer Course has just been announced.

The 2022 edition once again proved the immense value that the Summer Courses offer. From 1 to 19 August, the Academy hosted the attendees of over 60 different nationalities, providing them with lectures and seminars on various relevant topics, some time for research and visits to many of the Hague's international organisations, but also an opportunity for exchange of ideas, networking and creating friendships. As such, the Academy was truly a place to be this summer for everyone wanting to learn more on the matters of private international law, as

well as to connect with others who share the same or similar interests.

After the welcome speech by prof. **Jean-Marc Thouvenin**, Secretary-General of the Academy, this year's inaugural lecture was given by Dominique Hascher, judge at the Supreme Judicial Court of France. Judge Hascher opened the Summer Courses with the lecture on 'The Role of International Law in the Review of Awards'.

The General Course was given by **Louis d'Avout**, a professor of private international law at the Université Paris II Panthéon-Assas. Titled 'Towards Worldwide Law Consistency', the course provided the attendees with an overview of the core idea on which the discipline of conflict of laws was built upon: the coherence of rules of individual conduct on the global level. By analysing the sole definition of private international law, coordination mechanisms, the concept of legal relativity, connecting rules and factors, transnational cooperation and vertical disciplines in the regional context, prof. d'Avout offered a holistic view on the discipline of private international law itself, making the course a necessity for anyone wishing to excel in this area of law, either as a practitioner or as an academic. Through his lecture, prof. d'Avout invited all of the participants, particularly the younger generation of lawyers, to work towards the global coherence of law, as the desirable state of the system of law in general is that of a 'social construction' which guarantees predictability and security for its subjects that are faced with various sources of law and modes of conflict resolution. The course lasted for two weeks, which meant that there was plenty of time for participants to acquaint themselves with the matter at hand. Two of the seminars on the chosen topics were also held in the course of the two weeks.

Prof. **Arnaud Nuyts**, from the Université Libre de Bruxelles, held a Special Course on 'The Forum for Cyber-Torts', which is an excellent topic in today's day and age. He highlighted the diversity of civil cyber-torts, as well as the challenges of locating the torts that are committed on-line. The course also touched particularly upon European legal framework and the guiding principles of its case law, while also analysing the 'trichotomy' of the forum for cyber-torts: the forum for the place of the causal event, the forum for the place of accessibility of the website and the forum for the centre of interests of the victim.

Prof. **Ulla Liukkunen**, from the University of Helsinki, presented her Special Course on 'Mandatory Rules in International Labour Law', another important

topic considering the rising number of cross-border workers. As labour law is often connected to domestic rules, it is interesting to observe more closely the relationship between labour law and private international law. Throughout the course, the special nature of cross-border employment was acknowledged and the participants were acquainted with the concepts of triangular contracts, weaker-party protection, International Labour Organisation, the 'decent work' objective, etc. Prof. Liukkunen particularly highlighted the pluralism of regulatory sources in international labour law, and pointed to the fact that labour rights-based approach to decent work in developing regulatory private international law would advance the necessary protection for workers and ensure decent work for all.

Prof. **Tiong Min Yeo**, from the Singapore Management University, held a Special Course titled 'Common Law, Equity, and Statute: Effect of Juridical Sources on Choice of Law Methodology'. The course offered insight into the topic of choice of law methodology and the analysis that must be done in order to select the applicable law rules. It presented three juridical sources in hierarchy: statute, equity and common law. The analysis of various case law served to explain the effects that these sources have on the choice of law methodology.

Prof. **Kermit Roosevelt III**, from the University of Pennsylvania Carey Law School, presented the topic of 'The Third Restatement of Conflict of Laws'. Throughout this Special Course, the history of American choice of law was examined so as to better understand the context of the Third Restatement of Conflict of Laws, a current project of the American Law Institute. From the beginnings of American choice of law characterised by territorialist approach in the First Restatement and the Second Restatement as a 'transitional document', to the goals and framework of the Third Restatement, the course portrayed the full picture of the American choice of law rules. One of the core ideas that prof. Roosevelt developed throughout the course is that there are two different sets of values that a choice of law system should promote: so-called 'right answer' values and 'systemic' values. While the former one relates to selecting the law of the state with the best claim to regulatory authority, the latter relates to the certainty, predictability, uniformity and ease of application of the system.

Prof. **João Bosco Lee**, from the Universidade Positivo Brazil, presented an arbitration-related topic titled 'The Application of International Conventions by Arbitrators in International Trade Disputes'. On the one hand, this Special Course examined the application of international conventions pertaining to the law

applicable to the merits of the dispute in international commercial arbitration, either according to the choice of the parties or by the effect of determination of the lex cause by the arbitrator(s). On the other hand, the participants got the chance to study the cases in which international conventions could intervene in the resolution of international commercial arbitration without being the applicable law on the merits.

Prof. **Marco Frigessi di Rattalma**, from the Brescia University, held a Special Course on the 'New Trends in the Private International Law of Insurance Contracts'. By focusing on the specific cases that emerged in the recent years in the field of private insurance, the attendees of the course were immersed in diversity of topics relating to jurisdiction and applicable law in the matters of insurance contracts, the specific types of insurance contracts, compulsory insurance against civil liability in respect of the use of motor vehicles, as well as the impact of fundamental rights on such matters. Prof. Frigessi di Rattalma posed various important questions during his analysis of the relevant issues, e.g. what can characterise as an insurance contract; whether EU law may permit derogation from the equal treatment of men and women provided by insurance contracts in accordance with the applicable national law to persist indefinitely; what exactly falls under the notion of 'use of vehicles' in regards to Directive 2009/103 on the insurance against civil liability in respect of the use of motor vehicles; etc.

Additionally, *special lectures were given in tribute to the late Professor Emmanuel Gaillard* who was originally meant to hold the General Course at the 2022 Summer Courses. These lectures were held by **Yas Banifatemi**, **Diego P. Fernandez Arroyo**, **Dominique Hascher**, **Horatia Muir Watt** and **Luca Radicati di Brozolo** respectively, each of them focusing on a particular issue related to arbitration, the topic most dear to prof. Gaillard, as well as familiarising the attendees with the persona of Emmanuel Gaillard.

In the afternoons, participants could attend seminars and some of the lectures on specific topics which were organised each week, e.g. Lecture on the Permanent Court of Arbitration by Brooks Daly, Lecture on the use of the Library by Candice Alihusain, Lecture on the International Court of Justice by Florence Zaoui, Lecture on 'Fighting Human Trafficking: the Dutch Approach' by Warner ten Kate, Lecture on the Hague Conference on Private International Law by Philippe Lortie, and 'International Commercial Arbitration: the Role of Private

International Law in the Lifespan of an Arbitral Procedure' by Gerard Meijer and Camilla Perera-de Wit. For those eager to learn more, two extra short courses were held in addition: one on the law of the European Union held in the span of the first week and given by dr. Thomas Vandamme, and the other on the matters of Comparative Law, held on Saturday of the first week and given by dr. Brooke Marshall.

The participants were also given an opportunity of visiting some of the international organisations that are stationed in the Hague. For this year's session, the Academy planned visits to the Hague Conference on Private International Law, the International Criminal Court, the Kosovo Specialist Chambers, the Organisation for the Prohibition of Chemical Weapons and the Residual Special Court for Sierra Leone. By visiting various organisations that deal with such variety of matters, the attendees got a truly immersive experience. Besides the international organisations, visits to multiple embassies were organised, so the participants also got the feel of diplomacy. Various other activities were also held, e.g. a reception at the City Hall, Beach Party, Grotius Peace Palace Library Tour and a visit of the extraordinary Peace Palace itself.

During the Courses, the most advanced attendees had the opportunity to attend the Directed Studies sessions which delved deep into many intricate questions of private international law. An even smaller fraction of those students in the end got the chance to participate in the prestigious Diploma Exam of the Academy. In this year's Private International Law session, one Diploma by the Academy was awarded to Ms. Madeleine Elisabeth Petersen Weiner.

As it is obvious from the overview presented above, the 2022 Summer Courses on Private International Law were, as always, a huge success. Over 200 participants from all over the world and from various professional backgrounds got the experience of a lifetime thanks to the Academy, its Summer Courses and all the additional benefits that come with it. For anyone still doubting whether the Summer Courses, or perhaps the newer addition of the Winter Courses, are worth to attend, this post can serve as a clear answer and affirmative one at that.

More on the Validity of the PDVSA 2020 Bonds

Written by Mark Weidemaier, the Ralph M. Stockton, Jr. Distinguished Professor at the University of North Carolina School of Law, and Mitu Gulati, the Perre Bowen Professor of Law at the University of Virginia School of Law.

Governments with no realistic prospect of paying their debts often gamble for redemption, trying desperately to avoid default. Political leaders, with good reason, fear that a debt default will get them thrown out of office. But in trying to hold power, sometimes by borrowing even more, they often make matters worse for the country and its people. A prime example involves the collateralized bonds issued by Venezuelan state oil company, PDVSA.

Venezuela's Gamble

In 2016, PDVSA was about to default on its debt, as was the Venezuelan state itself. At that stage, it was already well beyond the point where the debt should have been restructured, given worsening domestic conditions. Instead, the Maduro government gambled. It conducted a debt swap in which investors exchanged unsecured PDVSA bonds for new ones due in 2020. To sweeten the deal, the PDVSA 2020s were backed by collateral in the form of a 50.1% interest in CITGO Holding, the parent company of U.S. oil refiner CITGO Petroleum. The deal bought a few extra years but put at risk the country's primary asset in the United States.

Even at the time, it was uncertain whether Venezuelan law authorized the transaction. The Venezuelan Constitution requires legislative approval for contracts in the national public interest. Maduro did not seek approval because opposition lawmakers controlled the National Assembly and had made clear they would not grant it. The deal went ahead anyway.

Times have changed. The United States recognizes Juan Guaidó as Venezuela's interim president (for now). The PDVSA 2020 bonds are in default. The bondholders want their collateral. PDVSA has challenged the validity of the bonds. But the bonds include a choice-of-law clause designating the law of New

York. Does this mean that validity is to be determined under New York law? John Coyle recently wrote a terrific post about the case and its significance on this blog. We write to provide some broader context, drawing from our article, Unlawfully Issued Sovereign Debt.

Sovereign Debt and Choice-of-Law Clauses

The story of the PDVSA 2020 bonds is a common one in government debt markets. A government borrows money in dodgy ways or at a time of financial distress. Arguably, the debt contravenes domestic law, although the government may obtain legal opinions affirming its validity. The debt also includes a choice of law clause providing for the application of foreign law, typically that of New York or England. Later, a new government comes to power and disputes the validity of the debt. We have seen this pattern in Venezuela, Mozambique, Ukraine, Zambia, Liberia, Puerto Rico, and in other sovereign and sub-sovereign borrowers. (The pattern goes back even further – for a delightful treatment of the hundreds of such cases from the 1800s involving municipal debt, see here).

These cases raise what seems like a simple question: Does an international bond—i.e., one expressly made subject to foreign law—protect investors against the risk that the bond will later be deemed in violation of the issuer's domestic law? Despite seeming simple, and how frequently the question arises, there is little clarity about the answer. New York law governs a big part of the sovereign debt markets, and the choice-of-law question in the PDVSA 2020 case has been certified to the New York Court of Appeals. Will that court's decision offer clarity?

Variations in Clause Language

Count us skeptical. The problem is not just the unpredictability of choice of law rules. It is that many choice-of-law clauses are drafted in perplexing ways, which leave unclear the extent of protection they offer to investors. Consider three examples. The first is from the PDVSA 2020 bond itself where the relevant language is capitalized (as if capitalization has some magic effect):

> *THIS INDENTURE AND THE NOTES SHALL BE CONSTRUED IN ACCORDANCE WITH, AND THIS INDENTURE AND THE NOTES AND ALL MATTERS ARISING OUT OF OR RELATING IN ANY WAY WHATSOEVER TO THIS INDENTURE AND THE NOTES (WHETHER IN CONTRACT, TORT OR*

> *OTHERWISE) SHALL BE GOVERNED BY, THE LAWS OF THE STATE OF NEW YORK WITHOUT REGARD TO THE CONFLICTS OF LAW PROVISIONS THEREOF (OTHER THAN SECTION 5-1401 OF THE NEW YORK GENERAL OBLIGATIONS LAW)*

This clause apparently seeks to extend New York law to the widest possible range of questions. Whether that includes the question of whether the bonds were validly issued is, as John's post puts it, the "billion-dollar question." And the answer is not clear. The decision by the New York Court of Appeals might provide some clarity on it . . . maybe.

But now consider this clause, from a Brazilian bond (emphasis ours):

> *The indenture and the debt securities will be governed by, and interpreted in accordance with, the laws of the State of New York without regard to those principles of conflicts of laws that would require the application of the laws of a jurisdiction other than the State of New York . . .;* ***provided, further, that the laws of Brazil will govern all matters governing authorization and execution of the indenture and the debt securities by Brazil.***

Does the bold text mean that investors cannot enforce a loan issued in violation of Brazilian law? We aren't sure. As we discuss in the paper, it can be hard to identify questions of "authorization" and "execution," especially in the context of sovereign borrowing. Consider the question whether a loan violates a constitutional or statutory debt limit. Does the debt limit negate the sovereign's capacity to borrow, limit the authority of government officials to bind the sovereign, or make the loan illegal or contrary to policy? How one categorizes the issue will affect the answer to the choice-of-law question. Carve outs like this—which reserve questions of authorization and execution for resolution under local law—appear in around half the New York-law sovereign bonds we examined.

Finally, consider this clause from a Turkish bond (again, emphasis ours):

> *[The] securities will be governed by and interpreted in accordance with the laws of the State of New York, except with respect to the authorization and execution of the debt securities on behalf of Turkey* ***and any other matters required to be governed by the laws of Turkey, which will be governed***

by the laws of Turkey

What now? This "other matters" carve out is even odder than the one for questions of authorization and execution. It hints that additional, unspecified matters might be governed by the sovereign's local law. Indeed, it implies that the sovereign's own law might determine which issues fall within the "other matters" exception. If so, the clause potentially allows the government to create new exceptions to the governing law clause.

Conclusion

Our discussions with senior sovereign debt lawyers have done little to dispel our uncertainty about the meaning of these clauses. They seem just as confused as we are. All we can say with confidence is that many choice of law clauses include traps for unwary investors. Until drafting practices converge on a consistent and coherent model, the choice-of-law question is likely to remain fodder for litigation.

[This post is cross-posted at Transnational Litigation Blog.]

The Billion-Dollar Choice-of-Law Question

Choice-of-law rules can be complex, confusing, and difficult to apply. Nevertheless, they are vitally important. The application of choice-of-law rules can turn a winning case into a losing case (and vice versa). A recent decision in the U.S. Court of Appeals for the Second Circuit, *Petróleos de Venezuela S.A. v. MUFG Union Bank, N.A.*, is a case in point. The Second Circuit was called upon to decide whether to apply the law of New York or the law of Venezuela to determine the validity of certain notes issued by a state-owned oil company in Venezuela. Billions of dollars were riding on the answer.

In this post, I first review the facts of the case. I then provide an overview of the

relevant New York choice-of-law rules. Finally, I discuss the choice-of-law question that lies at the heart of the case.

The Bonds

In 2016, Venezuela's state-owned oil company, Petróleos de Venezuela, S.A. ("PDVSA") approved a bond exchange whereby holders of notes with principal due in 2017 (the "2017 Notes") could exchange them for notes with principal due in 2020 (the "2020 Notes"). Unlike the 2017 Notes, the 2020 Notes were secured by a pledge of a 50.1% equity interest in CITGO Holding, Inc. ("CITGO"). CITGO is owned by PDVSA through a series of subsidiaries and is considered by many to be the "crown jewel" of Venezuela's strategic assets abroad.

The PDVSA board formally approved the exchange of notes in 2016. The exchange was also approved by the company's sole shareholder and by the boards of the PDVSA's subsidiaries with oversight and control of CITGO.

The National Assembly of Venezuela refused to support the exchange. It passed two resolutions – one in May 2016 and one in September 2016 – challenging the power of the executive branch to proceed with the transaction and expressly rejecting the pledge of CITGO assets in the 2020 Notes. The National Assembly took the position that these notes were "contracts of public interest" which required legislative approval pursuant to Article 150 of the Venezuelan Constitution. These legislative objections notwithstanding, PDVSA followed through with the exchange. Creditors holding roughly $2.8 billion in 2017 Notes decided to participate and exchanged their notes for 2020 Notes.

In 2019, the United States recognized Venezuela's Interim President Juan Guaidó as the lawful head of state. Guaidó appointed a new PDVSA board of directors, which was recognized as the legitimate board by the United States even though it does not control the company's operations inside Venezuela. The new board of directors filed a lawsuit in the Southern District of New York against the trustee and the collateral agent for the 2020 Notes. It sought a declaration that the entire bond transaction is void and unenforceable because it was never approved by the National Assembly. It also sought a declaration that the creditors were prohibited from executing on the CITGO collateral.

Choice of Law

If the 2020 Notes were validly issued, they are binding on PDVSA, and the CITGO assets may be seized by the noteholders in the event of default. If the notes were not validly issued, they are not binding on PDVSA, and the CITGO assets may not be seized by the noteholders in the event of default. Whether the Notes were validly issued depends, in turn, on whether the court applies New York law or Venezuelan law. This is the billion-dollar choice-of-law question. If New York law applies, then the notes will almost certainly be deemed valid and the noteholders can seize the pledged collateral. If Venezuelan law is applied, then the notes may well be deemed invalid and the noteholders will be stymied. With the stakes in mind, let us now turn to the applicable choice-of-law rules.

A federal court sitting in diversity must look to the choice-of-law rules of the state in which it sits—here, New York—to decide which jurisdiction's law to apply. N.Y. General Obligations Law 5-1401 states that a New York choice-of-law clause should be enforced whenever it appears in a business contract worth more than $250,000 in the aggregate. The 2020 Notes contain New York choice-of-law clauses. Since the aggregate value of the 2020 Notes is far greater than $250,000, and since the 2020 Notes have no relation to personal, family or household services, it may seem that the court should simply apply New York law and call it a day.

There is, however, another New York choice-of-law rule that may trump Section 5-1401. Section 5-1401 states that it shall not apply to any contract "to the extent provided to the contrary in . . . section 1-301 of the Uniform Commercial Code." Section 1-301(c) states that if N.Y Commercial Code Section 8-110 "specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified." Section 8-110(a), in turn, states that "[t]he local law of the issuer's jurisdiction . . . governs . . . the validity of a security."

All of this suggests that the applicable choice-of-law rule may not be the one laid down in Section 5-1401. Section 8-110 directs courts to apply the local law of the issuer's jurisdiction—here, Venezuela—to resolve issues relating to the "validity" of the security. The billion-dollar question is what exactly the word "validity" means in this context.

On the one hand, the term may be interpreted broadly to refer to *both* the corporate law of Venezuela *and* to Venezuelan law more broadly. Under this interpretation, the 2020 Notes may not be validly issued because they were never approved by the National Assembly as required under Article 150. On the other hand, the term "validity" may be interpreted to refer only to the corporate law of Venezuela. Under this narrower interpretation, it is irrelevant whether the National Assembly approved the 2020 Bonds because all of the corporate formalities needed to validly issue a security—approval by the board of directors, approval by the shareholders, etc.—appear to have been followed.

Interpretation in the District Court

In a lengthy decision decided on October 16, 2020, the U.S. District Court for the Southern District of New York (Judge Katherine Polk Failla) concluded that the term "validity" should be given a narrow interpretation and that New York contract law governed the issue of validity.

The court began its analysis by observing that the strongest argument in support of a broad interpretation is based on plain language. This term "validity" is not generally understood to refer solely to corporate formalities. It is understood to encompass the many reasons why a contract may not be enforceable as a matter of contract law. While this plain language reading is compelling at first glance, the court ultimately concluded that it did not mandate the application of general rules of Venezuelan law given the broader context of Article 8.

The court first quoted the following language from the Prefatory Note to Article 8:

> *[Article 8] deals with the mechanisms by which interests in securities are transferred, and the rights and duties of those who are involved in the transfer process. It does not deal with the process of entering into contracts for the transfer of securities or regulate the rights and duties of those involved in the contracting process (emphasis added).*

The court observed that if the term "validity" were given a broad scope, it would "swallow whole any choice of law analysis involving the formation of a contract for securities." The court cited state legislative history indicating that the term "validity" in Article 8 referred merely to whether a security "ha[d] been issued pursuant to appropriate corporate or similar action." The court also quoted the

authors of a leading treatise on Article 8 as saying that:

> *Obviously, the concept of "invalidity" as used in this section must have a narrower scope than one might encounter in other legal contexts, e.g., in a dispute about whether the obligation represented by the security is "enforceable" or "legal, valid, and binding."*

Finally, the district court noted the virtual absence of any New York case law supporting the broad interpretation of the validity favored by the plaintiffs. If the term was as sweeping as the plaintiff claimed, the court reasoned, there would be more cases where the courts had applied Section 8-110. The lack of any such cases cut against giving the term a broad interpretation. The district court's analysis of this issue has attracted support from some commentators and criticism from others.

After concluding that the term "validity" in Section 8-110 should be interpreted narrowly to select only Venezuelan corporate law, the district court applied New York contract law. It held that the 2020 Notes were valid and enforceable and that the defendant trustee was entitled to judgment in the amount of $1.68 billion. The plaintiffs appealed.

Interpretation in the Second Circuit

On October 13, 2022, the U.S. Court of Appeals for the Second Circuit declined to provide a definitive answer as to the interpretive question discussed above. After reviewing the various arguments for and against a broad interpretation of "validity," the court certified the question to the New York Court of Appeals. In so doing, the court commented on the issue's importance to "the State's choice-of-law regime and status as a commercial center." It also noted the importance of the choice-of-law issue to the ultimate outcome in the case:

> *If the court concludes New York choice-of-law principles require the application of New York law on the issue of the validity of the 2020 Notes, and that Article 150 and the resolutions have no effect on the validity of the contract under New York law, then we would affirm the district court's decision to apply New York law and uphold the validity of the bonds. On the other hand, if the court concludes Venezuelan law applies to the particular issue of PDVSA's legal authority to execute the Exchange Offer, then we would likely remand for an*

assessment of Venezuelan law on that question and, if necessary, for consideration of the Creditors' equitable and warranty claims.

The fate of the 2020 Notes—and the billions of dollars those notes represent—is now in the hands of the New York Court of Appeals.

Conclusion

There will be additional updates and commentary on *Petróleos de Venezuela S.A. v. MUFG Union Bank, N.A.* at Transnational Litigation Blog in the weeks and months ahead. In the meantime, please feel free to mention this case the next time a student or a colleague questions the importance of choice-of-law rules. These rules matter. A lot.

[This post is cross-posted at Transnational Litigation Blog.]

What is an international contract within the meaning of Article 3(3) Rome I? – Dexia Crediop SpA v Provincia di Pesaro e Urbino [2022] EWHC 2410 (Comm)

The following comment has been kindly provided by Sarah Ott, a doctoral student and research assistant at the University of Freiburg (Germany), Institute for Comparative and Private International Law, Dept. III.

On 27 September 2022, the English High Court granted summary judgment and declaratory relief in favour of the Italian bank Dexia Crediop SpA ("Dexia") in its lawsuit against the Province of Pesaro and Urbino ("Pesaro"), a municipal authority in the Marche region of Italy. This judgement marks the latest

development in a long-running dispute involving derivative transactions used by Italian municipalities to hedge their interest rate risk. Reportedly, hundreds of Italian communities entered into interest rate swaps between 2001 and 2008 having billions of Euros in aggregate notional amount. It is also a continuation of the English courts' case law on contractual choice of law clauses. Although the judgments discussed in this article were, for intertemporal reasons, founded still on Art. 3(3) of the Rome Convention, their central statements remain noteworthy. The Rome Convention was replaced in almost all EU member states, which at the time included the United Kingdom, by Regulation (EC) No 593/2008 ("Rome I"), which came into effect on 17 December 2009. Article 3 Rome I Regulation contains only editorial changes compared to Article 3 of the Rome Convention. As a matter of fact, Recital 15 of the Rome 1 Regulation explicitly states that despite the difference in wording, no substantive change was intended compared to Article 3(3) of the Rome Convention.

In the case at hand, Pesaro and Dexia entered into two interest rate swap transactions in 2003 and 2005. Each of the transactions was subject to the 1992 International Swap Dealers Association ("ISDA") Master Agreement, Multicurrency – Cross Border and a Schedule therto. During the 2008 financial crisis, the swaps led to significant financial burdens for Pesaro. In June 2021, Pesaro commenced legal proceedings in Italy seeking to unwind or set aside these transactions. Dexia then brought an action in England to establish the transactions were valid, lawful and binding on the parties.

A central question of the dispute was the law applicable to the contract. Pesaro claimed breaches of Italian civil law in its proceedings, while Dexia argued that only English law applies. As correctly stated by the court, the applicable law is determined by the Rome Convention, as the transactions between the parties took place in 2003 and 2005. According to Article 3(1) Rome Convention, a contract is governed by the law chosen by the parties. The ISDA Master Agreement in conjunction with the Schedule contained an express choice of law clause stating that the contract is to be governed by and construed in accordance with English law. Of particular importance therefore was whether mandatory provisions of Italian law could nevertheless be applied via Article 3(3) Rome Convention. This is the case if "*all the [other] elements relevant to the situation at the time of the choice are connected with one country only […]*". In order to establish weather Article 3(3) applied, the court referred to two decisions of the English Court of

Appeal. Both cases also concerned similar interest rate swap transactions made pursuant to an ISDA Master Agreement with an expressed choice of English law.

In *Banco Santander Totta SA v Companhia de Carris de Ferro de Lisboa SA* [2016] EWCA Civ 1267, the Court of Appeal extensively discussed the scope of this provision in connection with the principle of free choice of law, more precisely, which factors are to be considered as "*elements relevant to the situation*". This was a legal dispute between the Portuguese Santander Bank and various public transport companies in Portugal. First, the Court of Appeal emphasised that Article 3(3) Rome Convention is an exception to the fundamental principle of party autonomy and therefore is to be construed narrowly. Therefore, "*elements relevant to the situation*" should not be confined to factors of a kind which connect the contract to a particular country in a conflict of laws sense. Instead, the Court stated that it is sufficient if a matter is not purely domestic but rather contains international elements. Subsequently the court assessed the individual factors of the specific case. In so far, the Court of Appeal confirmed all factors the previous instance had taken into account. Relevant in the case was the use of the "Multi-Cross Border" form of the 1992 ISDA Master Agreement instead of the "Local Currency-Single Jurisdiction" form, that the contract included the right to assign to a foreign bank and the practical necessity for a foreign credit institution to be involved, as well as the foreseeability of the conclusion of hedging arrangements with foreign counterparties and the international nature of the swap market. These factors were found sufficient to establish an international situation.

In *Dexia Crediop S.P.A. v. Comune di Prato* [2017] EWCA Civ 428, the Court of Appeal addressed the issue again and concluded that already the fact that the parties had used the "Multi-Cross Border" form of the 1992 ISDA Master Agreement in English, although this was not the native language of either party, and the conclusion of back-to-back hedging contracts in connection with the international nature of the derivatives market was sufficient.

In the present case, Dexia again relied on the use of the ISDA Master Agreement, Multicurrency – Cross Border and on the fact that Dexia hedged its risk from the transactions through back-to-back swaps with market participants outside Italy. But as the relevant documents were not available, the second circumstance could not be taken into account by the court. Nevertheless, the court considered that the international element was sufficient and Article 3(3) of the Rome Convention

was not engaged.

Thus, this new decision not only continues the very broad interpretation of the Court of Appeal as to which elements are relevant to the situation, but also lowers the requirements even further. This British approach appears to be unique. By contrast, according to the hitherto prevailing opinion in other Member States, using a foreign model contract form and English as the contract language alone was not sufficient to establish an international element (see, e.g., *Ostendorf* IPRax 2018, p. 630; *Thorn/Thon* in Festschrift Kronke, 2020, p. 569; *von Hein* in Festschrift Hopt, 2020, p. 1405). Relying solely on the Master Agreement in order to affirm an international element seems unconvincing, especially when taking Recital 15 of the Rome I Regulation into account. Recital 15 Rome I states that, even if a choice of law clause is accompanied by a choice of court or tribunal, Article 3(3) of the Rome I Regulation is still engaged. This shows that it is the purpose of this provision to remove the applicability of mandatory law in domestic matters from the party's disposition. The international element must rather be determined according to objective criteria. With this interpretation, Article 3(3) of the Rome I Regulation also loses its *effet utile* to a large extent.

Unfortunately, the Court of Appeal considered its interpretation to be an *acte clair* and therefore refrained from referring the case to the CJEU. Since Brexit became effective, the Rome I Regulation continues to apply in the United Kingdom in an "anglicised" form as part of national law, but the English courts are no longer bound by CJEU rulings. As a result, a divergence between the English and the Continental European assessment of a choice of law in domestic situations is exacerbated.

This also becomes relevant in the context of jurisdiction agreements. In the United Kingdom, these are now governed by the HCCH 2005 Choice of Court Convention which is also not applicable according to article 1(2) if, "*the parties are resident in the same Contracting State and the relationship of the parties and all other elements relevant to the dispute, regardless of the location of the chosen court, are connected only with that State*". As there is a great interest in maintaining the attractiveness of London as a the "jurisdiction of choice", it is very likely that the Court of Appeal will also apply the standards that it has developed for Article 3(3) Rome I to the interpretation of the Choice of Court Convention as well.

One can only hope that in order to achieve legal certainty, at least within the European Union, the opportunity for a request for referral to the CJEU will present itself to a Member State court as soon as possible. This would allow the Court of Justice to establish more differentiated standards for determining under which circumstances a relevant foreign connection applies.