OVERRIDING MANDATORY RULES IN INTERNATIONAL COMMERCIAL DISPUTES

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OVERRIDING MANDATORY RULES

- What are overriding mandatory rules ('OMR')?
- Why are they relevant in international commercial litigation and arbitration?
- How to determine OMR?

OMR AS A LIMIT TO PARTY AUTONOMY

- Party autonomy

  - A contract shall be governed by the law chosen by the parties
  - ‘sanctity of governing law’

- In cases where the parties to a contract chose a foreign law as applicable law, the law of the forum (*lex fori*) would normally not apply
- However, some provisions of *lex fori* apply, irrespective of the *lex fori* not being *the lex contractus*

OMR AS A LIMIT TO PARTY AUTONOMY

- (Domestic) Mandatory rules: e.g. principle of good faith, good morals

Art 3 Rome Convention Freedom of Choice

3. The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country 'which cannot be derogated from by contract, hereinafter called ' mandatory rules',

Art 3 Rome I Regulation

Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.

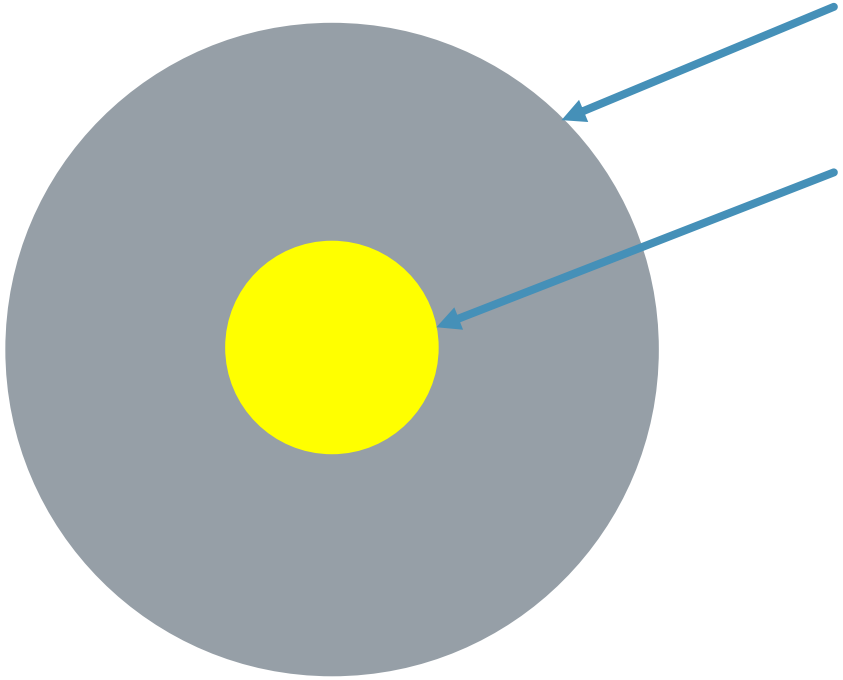
OMR AS A LIMIT TO PARTY AUTONOMY

- Overriding mandatory rules

Rome Convention
Article 7 Mandatory rules
2. Nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract.

Rome I Regulation
Article 9 Overriding mandatory provisions
1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

OMR V DOMESTIC MANDATORY RULES ('DMR')



- DMR: can be excluded by a foreign choice of law agreement
- OMR: cannot be excluded by a foreign choice of law agreement

OMR: HISTORICAL BACKGROUND

- von Savigny: "*Gesetze von streng zwngender Natur, die eben wegen dieser Natur zu jener freien Behandlung, unabhängig von den Gränzen vershiedener Staaten, nicht geeignet sind*"
- Political disorders following the World Wars: exchange control, currency regulation, export control
- De Winter: the application of mandatory rules in international contracts is contingent on whether they emanate from the *lex voluntatis*, save for the mandatory rules which fulfill such an important social purpose to overcome the parties' contractual choice of applicable law (1940)

EUROPEAN COURT OF JUSTICE: *ARBLADE*

- Judgment of the Court of 23 November 1999, Criminal proceedings against Jean-Claude Arblade and Arblade & Fils SARL (C-369/96) and Bernard Leloup, Serge Leloup and Sofrage SARL (C-376/96). (‘*Arblade*’)

> “…the classification of the provisions at issue as public-order legislation under Belgian law, that term must be understood as applying to national provisions compliance with which has been deemed to be so crucial for the protection of the political, social or economic order in the Member State concerned as to require compliance therewith by all persons present on the national territory of that Member State and all legal relationships within that State.”

THE ROME I REGULATION

- Rome I Regulation

Article 9 Overriding mandatory provisions

1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

OMR IN INTERNATIONAL COMMERCIAL LITIGATION

- OMR may undermine the predictability of the appliable law to a contract
- Three contexts in which OMR are relevant in litigation

- *Lex fori*
- *Lex contractus*
- *Third-country mandatory rules*

EXAMPLE 1

Seoul Central District Court 2018Na63343, Supreme Court of Korea 2020Da225442

- A, a Dutch Company (franchisor), and B, a Korean national, concluded a franchise agreement under which B shall operate a store in Korea, and the franchisor shall not open a competitive store
- The franchise agreement was governed by Dutch law
- Arbitration clause to settle disputes at the International Centre for Dispute Resolution
- A opened a store nearby B's store. B initiated proceedings against A to claim damages
- A contended that B's claim should be dismissed for jurisdictional grounds (arbitration clause)
- B argued that the arbitration clause was against Art 12 of the Korean Fair Transactions in Franchise Business Act and therefore invalid

EXAMPLE 1

Seoul Central District Court 2018Na63343, Supreme Court of Korea 2020Da225442

Article 12 (Prohibition on Unfair Trade Practices)

(1) No franchiser shall engage in, or cause any other business entity to engage in, any of the following acts that are likely to hamper fair franchise transactions:

3. Putting a franchisee at an unfair disadvantage by abusing its position in transactions;

- Is Art 12 an OMR?

EXAMPLE 2

Supreme Court of Korea 99Da55533

- A, an English Insurance Company, and B, a Korean company, concluded a marine cargo insurance contract incorporating the Institute Cargo Clauses
- The contract was governed by English law
- B's cargo was lost during the voyage
- B initiated proceedings for an insurance claim against A
- A contended that A was not liable due to B's breach of the Institute Classification Clause
- B argued that the Institute Classification Clause was not incorporated into the contract as per Art 3 of the Korean Act on the Regulation of Terms and Conditions

EXAMPLE 2

Supreme Court of Korea 99Da55533

Article 3 (Obligation, etc. to Prepare and Explain Terms and Conditions)

(3) A business entity shall explain important details provided in the terms and conditions of a contract so that customers can understand them.

(4) If a business entity enters into a contract in violation of paragraphs (2) and (3), it may not claim that the relevant terms and conditions constitute the content of the contract.

- Is Art 3 (3) an OMR?

EXAMPLE 3

Seoul High Court 2004Na14040

- A, a Korean company (commercial agent), and B, a Canadian company (principal), agreed to an agency contract under which A shall sell B's product in Korea
- The agreement is governed by the law of the State of Ontario
- B unduly terminated the contract, and A sought compensation pursuant to Art 92-2 Korean Commercial Act.

EXAMPLE 3

Seoul High Court 2004Na14040

Article 92-2 Commercial Agents' Right to Request Compensation

(1) If a principal obtains new customers or its business transactions increase substantially through the activities of their commercial agent, and the principal receives profits therefrom even after the contract is terminated, the agent may request reasonable compensation from the principal, except when the contract is terminated by any reason attributable to the agent.

- Is Art 92-2 an OMR?

OMR IN INTERNATIONAL COMMERCIAL ARBITRATION

- No ‘lex fori’ in international arbitration
- OMR may affect an arbitration agreement

- Russian Arbitration Procedure Law in *UniCredit v RusChemAlliance* [2024] UKSC 30

- OMR may affect arbitrability of claims based on OMR

- German/Belgian courts
- *Mitsubishi Motors Corp v Solar Chrysler-Plymouth Inc* (US)

- OMR may affect enforceability of arbitral awards under public policy grounds

- *Eco Swiss China Time Ltd v Benetton International NV* Case C-126/97 [1999] ECR 3055 (ECJ)

HOW TO IDENTIFY OMR

- Although it is widely accepted that the overriding mandatory rules of the forum apply, how to identify those rules is unclear

Rome Convention

Art 7 Mandatory rules

2. Nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law applicable to the contract.

Rome I Regulation

Art 9 Overriding mandatory provisions

2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

THE ROME I REGULATION

- Rome I Regulation

Article 9 Overriding mandatory provisions

1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

HOW TO IDENTIFY OMR

KAPIL

Article 20 (Mandatory Application of Acts of the Republic of Korea)

In light of the purpose of the legislation, irrespective of the applicable laws, the mandatory provisions of the Republic of Korea shall govern the corresponding legal relations even if foreign laws are designated as applicable laws thereof under this Act.

- Legislative purpose
- Legislative intention to apply the provision irrespective of the law otherwise applicable (*Anwendungswille*)

HOW TO IDENTIFY OMR

Swiss FAPIL

Art. 18 (Zwingende Anwendung des schweizerischen Rechts)

Vorbehalten bleiben Bestimmungen des schweizerischen Rechts, die wegen ihres besonderen Zweckes, unabhängig von dem durch dieses Gesetz bezeichneten Recht, zwingend anzuwenden sind.

(Mandatory provisions of Swiss law which, by reason of their special purpose, are applicable regardless of the law referred to by this Act are reserved.)

OVERRIDING MANDATORY RULES: SWISS FAPIL

- Art 18 Application of mandatory provisions of Swiss law

Mandatory provisions of Swiss law which, by reason of their special purpose, are applicable regardless of the law referred to by this Act are reserved.

- Art 18 does not define OMR
- Legislative material of 1983:

“The observance of foreign legal provisions shall be precluded where national provisions require exclusive recognition by reason of their special

OVERRIDING MANDATORY RULES: SWISS FAPIL

aim…Only those provisions which must be applied by reason of their very specific purpose of maintaining public order may take priority…For example, the legislative purpose of regulations…governing the acquisition of Swiss real estate by persons abroad…requires that they be applied even if the real estate transaction is no subject to Swiss law. Similarly, the public law provision establishing certain standards of protection in the Labour Code apply as soon as a business within the meaning of that Code is located in Switzerland; whether the individual employment is subject to Swiss or foreign law is irrelevant…"

OVERRIDING MANDATORY RULES: SWISS FAPIL

- Examples of OMR: family, labour law
- Principle of good faith sets limits on the application of foreign law: invoking a foreign limitation period may, under exceptional circumstances, be regarded as a ‘manifest abuse of rights’ and constitute a violation of the principle of good faith (Swiss Federal Court 21.2.2002 – BGE 128 III 201. [206], [207]
- Provisions of labour law (minimum salary, duration of holidays, notice of termination) is OMR: responding to essential, social, political or economic interests (Swiss Federal Court 16. 10. 2012. – BGE 138 III 750, [753]

HOW TO IDENTIFY OMR

- Art 18 Swiss FAPIL, Art 7 Rome Convention were models for Art 20 KAPIL
- Art 18 Swiss FAPIL and Art 20 KAPIL are similar in that 'the (special) purpose' of legislation forms the ground that the relevant provision shall apply irrespective of the law otherwise applicable
- A commentary to Art 18 Swiss FAPIL defines the 'mandatory law' referred to in Art 18 as "a provision, due to its special purpose of maintaining public policy, that requires a mandatory application"
- Provisions of fundamental importance for the state and the legal community, which imperatively demand application because of their very special objective of maintaining public order

HOW TO IDENTIFY OMR

- Unlike Art 18 Swiss FAPIL, Art 7 2. Rome Convention does not refer to a 'special purpose' of legislation
- However, it is accepted that under the Rome Convention, a special purpose is required for an overriding mandatory provision
- De Winter, whose theory formed the basis for Art 7 Rome Convention, acknowledged 'mandatory rules which fulfill such an important social purpose to overcome parties' contractual choice of governing law

HOW TO IDENTIFY OMR

- Prevailing view in Germany and Korea: provisions protecting public interests such as national interests or economic policies are OMR. Provisions protecting private interest are DMR.
- Anti-trust law, foreign exchange regulation, export control are OMR
- provisions that protect both private/public interests?

HOW TO IDENTIFY OMR

- **BGH**: provisions in Consumer Credit law (*Verbraucherkreditgesetz*) are mainly protecting the private interest and public interests are only indirectly protected
- How much harm can be caused by the violation of the relevant provisions (Martiny, Schäfer, Günther)

HOW TO IDENTIFY OMR

- Exceptional circumstances (KH SUK)
- Provisions ultimately protecting public interests through primarily protecting private interests (IH KIM)
- Weighing up party autonomy and the public policy the relevant provision is aiming to protect (HM LEE)
- Provisions protecting weaker parties for social purposes (HS CHOI)

INGMAR GB LTD. V. EATON LEONARD TECHNOLOGIES CASE C-381/98

- Eaton (principal), a company established in California, concluded a contract under which Ingmar, a UK company, was appointed as Eaton's exclusive commercial agent in the UK
- The contract is governed by the law of the State of California
- After the contract was terminated, Ingmar instituted proceedings in the UK, seeking payment of compensation for damage suffered as a result of termination, pursuant to Art 17 of the Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents

INGMAR GB LTD. V. EATON LEONARD TECHNOLOGIES CASE C-381/98

- **Question referred to the CJEU**

Are the provisions in the Council Directive, as implemented in the member state, relating to the payment of compensation to agents, applicable:

- when the principal is established in a non-member state,
- and appoints a commercial agent to carry out its activities in a member state,
- and when the applicable law of the contract is the law of the State of California?

INGMAR GB LTD. V. EATON LEONARD TECHNOLOGIES CASE C-381/98

- Judgment: Arts 17 and 18 must be applied
  - The purpose of Arts 17 to 19 of the Directive is to protect the commercial agent after the termination of the contract and is mandatory in nature
  - The harmonising measures laid down by the Directive are intended, *inter alia*, to eliminate restrictions on the carrying-on of the activities of commercial agents, to make the conditions of competition within the Community uniform, and to increase the security of commercial transactions

INGMAR GB LTD. V. EATON LEONARD TECHNOLOGIES CASE C-381/98

- Judgment

- The purpose of the regime is to protect, for all commercial agents, freedom of establishment and the operation of undistorted competition in the internal market.
- Those provisions must therefore be observed throughout the Community if those Treaty objectives are to be attained
- It is essential for the Community legal order that the principal established in a non-member country, whose commercial agent carries on his activity in the territory of a Member State, irrespective of the law by which the parties intended the contract to be governed.

INGMAR GB LTD. V. EATON LEONARD TECHNOLOGIES CASE C-381/98

The CJEU emphasised 'the uniform conditions of competition within the Community' and 'the security of commercial transactions'

Arts 17 to 19 of the Directive aim to implement an economic policy

HOW TO IDENTIFY OMR

- Freedom of contract v interventionism
- Neutrality, depoliticisation of private international law
- OMR as an exception
  - Limit to party autonomy
  - Equivalence and substitutability of law

STANDARDS AND FACTORS TO CONSIDER

1. Legislative purpose

- Essential policy interests: political, social, and economic policies
- Correcting imparity in the individual (legal) contractual relationship is not enough
- Correcting Imparity arising from a structural, systemic shortcoming

➢ e.g., provisions protecting the constitutional order, such as the economic system set out in the constitution, correction of economic injustice, provisions to achieve gender equality

- No equivalence or substitutability of foreign laws

STANDARDS AND FACTORS TO CONSIDER

2. Applicable irrespective of the law otherwise applicable

- Does the provision stipulate so?
- Does the provision apply extraterritorially?
- Does the provision set out the international/territorial scope of application?
- If not, are there clues to ascertain the international/territorial scope of the application? (connection/proximity to the forum)
- Is the provision an essential means to the goal it is aiming to achieve?
- Would the legislative objective be compromised if the said provision does not apply regardless of the law otherwise applicable?
- Are criminal/administrative sanctions imposed for the violation?

APPLICATION

Test:

1. Does the wording of the provision in question appears to be applicable regardless of the governing law of the legal relationship?

- Does the provision specify so?
- Is there a provision on the international or territorial application? (e.g. exterritorial application clause)

➔ If the answer is ‘yes’, examine the legislative purpose of the provision (refer to slide 36), if the legislative purpose suffices those criteria, the provision is OMR

APPLICATION

2. If the answer to question 1. is ‘no’,

➔ examine the legislative purpose first

➔ and then see if there are clues to limit the international or territorial scope of application (e.g. Korean market)

➔ If yes, consider the following to ascertain the legislative intention to apply the provision irrespective of the law otherwise applicable

- Is the provision an essential means to the goal it is aiming to achieve?

- Would the legislative objective be compromised if the said provision does not apply regardless of the law otherwise applicable?

- Are criminal/administrative sanctions imposed for the violation?

EXAMPLE 1

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3. Putting a franchisee at an unfair disadvantage by abusing its position in transactions;

- Is Art 12 an OMR?

EXAMPLE 1

- Art 12 Fair Transactions in Franchise Business Act
- Does not state that it applies irrespective of the applicable law of the relevant legal relationship
- Does not have a provision on extraterritorial application or international/territorial scope of application
- What is the legislative purpose of Art 12?

- ‘Fairness in transactions’
- Legislative history: enacted separately what had previously been regulated as a type of abuse of bargaining position under the Fair Trade Act

EXAMPLE 1

- Legislative purpose: Art 1

'…To contribute to the promotion of the welfare of consumers and the sound growth of the national economy by establishing a fair trading order for franchise businesses and by ensuring the mutually complementary and balanced growth of franchisors and franchisees on an equal footing'

- Shares the legislative purpose of the prohibition of unfair trade practices under the Fair Trade Act
- The purpose of the Franchise Act in prohibiting franchisors from engaging in unfair trade practices is not simply to rectify the imbalance of bargaining power between individual franchisors and franchisees, but also to eliminate unfair practices that have become customary in trade, with the strong public purpose of improving market competition conditions and thereby to implement the important constitutional value of correcting economic misconduct.

EXAMPLE 1

- The legislative purpose of regulating unfair trade practices in the Franchise Act is not simply to adjust the imbalance of tangible status between franchisors and franchisees, but also to correct unreasonable practices that have become customary in the Korean market
- correction of economic injustice in the domestic market
- This cannot be achieved by foreign laws, so there is no equivalence or substitutability of laws.
- The interests protected by Article 12 of the Franchise Act can be recognised as national and economic in nature. This corresponds to the special legislative purpose of Article 20 of KAPIL

EXAMPLE 1

- Are there clues to ascertain the international/territorial scope of application of Art 12?
- - Art 2(12) of the Act defines ‘sales territory’ as ‘an area where a franchisee sells products or services in accordance with a franchise agreement’
- The Franchise Act derived from the Fair Trade Act, which protects the Korean market
- This suffices the connection to the forum
- Personal scope of application: the Franchise Act does not limit it to domestic businesses.
- The Franchise Act presupposes that it applies to all business transactions that meet the requirements of franchise agreements (Art 2(1)): only excluded when the franchise fee is small, or when sales are small and the number of franchisees is four or less (Art 3(1)).

➔ The territorial scope of application can be ascertained as ‘cases where the franchisee is located in Korea’

EXAMPLE 1

- Legislative intention: Did the legislator intend to apply Art 12 irrespective of the law otherwise applicable?

- The prohibition in Article 12(1) of the Franchise Act is an essential means of realising the legislative purpose.

- In addition, a franchisor that engages in unfair trade practices in violation of Article 12(1) is liable to treble damages (Art 37(2)(1) and –(2)) and subject to corrective measures (Article 33(1)).

- The franchisor may be required to publish the fact that it has received an order for correction or notify the counterparty of that fact (Art 33(3)) and is subject to penalty surcharges (Article 35(1)). If the corrective measures are not followed, the franchisor is then subject to criminal punishment (Art 41)

EXAMPLE 1

- Prior to the enactment of the Franchise Act in 2002, unfair practices were regulated under the Fair Trade Act
- Art 32 of the former Fair Trade Act (before amendment by Act No. 14137 on 29 March 2016) was restricting the execution of unfair international agreements: it was possible to read the legislator's intention to apply the provisions on unfair trade practices even in cases where foreign elements are in play.
- The removal of Art 32 of the former Fair Trade Act does not mean that the current Fair Trade Act would not apply to contracts with international elements, and even though the Franchise Act was enacted as a separate Act, Article 12 of the Franchise Act cannot be deemed to have lost the nature of unfair trade practices under the current Fair Trade Act.

➔ Franchise Act was intended to apply even when the franchisor is a foreign business entity as long as involved its trade practices in the Korean market

EXAMPLE 1

- Art 12 is OMR: overrides the applicable law of the arbitration agreement, Dutch law
- Does Art 12 invalidate the arbitration agreement?
  - Fact specific: Dutch franchisor, Korean franchisee, arbitration in the US in English
  - Can it be seen as the franchisor's abuse of bargaining position?

OTHER EXAMPLES OF OMR IN KOREAN LAW

- Articles 5, 9, 11, 40, 45 and 109 of the Monopoly Regulation and Fair Trade Act, Articles 6 and 15 through 18 of the Foreign Exchange Transactions Act, Articles 19(1) and (2) of the Foreign Trade Act, Article 33(1) of the Employment Security Act and Article 5(2) of the Act on Contracts to which the State is a Party are of overriding mandatory character.

➔ These provisions apply irrespective of the applicable law of the relevant legal relationship, under the extraterritorial application clauses or in accordance with their stipulated international or spatial scope of application. Special legislative purposes are also recognised.

OTHER EXAMPLES OF OMR IN KOREAN LAW

- Article 3(4) of the Fair Transactions in Subcontracting Act, Article 12 of the Fair Transactions in Franchise Business Act, and Articles 8 and 11 of the Equal Employment Opportunity and Work-Family Balance Assistance Act are of overriding mandatory nature

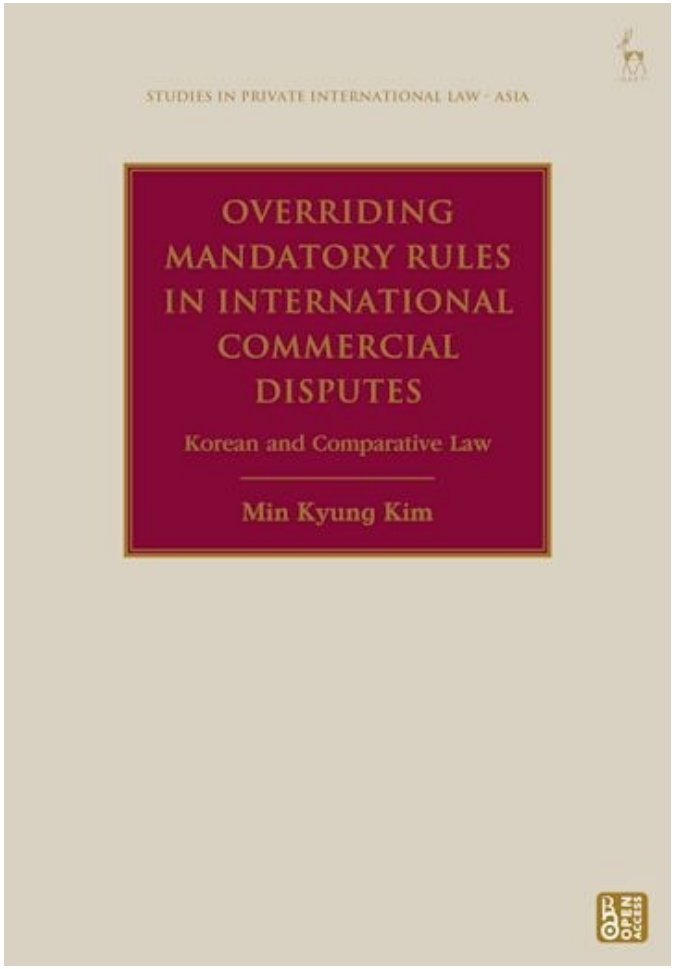
➔ Although they do not apply extraterritorially and do not explicitly provide for the international and spatial scope of application. However, these provisions aim to achieve special legislative purposes, and their international or spatial scope of application can be identified by interpretation.

OTHER EXAMPLES OF OMR IN KOREAN LAW

- Article 3(3) of the Act on the Regulation of Terms and Conditions and Articles 799 and Article 92(2) of the Commercial Act do not constitute overriding mandatory rules

➔ Special legislative purposes are not recognised and the international or spatial scope of application cannot be specified

THANK YOU



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