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Characteristic Performance—A New Concept in the Conflict of Laws in Matters of Contract for the EEC

Kurt Lipstein*

The concept of "characteristic performance," used in conflicts law to determine which country's law applies in the absence of an express or implied choice of law, has been incorporated into Article 4 of the Draft Convention on the Law Applicable to Contractual and Non-Contractual Obligations. In this article, Professor Lipstein examines the purpose, history, and criticisms of the concept of "characteristic performance" and concludes by supporting the use by the Member States of characteristic performance as a means of determining the legal system governing the contract as a whole.

INTRODUCTION

In 1972, a committee of experts appointed by the Commission of the European Communities published the Preliminary Draft of a Convention on the [choice of] Law Applicable to Contractual and Non-Contractual Obligations.1 Its final revision was completed in 1979,2

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and adopted by the Ministers of Justice of the Member States on June 19, 1980. The draft heralds incorporation of the Convention into the Law of the Ten within the not too distant future. Although several provisions of the Draft Convention have attracted special attention, only Article 4 will be examined here. This article, which determines which country’s law applies in the absence of an express or implied choice of law, provides:

1. To the extent that the law applicable to the contract has not been chosen in accordance with article 3 [i.e. expressly], the contract shall be governed by the law of the country with which it is most closely connected.

2. It shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party’s trade or profession, that country shall be the country in which the principal place of business is situated.

3. [Deals with contracts relating to rights in immovables].

4. [Deals with carriage of goods].

5. Paragraph (2) shall not apply if the characteristic performance cannot be determined and the presumptions in paragraphs (2), (3) and (4) shall be disregarded, if it appears from the circumstances as a whole that the contract is more closely connected with another country.

In the United States, the Draft Convention has been subjected to a critical examination by Professor Cavers while the concept of “characteristic performance” has been pillared by Jessurun d’Oliveira. Given the novelty of the approach, it is useful to examine its history, and, as far as available, its practical application.

The Concept of Characteristic Performance

By stating that, in the absence of an express or implied choice of law the law of the country applies with which the contract is most

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6 Draft Convention, supra note 2, at art. 3(1).
closely connected, the Draft Convention introduces the connecting factor “closest connection,” which is not new to the common law countries. Subsequently, the Convention identifies the “closest connection” with the place of the characteristic performance. The place of the characteristic performance is then revealed to be either (1) the place of habitual residence or central administration, or (2) the principal place of business of the debtor owing the particular characteristic performance.

In so defining the connecting factor of the choice of law rule for contracts as a whole, the “closest connection” includes a feature which in reality makes up the other part of a normal conflicts rule, namely the operative facts. In referring to the “place of performance which is characteristic of the contract,” the emphasis is placed only in part on the particular place of performance. Characteristic performance is also made to depend upon the type of contract to be performed; the characteristic performance is identical with the characteristic obligation owed in a contract which gives this type of contract its individual features. Thus, what appears in the guise of a connecting factor (place of performance) is in reality a category of legal relationships (commonly called “operative facts” for want of a better term) which are joined to the connecting factors: place of habitual residence, central administration or principal place of business of the party owing the obligation which is characteristic of the particular type of contract.

Thus understood, the confusion created by the introduction of the criterion of characteristic performance as part of a connecting factor can be resolved. Far from being a connecting factor, it is rather a set of operative facts introducing a series of conflict rules fashioned on the basis of a number of types of contract. The characteristic performance flowing from the characteristic obligation serves to establish a typology of contracts, and the residence, central administration or place of business of the party owing the obligation which is characteristic of the contract serves as a connecting factor.

The concept of “characteristic performance” is not, as yet, current in the countries of the European Economic Community. In Germany, however, in order to ascertain the hypothetical intention of the parties absent an express or implied choice of law, courts have looked to “typical groups of situations,” and to the “obligation typical of a profession”

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7 Draft Convention, supra note 2, at art. 4(2).
9 See Lipstein, 135 (1972 I), Hague Rec. 99 at 196 and n.11 with references, especially to Rabel, Conflict of Laws I 47 (2d ed. 1958).
or of a "certain type of contract." The technical term "characteristic performance" was coined in the Swiss literature and developed in the practice of the Swiss Federal Tribunal. That practice must be examined here in detail, since it seems likely that, in adopting the concept of characteristic performance, the Convention has also incorporated the Swiss practice which engendered it.

In seeking to formulate a choice of law rule, the parties to the Convention resorted to the Swiss solution rather than to any developed in one of the Member States. They selected the Swiss solution because they were reluctant to rely on either the application of the lex loci solutionis—which they regarded as too inflexible—or on that of the law having the closest connection—which they regarded as too vague. It remains to be seen, however, whether the Swiss solution offers a more balanced result.

The Swiss Experience

The Swiss solution was the outcome of a legal development in the conflict of laws in matters of contract peculiar to that country. Swiss theory and practice had distinguished, on the one hand, between the law governing the conclusion of the contract and the effects of the contract (known as the "great scission"), while on the other hand, with respect to the effects of the contract, it distinguished between the laws governing either party's respective performance (known as the "little scission").

Even during this period, a well-known writer, Schnitzer, advocated that in both respects attention should be concentrated on one legal system only, namely the law of the country where the obligation characteristic of the contract as a whole was to be performed. In 1952, the Swiss Federal Tribunal abandoned the principle of the "big

10 For Germany, see Staudinger-Firsching, Einführungsgesetz zum Bürgerlichen Gesetzbuch, Pt 2b InternationalesSchulrecht I (10/11 ed. 1978) nos. 483-592, i.e., sale (483), manufacture (483), exclusive distributorship (485), lease (493), loan (498), employment (500), professional services (533), mandate (539), letters of credit (540), brokerage (543), agency (546), publishing (548), forwarding (549), carriage of goods (550 fl), bill of lading (559), carriage of passengers (568 fl), deposit (574), innkeepers (577), travel agents (578), insurance (587), partnership and joint venture (590). See also 7 Soergel-Siebert-Kegel, Bürgerliches Gesetzbuch (10th ed. 1970), particularly notes 246-62 before Article 7 of the Introductory Law to the Civil Code regarding, e.g., contracts with banks, insurance companies, carriers, warehousemen, general contractors, publishers, professional services, mandate, brokers, commercial agents, carriage of goods, bills of lading, stock exchange and markets.

11 A. Schnitzer, II Handbuch des Internationales Privatrechts 624, 633, 639 (4th ed. 1958). See also the reports by Niederer and Knapp (1941), referred to in Vischer, Internationales Vertagsrecht 137 (1962). For a discussion on the "great" and "little" scission, see Schnitzer, supra at 624 and 627; Vischer, The Principle of the Typical Performance in Interna-
scission" following reassessment of its previous approach to the selection of the law governing the effects of a contract absent an express or implied choice. Previously, the Federal Tribunal had relied first on the laws of the respective places of performance and later (in order to avoid the difficulties arising out of the "little scission") on that law indicated objectively by its closest connection or by the hypothetical intention of the parties. The criterion of "closest connection" was now narrowed down to coincide \textit{prima facie} with the country where that party owing the "characteristic performance" resides or operates. Thus, a single law was made to govern the conclusion and the effects of a contract including, with respect to bilateral contracts, the performance of both parties.

It may be useful to supplement the term "characteristic performance" by reference to some interpretations provided by the Federal Tri-


17 Judgment of Feb. 12, 1952, BGE 78 II 74, 78, 85. For a short summary of the development of the rule, see Vischer, supra note 10, at 25-6.
bunal itself. The Tribunal aimed to pinpoint that obligation incumbent upon one of the contracting parties which is peculiar to the type of contract in issue, or which marks the nature of the contract.\(^{18}\) Somewhat incongruously, the Federal Tribunal has very occasionally paid due regard to the distribution of risk.\(^{19}\) Furthermore, it rightly reserved its position in instances where the contract is even more closely connected with another country,\(^{20}\) as, for example, in the case of standard contracts, arbitration clauses, or submissions to the courts of a particular country where it may be possible to detect an implied choice of law.\(^{21}\)

In subsequent years a rich and varied practice has further explained the term "characteristic performance" by establishing a precise system of characteristic obligations arising from a diversity of contracts. Thus, today, it is possible to connect, at least generally, a series of different types of contract with the law of the place of residence or business administration of one of the parties to the agreement, as the following survey will show:

(i) sale of goods—law of the vendor's residence or place of business\(^{22}\)
(ii) sale of land—form: \textit{lex rei sitae}\(^{23}\)
(iii) exclusive distributorship—sale\(^{24}\)


\(^{19}\) Judgment of June 10, 1952, BGE 78 II 190, 191 (loans).


\(^{21}\) See Vischer, \textit{14 ANNUAIRE SUISSE DE DROIT INTERNATIONAL} 43, 57 (1957).


\(^{24}\) Judgment of May 15, 1962, BGE 88 II 169, 170; Judgment of Aug. 8, 1962, BGE 88 II 325,
(iv) private loan—law of lenders' residence or place of business
(v) public loan—law of place of issue
(vi) mandate—law of place where mandatory must carry out his essential duties
(vii) mandate—by check to bank—same
(viii) letters of credit—law of addressee's residence or business—seat of bank
(ix) brokerage—quaere—exceptional circumstances
(x) agency; inter partes—law of agent's residence
(xi) exclusive agency—law of place where agent operates; exception, if contract of long duration, without obligation to make minimum purchases, totally devoted to principal's interests
(xii) carriage of goods—law of carrier's seat
(xiii) deposit—law of place of depositee
(xiv) insurance—law of insurer's place of business or branch
(xv) partnership—civil—law of managing partner's place of business—commercial: law of seat of partnership
(xvi) guarantee—law of residence, place of business, seat of promisor
(xvii) trust—law of residence of trustee

28 Judgment of June 29, 1976, BGE 102 II 270; Judgment of July 1, 1974, BGE 100 II 200, 204.
35 Judgment of Sept. 23, 1959, BGE 85 II 267, 269.
36 Judgment of July 1, 1974, BGE 100 II 200, 208.
39 Judgment of Nov. 26, 1959, BGE 85 II 452, 454.
40 Id. at 453.
(xviii) licence—law of licensor's residence\textsuperscript{42}
(xix) unjustifiable enrichment—law governing underlying relationship or \textit{lex rei sitae} or law of the place of enrichment.\textsuperscript{43}

**CRITIQUE AND SUGGESTIONS**

Swiss writers support the new technique on the ground that it “requires an examination of the function of a contract with special regard to its specific social purpose.” This function is said to be represented by certain rights and duties forming the contract, which are normally those requiring a non-pecuniary performance.\textsuperscript{44}

Strong and weighty criticism has been voiced by a Dutch writer against reliance on the concept of characteristic performance.\textsuperscript{45} It is contended that

(i) the principle of “characteristic performance” is no more specific than any of those principles it is intended to supersede (proper law, seat of the relationship, place of performance, closest connection, hypothetical intention) and that various categories must be established by ascertaining for each of them the characteristic obligation;

(ii) the connecting factors are chosen arbitrarily, as are the criteria for determining the characteristic performance, which are ill defined;

(iii) the essence of specific types of obligations can be determined no more readily by the new process than by the techniques previously employed;

(iv) legal relationships cannot be individualized by grouping them, but only by analyzing each relationship singly. Some contracts are atypical; others are complex;

(v) the attribution of a contract to a particular category cannot determine its characteristic obligation;

(vi) the duty to pay money may also constitute a characteristic obligation;

(vii) a criterion which relies on the essence and on the function of a relationship or obligation is misconceived. The latter cannot colour the former, since the former must be immutable, while the second must vary;


\textsuperscript{44} See Vischer, supra note 10, at 27.

(viii) the economic function of a contract differs from its social or socio-logical function.

In reply to these criticisms, it must be admitted that the description of the criteria for determining the characteristic performance, i.e. of the essence and the function of the obligation involved, is turgid. It conceals the real purpose of the exercise which is the search for one place of performance in order to concentrate the legal relationship there. Such a search is necessary to ascertain those legal provisions which either supplement when necessary the terms of the contractual agreement (implied general legal terms; droit supplétif) or which render it invalid or illegal (mandatory rules). So viewed, the question is whether the implied legal and mandatory rules applying at the seat of the party owing the obligation in kind, or those of the party owing the pecuniary considerations, are to be applied in order to determine the minutiae of the duties owed and the consequences of deficient performance, impossibility or frustration on the part of the former, and illegality.

The problem, therefore, is whether the party owing the performance in kind should look to its own law in order to ascertain the extent and consequences of its substantive obligations, or whether it should look to the law of the party owing the pecuniary obligation.

The answer seems to be that absent an express or implied choice of law the selection is centered on the respective leges solutionis of the parties, and the party which owes the performance in kind is most likely to look to its own law for guidance as to the duties arising from the specific obligation in kind it has undertaken. The party owing the pecuniary performance, however, owes duties which flow from the bilateral nature of the contract and are precise. They do not need supplementing. The expectation of receiving the stipulated performance in accordance with the standards and implied duties of its own law is more remote than that party's right to refuse payment if the standards imposed by the law of the other party have not been observed.

These considerations, it must be stressed, apply only when the parties have failed to make an express or implied choice of law either in favor of the law of the party owing the pecuniary obligation or of any other. If it should be argued that even in the absence of an express or implied choice of law other legal systems should be taken into account, the answer must be that the law of the place of conclusion of the contract has no special claim to consideration. It is conceded, however,
that in all legal systems and in the EEC Draft Convention, stipulated performance in a third country attracts the application of certain stringent rules in force in that country.\textsuperscript{48}

The reasons given above favoring the application of the law of the party owing a performance in kind in preference to that of the party owing the pecuniary obligation do not always apply. Where pecuniary obligations exist on both sides, such as in the case of a loan, the obligations of the borrower are precise. The lender's obligations, however, may require supplementing by legal terms implied by law (e.g., the right to recall the loan in certain circumstances); here the lender's position is comparable to that of a party owing a performance in kind, and therefore, the law of the lender's residence or business seat should be applied.

**Recent Legislation**

The technique adopted by the EEC Draft Convention is not without historical precedent. It was first employed in Poland when the Law of August 2, 1926 concerning Private International Law\textsuperscript{49} produced special choice of law rules for different types of contract in the absence of an express choice of law.\textsuperscript{50} This law was superseded by the Law of November 12, 1965\textsuperscript{51} which contained a slightly enlarged catalog, though somewhat different in substance.\textsuperscript{52} After the Second World War Czechoslovakia followed the same pattern in the Law of March 11, 1948 concerning International and Inter-local Private Law;\textsuperscript{53} it was superseded by the Law of December 4, 1963\textsuperscript{54} which modified the catalog set out in the previous statute.\textsuperscript{55} The Law of December 5, 1975 on

\textsuperscript{48} Draft Convention, \textit{supra} note 2, at arts. 3(3), 6(2), and 7.

\textsuperscript{49} 23 \textit{REV. CRIT. D.I.P.} 190 (1928); 1 \textit{QUELLEN DES INTERNATIONALEN PRIVATRECHTS s.v. La Pologne/Polen} 3 (2d ed. A. Makarov ed. 1953).

\textsuperscript{50} 23 \textit{REV. CRIT. D.I.P.} at 191, art. 8 (1928); Makarov, \textit{supra} note 49, at 6.


\textsuperscript{52} \textit{Id.} at 326, art. 25(2) (contracts relating to land or supply of goods); \textit{Id.} at 326, art. 27(1) (contracts for services, mandate, carriage of goods, deposit, warehousing, insurance, copyright); \textit{Id.} at 326, art. 28 (contracts on the stock exchange).

\textsuperscript{53} 38 \textit{REV. CRIT. D.I.P.} 381 (1949); 31 J. \textit{COMP. LEGIS. & INT'L L.} 78, pts. III & IV (1949); Makarov, \textit{supra} note 49, at 3 s.v.; La Tchechoslovaquie/Tschechoslowakei: Contracts relating to immovables (art. 44); on the stock exchange (art. 45); for sale, work or labor in the course of a mercantile or trade enterprise; of insurance; with professional people; of employment or apprenticeship (art. 46 (i)-(iv)).

\textsuperscript{54} Loi de 4 Decembre 1963 sur le droit international privé et de procédure, 54 \textit{REV. CRIT. D.I.P.} 614 (1965); \textit{see also} Makarov, \textit{supra} note 49, at 293-305.

\textsuperscript{55} Contracts involving Sale or Work to be executed, relating to land, carriage of goods, insurance, agency and brokerage, and barter, art. 10, 54 \textit{REV. CRIT. D.I.P.} at 616.
the Application of Laws\textsuperscript{56} enacted by the German Democratic Republic is more elaborate, and its detailed provisions are similar to the rules established by the Swiss practice,\textsuperscript{57} especially in its reliance upon the characteristic performance as a subsidiary test.\textsuperscript{58} The Austrian Law of June 15, 1978 concerning Private International Law\textsuperscript{59} generally provides that absent an express or implied choice of law, bilateral contracts are governed by the law of the party which does not owe an obligation expressed preponderantly in pecuniary terms. Thereby, the statute follows the Swiss example.\textsuperscript{60} More specifically, the detailed provisions as to which party's law is to govern a particular type of transaction, once again reflects the Swiss practice, supplemented by some sophisticated additions.\textsuperscript{61} The Swiss Draft of a Federal law of Private International Law (1979)\textsuperscript{62} following the previous practice, naturally relies in the first place on the law of the closest connection, which is determined \textit{inter}...
by the nature of the characteristic performance; and is centered on the law of the place of business or of the ordinary residence of the debtor owing this performance. The closest connection may, however, exist with another law such as that of the purchaser who enters into an installment contract, a borrower taking up a small loan, a surety (otherwise than for a commercial transaction) and an employee engaged in a contract of employment, for the reason that these parties deserve special protection.

CONCLUSION

The search for the characteristic performance to pinpoint the legal system governing the contract as a whole is neither new nor unknown to the common law as practiced in the United States. Only the terminology is novel. Articles 189-197 of the Restatement Second, Conflict of Laws, express the same attitude. As early as 1938, the present writer drew attention to the use of contractual typology as a means of ascertaining the law governing contracts absent an express or implied choice of law. This technique introduces an element of objectivity for the purpose of ascertaining which performance among the two contracting parties is of predominant importance and therefore attracts the law of the place of that debtor's residence or place of business. The objective element is also functionally justifiable. The implied legal terms, or droit supplétif, of the residence or place of business of the contracting party owing the relevant obligation in kind, must supplement the obligation undertaken by that party; the pecuniary obligations of the other contracting party are precise and do not require supplementation. Therefore, the synallagmatic right of refusing performance, absent performance by the other side, suffices, and no supplementation of the law governing that party's duties is required. No expectation can exist on the part of the debtor owing the pecuniary duty that the duties

63 Art. 120(1), (2). Sale: performance of transferor; licenses and user: performance of grantor; labor: performance of a work; deposit: performance of depositee; security: performance of the pledgor, etc. (art. 121(2)(a)-(e)); agency, between principal and third party: place of business of agent or place of acting, subject to certain exceptions (art. 127); unjustifiable enrichment: law governing the underlying transaction (art. 128(1)), otherwise: law of the place where the enrichment occurred (art. 128(2)). See 68 REV. CRIT. D.I.P. at 212-14 (1979); 42 RABELS Z. at 739-41 (1978).
64 See, e.g., art. 121(1), 68 REV. CRIT. D.I.P. at 212 (1979); 42 RABELS Z. at 739 (1978).
66 See, e.g., art. 120(2), 68 REV. CRIT. D.I.P. at 212 (1979); 42 RABELS Z. at 739 (1978).
of the party owing the performance in kind will be supplemented and determined by the law of the residence or place of business of the party owing the pecuniary performance. Any such expectation can and should be put into practice by an express choice of law.

It is interesting to note that Swiss practice has always allowed an exception in favor of a legal system having an even closer connection, although experience has shown that such cases are rare. It is, therefore, not surprising that the same exception appears in the recent Swiss draft. What is surprising is that the effect of the characteristic performance principle has been much watered down by the reference to the law of the party deserving special protection. If it is true that certain parties require special protection, it does not necessarily follow that their own law offers them greater protection than the law of the other contracting party. Although in allowing an express choice of law it may be advisable to curtail the stronger party's power to select the law most favorable to him, such is not the problem where the parties have failed to choose the applicable law. All that can be said in favor of applying the law of the weaker party in cases where the stronger party has not insisted on an express choice of law is that the weaker party will be in a better position to know the law it has to deal with, even though this may not be the better law for its situation.

If it should be argued that a legal system other than that of a contracting party may be applicable, as for instance when performance is to take place in a third country where mandatory rules of a hybrid character are in force—partly of a private law and partly of a dirigist character affected by administrative or political considerations—the answer is that additional conflict rules must provide for this contingency principally connected with an extraneous place of performance. The Draft Convention handles such contingencies through a series of provisions which cannot be examined here.

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69 This was first introduced by Lando, supra note 1, at 32. See also Lando, The Substantive Rules in the Conflict of Laws: Comparative Comments from the Law of Contracts, 11 TEX. INT'L L. J. 505, 523 (1976).

70 Draft Convention, supra note 2, at arts. 3(3), 5(2), 6(2) & 7.