

Topic 6: The Law Applicable to Contracts

(a) Identification of the Applicable Law

Contracts are made by reference to some system of law

- Starting point: when parties make promises to each other in a contract those promises aren't enforceable just because the parties want them to be, the mere will of those parties does not make those promises exchanged enforceable.
- The promises are "devoid of all legal effect unless they are made by reference to some system of private law" - **Amin Rasheed**, 64 (Lord Diplock)
- We presume that parties intend their promises to have legal effect, i.e., that they make their promises by reference to some legal system.

Approach to identifying the proper law

- In general, the choice of law rule in contract is the **proper law of the contract**.
 - o BUT not the choice of law rule for all contractual issues, e.g., to enforce the right or obligation under a contract.
 - o The proper law is ".. the law that governs the interpretation and the validity of the contract and the mode of performance and the consequences of breaches of the contract.." – **Amin Rasheed**, 60.
- **3 stage analysis**:
 - o 1. Is there an **express** choice of law?
 - o 2. If not, is there an **inferred** choice of law?
 - o 3. If there is neither express nor inferred choice, what is the law with which the contract has its **closest or most real connection**?
- In the first and second step, we are looking for a choice that is made by the parties - "concerned with giving effect to the intention of the parties" - **Akai**
 - o In the first situation that choice is made express in the contract.
 - o In the second situation, the parties have made a choice but not set that out in a specific term of the contract.
- This common law approach to determine the proper law of the contract can be changed by statute.

(i) Express choice of law and limitations on party autonomy

Party autonomy

- Principle of autonomy – parties may choose the law of the contract
 - o Proper law of the contract - the **law which the parties intended to apply**
 - o Must the choice be express? Inferred intention is sufficient – **Merwin Pastoral**.

* **Merwin Pastoral Co. Pty Ltd v Moolpa Pastoral Co Pty Ltd (1933) 48 CLR 565**

- Issue: Whether the law of New South Wales or the law of Victoria is the governing or proper law of the contract sued upon?

Rich and Dixon JJ:

- The parties are competent to choose what system of law governs their contractual relations.
 - o "When an agreement is made which, because of its nature or the circumstances attending it, may involve one or other of two or more countries or legal systems, the choice of the law with reference to which the parties contract, the law which is to govern the ascertainment of the rights

and liabilities arising out of the contract, is considered a matter within the competence of the contracting parties.”

- Accordingly, “the proper law of the contract is to be determined primarily by the intention of the parties”.
- If the intention is not express, look for **supposed, presumed or constructive intention**.
- Choice of parties should prevail except in exceptional cases
- Choice of parties at time of making contract prevails notwithstanding ex post facto changes to proper law not anticipated by parties
- No basis for refusing to apply law of another state on public policy grounds (NSW Moratorium Act) (Evatt J)
- The law of NSW as the lex situs, law of the place where the land is situated, should be considered the proper law of the contract, because it has the most real and substantial connection with the transaction (Starke J).

* **Vita Food Products v Unus Shipping Co [1939] AC 277 (Privy Council)**

Facts:

- Appellant was a company carrying on business in NY, Respondent was incorporated in Canada.
- There was a bill of lading, which was issued in Newfoundland, Canada, and was for carriage of goods from Newfoundland to NY.
- The ship in question was registered in Nova Scotia (Canada).
- On the course of this vessel, the herrings were damaged and a claim in negligence was brought.
- Newfoundland legislation gave Hague Rules force of law; required that Hague Rule provisions be included in bills of lading
- The bills of lading said: ‘this contract shall be governed by English law’, attempt to rely on exclusion clause in the bills under English law.
- The parties and the underlying subject of the contract has no connection to England.

Lord Wright:

- The bills of lading were not illegal and must be accepted as valid documents by the Courts of Nova Scotia.
- The Court said that the express words of the bill of lading must receive effect, with the result that the contract is governed by English law.
 - o We give effect to the express choice of law made by the parties.
- “.. where there is an express statement by the parties of their intention to select the law of the contract, it is difficult to see what qualifications are possible, provided the **intention expressed is bona fide and legal**, and provided there is no reason for avoiding the choice on the ground of public policy.” - 290

Is a connection with the proper law required?

- A connection with English law is not essential: The Court had to give effect to the express choice of law even though there was no connection to England.
- “Connection with English law is not as a matter of principle essential. The provision in a contract (e.g., of sale) for English arbitration imports English law as the law governing the transaction, and those familiar with international business are aware how frequent such a provision is even where
- the parties are not English and the transactions are carried on completely outside England.”

Requirement of bona fide choice?

- Exceptions: bona fide and legal; public policy

Golden Acres v Queensland Estates Pty Ltd [1969] Qd R 378

Facts:

- The contract in question was a deed appointing a real estate agent.
- The deed provided for a commission.
- The land in question was in QLD. The seller was a company incorporated in QLD. The deed was entered into in QLD. But the deed had an express choice of HK law.
- The real estate agent was incorporated in HK and intended to find some of the purchasers in HK.
- Under QLD law, the agent could not recover the commission.

Issue:

- Whether the real estate agent was entitled to the commission provided for in the deed?

Held:

- The court applied the statement in **Vita Food**: “Where the parties expressly stipulate that the contract shall be governed by a particular law, it has been held that that law will be the proper law of the contract provided the selection is bona fide and that there is no infringement of public policy”.
- In this case, the choice of law was not bona fide, because the real estate agent was aware of the restriction under QLD law and deliberately chose HK law to avoid the restriction under QLD law.
 - o “the selection of a law other than QLD was made for the specific purpose of avoiding the consequences of illegality which would or might have followed if QLD law applied”.
- Also contrary to public policy “for the legislative intention to be stultified by parties to a contract, of which the proper law would be QLD, selecting some other law for the purpose of avoiding the application of QLD law”.
- The court disregarded it and applied the law of QLD instead.

BHP Petroleum Pty Ltd v Oil Basins Ltd [1985] VicRp 71; [1985] VR 725

Facts:

- Involved a royalty distribution contract. It was royalty payments from BHP which Oil Basins distributed.
- BHP is Victorian, Oil Basins is registered in Bermuda.
- The royalties were paid to Oil Basins in Victoria but there was an express choice of NY law in the agreement.

Held:

- Murray J – choice only overridden if choice aimed to avoid “operation of a fiscal or policy provision of the law which would otherwise apply...”
- 1. The Court said there is no difference between those wordings (shall be governed and shall be interpreted and applied), both is an express choice of law.
 - Express choice of law clause said: “this agreement shall be interpreted and applied in accordance with the law of the State of NY”.
- 2. As we saw in **Vita Food**, the fact that there was no connection with NY is irrelevant.
- 3. The court refers to the fact that there have been cases that have refused to give effect to an express choice of law where the express choice of law avoided the operation of a fiscal or policy provision - **Golden Acres**.
 - o “There are of course instances in which the courts have refused to allow a choice of law by the parties to operate, but these instances are all cases in which the parties have sought by their choice of law **to avoid the operation of a fiscal or policy provision of the law which would otherwise apply to the contract**: see *Golden Acres Ltd v Queensland Estates Pty Ltd*
- Not applying the bona fide requirement but saying that courts have refused to allow a choice of law where it has been made to “avoid the operation of a fiscal or policy provision”.
- There is no such element in the present case.

Critique of bona fide requirement

- Both Mortensen and Nygh are critical of the requirement of bona fide.
 - o Mortensen: it should not be regarded as good law.
 - o Nygh: agrees saying that this requirement is inconsistent with the predominantly objective approach to contractual construction.
 - o This issue should instead be dealt with in the context of mandatory law of the forum.
- PQ: Both Mortensen and Nygh have said that what was held in **Golden Acres** should be dealt with on a different basis – mandatory law of the forum.
- Essential distinction is that if you proceed as in **Golden Acres**, if you have not made a bona fide choice, that completely vitiates the express choice of law.
- If you deal with the issue in terms of a mandatory law of the forum, you don’t vitiate the express choice of law, but the mandatory law of the forum overrides the express choice of law on the particular point in question.

(ii) Inferred choice

- Where no express choice by parties, choice by parties can be inferred from terms of contract and circumstances surrounding contract.

Contract points "ineluctably" to an agreed choice of law

* **Akai Pty Limited v People's Insurance Company Limited** (1996) 188 CLR 418

Facts:

- Insurance contract with an express choice of English law.
- S 8(2) of the *Insurance Contract Act* provided that "where the proper law of a contract ... would, but for an express provision to the contrary included ... in the contract ... be the law of a State or of a Territory in which this Act applies ... then, notwithstanding that provision, the proper law of the contract is the law of that State or Territory".
 - o i.e., to disregard an express choice of law where the contract had its closest and most real connection with a state or territory of Australia – overriding statutory provision.
- Akai contends that the contract of insurance is one to which the Act applies.

Issue:

- Statutory interpretation: does "express provision to the contrary" cover only a clear choice by the parties, or also the choice inferred by the court?

Toohey, Gaudron and Gummow JJ:

- Aim is to ascertain intention of parties from terms of contract – not a separate category from express choice of parties: "The words 'express provision'... embrace those provisions of the contract from which, or by recourse to which, it would be determined that the parties to the contract had selected or chosen a proper law which was not the law of a State or a Territory." (Toohey, Gaudron and Gummow JJ)
- S 8(2) does not only identify an express choice of law clause, but also applies to contracts where an express choice of law can be inferred.

Methodology

- Not a tripartite classification method: (i.e., express, inferred and objective choice of law)
- Bipartite: intention to select a governing law; if not, objective choice of law rules apply
- Maj: "There is, in truth, only one question here, and that is whether, upon the proper construction of the contract (which may include an expression of choice in direct language), the court properly may conclude that the parties exercised liberty given by the common law to choose a governing law for their contract. If the answer to this is in the negative, then the law itself will select a proper law."

Inferring intention of the parties

- Not a matter of implying a term in the contract
 - o "It is not a question of implying a term as to choice of law. Rather it is one of whether, upon the construction of the contract and by the permissible means of construction, the court properly may infer that the parties intended their contract to be governed by reference to a particular system of law."
- When determining if there is an inferred choice of law, apply common law rules of construction of contracts: "consideration of the terms and nature of the contract and 'the general circumstances of the case'" (Mason J –Codelfa)
- If court concludes parties have not made a choice, fall back on objective factors
- The difference between an express and an inferred choice is just evidentiary, in both situations the parties are making a choice. Is that choice evidenced by an express clause in the contract or is it evidenced by some other things in the terms of the contract?
- If you cannot say that the parties have made a choice express or inferred, then it is for the court to choose for the parties by determining with which legal system the contract has its closest and most real connection.

* **Amin Rasheed Corporation v Kuwait Insurance Co [1984] AC 50 (UKHL)**

Facts:

- Involved a maritime insurance contract taken out by Rasheed.
- The policy was expressed to be issued in Kuwait.

Issue:

- Whether the parties had evinced a common intention as to the system of law?

Held:

- There was the inferred choice of English law.
- Court relying on adoption of standard contract using English legal terminology.
- "...provisions of the policy taken as a whole by necessary implication led to the inevitable conclusion that it was the parties' intention that their mutual rights and obligations...should be determined in accordance with the English law of marine insurance..."
- The court says when determining whether there is an inferred choice, we look at the **terms and the surrounding circumstances at the time the contract was entered into** (ordinary principles of contractual construction).
- Terms of the contract: Necessary to apply English *Marine Insurance Act* 1906 in order to understand or interpret obscure terms of the policy document.
 - o "Except by reference to the English statute and to judicial exegesis of the code that it enacts it is not possible to interpret the policy or to determine what those mutual legal rights and obligations are".
- Crucial surrounding circumstance: Kuwait did not have law regarding marine insurance, whereas English law did have a developed statute regarding marine insurance.
- The court also pointed to other factors including that:
 - o This was the 2nd renewal of the marine insurance contract
 - o Rasheed took out the insurance contract through the London office of one of the companies in its group.
 - o Rasheed paid its premiums to that insurance broker in London.
 - o Although the policy was issued in Kuwait, it was given to the insurance broker in London which then gave it to Rasheed.
 - o In practice, claims under the policy were settled in a bank account in London in pounds.

Exclusive jurisdiction clause

- Exclusive jurisdiction clause may constitute inferred choice of law clause – "must be indication" that governing law was French – **Lewis Construction**.

Lewis Construction Co v. M Tichauer [1966] VR 341

Facts:

- A contract for the sale of two cranes.
- Vendor – French (D), purchaser – Victorian (P).
- Cranes were manufactured in France and shipped to Melbourne.
- In Melbourne, part of the crane fell off and injured and killed some people.
- One of the conditions of sale: "In case of litigation, the Commercial Court of Lyon is the only competent Court".
- P contended that the contract had a most real connection with Victoria.

Issue:

- What is the governing law of the contract?

Held:

- There was no express choice. The court considered if there was an inferred choice and if an inferred choice was indicated by the fact that there was a jurisdiction clause.
- The general condition of sale that any litigation arising under the contract must be adjudicated upon in the Commercial Court of Lyon, "is to be taken as the determining factor in the present case" that there was an inferred choice of French law by the parties.

- The proper law of the contract is French law, notwithstanding, that the contract was in English and that the contract was entered into in Victoria.

- Note: Hague Principles on Choice of Law: Art 4 "... choice of law.. must be made expressly or appear clearly from the provisions of the contract or the circumstances ..." NOT necessarily jurisdiction clause

Summary

- When looking at when there is an inferred choice:
 1. Apply the ordinary rules of contractual construction – **Akai**.
 2. Look at the terms and the relevant surrounding circumstances – **Amin Rasheed**.
 3. Ask if those terms and circumstances point ineluctably to an agreed choice of law – **Amin Rasheed**.
 4. What are the relevant considerations we can look at.
 - o If there is an exclusive foreign jurisdiction clause – **Lewis**.
 - o Is there terminology or provisions that cannot be understood without reference to a particular legal system – **Amin Rasheed**.

(iii) Objective proper law: 'the system of law with which the transaction has its closest and most real connection'

- This third category is sometimes called the objective proper law and the first and second are called the subjective proper law.

* **Bonython v Commonwealth of Australia** (1950) 81 CLR 486

Facts:

- Concerned debentures issued by the colony of QLD in 1895 in denominations of 500 or 1000 pounds.
- The government of the colony of QLD issued 200 million pounds of these.
- They were said to be payable in 1945 in either Sydney, Brisbane, Melbourne or London at the option of the holder of the debenture.
- The Court had to determine the proper law of these debentures, because by 1945, the Australian pound was different to the English pound and there was a question as to which pound the debentures had to be repaid in.

Issue:

- What is the proper law of the contract, and therefore what is the substance of the obligation created by it?

Held:

- Authority for the proposition: where there is no choice of law, we look for the **system of law** with which the contract [transaction] has its closest and most real connection.
 - o "the substance of the obligation must be determined by the proper law of the contract, i.e., the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection".
 - o With which the contract has its closest and most real connection – Akai, Amin Rasheed (See Nygh [19.32]).
- Sometimes a decisive factor is the particular place that is chosen for performance.
 - o BUT the place of performance could have been one of four places (Sydney, Brisbane, Melbourne or London), so the place of performance is not that important in this case.
- If it had been provided that payment would be made in London only, that would have been an important factor in determining the substance of the obligation.
- The legal system with which the contract had its closest and most real connection was the law of QLD:
 - o The debentures were issued on the authority of a Queensland Act and by the same Act the loan was secured on the public revenues of the Colony.

- When using terms “apt to describe its own lawful money” would need strongest evidence to show it intended some other money
- In this case, those factors had to be given decisive weight in determining that the contract had its closest and most real connection with the legal system of QLD.

Oceanic Sun Line Special Shipping Co v Fay (1988) 165 CLR 197, [32] (Wilson and Toohey JJ)

Factors:

- Look for “system of law ..with which the contract has its closest and most real connexion” ie., not the country, but the system of law: **Bonython**.
- Oceanic Sunline: indicia: even though contract made in NSW it was to be wholly performed in Greece; passengers for cruise drawn from the USA, Australia and other countries – should clearly only be one governing law
- “It would be extraordinary if the obligations of the appellant towards its passengers were to be governed by a variety of different laws, depending on where the fare was paid and the contract concluded.”
- Prima facie the proper law of the contract is the law of Greece.
- Decisive consideration: contract was to be wholly performed in Greece
- Submission to exclusive jurisdiction of Greek courts [supposed submission]
- Flag of ship
- Domicile of ship’s owner and operator
- Tour from and to Greece through Greek waters [Brennan]
- Connection with the contract or the transaction? **Amin Rasheed**; **Akai** – the contract, rather than the underlying transaction

*** Akai Pty Limited v. People's Insurance Company Limited (above)**

- After the court had disregarded the express choice of law, it had to determine the legal system with which the insurance contract had its closest and most real connection.
- The court referred to where the contract has “its natural seat or centre of gravity”.
- The court mentioned a number of factors that can be relevant to the determination
 - o Places of **residence** or business of the parties
 - o **Place of contracting**
 - o **Place of performance**
 - o **Nature and subject matter of the contract**
- The Court decided that the contract had its closest and most real connection with NSW law.
- One option is Singapore
 - o The insurer was a Singapore company
 - o The policy was negotiated in communications between Sydney and Singapore.
 - o But the contract had no practical connection with Singapore.
- England
 - o No connections to England whatsoever.
- NSW
 - o Where the insured was.
 - o The risk that the insured was insured against was substantially located in NSW.
 - o Akai sold goods on credit. It was insured against the risk of people not repaying or paying for the goods at a later date. The goods were supplied to it in NSW. The insurance policy only covered Australia and NZ.
 - o The maximum liability under the policy was in Australian currency.
 - o That was also the currency of the policy more generally.

Summary of factors:

- Location of land in contract relating to land – **Merwin Pastoral**.
- Currency of payments – **Bonython**
- Place of performance (important but not definitive)
- Form of contract – e.g., English form - **Amin Rasheed**
- Residence of lender [but otherwise residence not necessarily important] [or borrower if a government]

- Place of payment
- Principle of validation – parties want valid contract
- Law of flag – **The Halley**
- Residence, place of contracting, place of performance (little weight), nature and subject matter of contract - **ACCC v Valve** following **Akai**

Sale of Goods (Vienna Convention) Act 1986 No 119

- Sale of Goods (Vienna Convention) incorporates Convention into NSW law and prevails over NSW law to the extent of any inconsistency.
- Sale of Goods Act implements the UN Convention on Contracts for the International Sale of Goods.
- For contracts to which this convention applies, the applicable law is the rules set out in the convention.
- What contracts does this convention apply to?
 - o It applies to contracts where the two parties have their place of business in different countries and those two countries are parties to the Convention and if you applied the usual rules of choice of law, the governing law of the contract would be a country that is also a party to the convention.
- But parties can expressly contract out of these rules.

(iv) Renvoi?

- Traditional view – no renvoi in relation to contracts – intention of parties choosing law to choose the general law – not conflicts or doctrine of renvoi
- BUT **Vita Foods** – Lord Wright: contemplated renvoi in connection with contracts
- The parties proceeded on the basis that renvoi extends to contracts - ***O’Driscoll v J Ray McDermott, SA** [2006] WASCA 25
 - o Both parties accept for the purposes of the appeal that the principle in Neilson extends to contracts.
 - o The court determined that the employment contract had its closest and most real connection with Singapore law (under WA choice of law rules)
 - o BUT Singapore conflict of laws rules the same as in Australia – both is the proper law of the contract.
 - o “as the lex fori and lex causae have the same choice of law rule and apply it in the same way, there is no relevant conflict and no need to consider the respective jurisdiction's attitude to renvoi.”
- Apply traditional view (no renvoi in contract) until appellate court says otherwise - **Proactive Building Solutions v Mackenzie Keck** [2013] NSWSC 1500.
 - o “the orthodox doctrine is that the doctrine of renvoi plays no part in the choice of law rules concerning contracts, at least where the governing law of the contract has been the matter of express decision by the parties”.
 - o The doctrine of renvoi should not apply when you have an express choice of governing law.
- Where there is an express choice of governing law, there is no role for renvoi – **Proactive Building Solutions**.
 - o Inferred choice would be treated the same.
- Contrast: where you determine the contract by the legal system with which it has its closest and most real connection – rationale to apply renvoi as in Neilson – **O’Driscoll**.

- Note: Contractual issues, where the choice of law rule is not the proper law of the contract.

(b)Capacity

- The power to enter into a contract.
- What legal system do we resolve that issue by reference to?
- Grounds of incapacity:
 - o Minority
 - o Intoxication
 - o Mental or physical impairment.
- Various options for what can govern an issue of capacity:
 - o Proper law of the contract
 - o The lex domicile – the place where the party is domiciled
 - o The lex loci contractus – the place of contracting

Individuals

- Questions of capacity of a natural person are resolved by reference to **the proper law of the contract** – **Homestake Gold**.

* **Homestake Gold of Australia v Peninsula Gold (1996) 20 ACSR 67**

Facts:

- Involves a warehousing scheme for shares involving minors (Aus, UK, NZ) to defeat compulsory acquisition of Homestake Gold.
- Deeds were entered into between a lawyer for Peninsula Gold, Mr Thomson, and the guardians or parents of certain minors.
- The agreements allowed Mr Thomson to put the shares in Homestake Gold in the names of the minors and transfer them from the minors to other third parties.

Issue:

- Which law governs capacity of minors?

Young J:

- You apply the **proper law of the contract** to determine the question of capacity, which was NSW law (law of the forum).
- Under NSW law, the parents or guardians could not bind the minors to these contracts.

Corporations

- Common law: law of place of incorporation determines “capacity of a foreign corporation and the functions and powers of its organs or officers” **Carl Zeiss Stiftung v Rayner and Keler Ltd (No 2)** [1967] 1 AC 853, at 919 per Lord Reid
- Foreign Corporations (Application of Laws) Act 1989, s 7
 - o questions regarding the capacity of corporations to contract are governed by the law of the place of incorporation, including validity of its dealings.

- (2) Any question relating to whether a body or person has been validly incorporated in a place outside Australia is to be determined by reference to the law applied by the people in that place.
- (3) Any question relating to:
- (a) the status of a foreign corporation (including its identity as a legal entity and its legal capacity and powers); or
 - (b) the membership of a foreign corporation; or
 - (c) the shareholders of a foreign corporation having a share capital; or
 - (d) the officers of a foreign corporation; or

(e) the rights and liabilities of the members or officers of a foreign corporation, or the shareholders of a foreign corporation having a share capital, in relation to the corporation; or
(f) the existence, nature or extent of any other interest in a foreign corporation; or
(g) the internal management and proceedings of a foreign corporation; or
(h) the validity of a foreign corporation's dealings otherwise than with outsiders
is to be determined by reference to **the law** applied by the people in **the place in which the foreign corporation was incorporated**.

PT Ltd v Maradona Pty Ltd (1991) 25 NSWLR 643

Facts:

- There was a loan from EMF NV (a Netherlands Antilles corporation) to Maradona, and this loan was guaranteed by members of the Thompson family.
- The relevant rights in relation to the loan and the guarantee were assigned by EMF BV (Netherlands) to PT.
- The EMF group loaned money and had a guarantee for that loan, and then they assigned their rights to PT, but there were different EMF entities involved.

Issues:

- 2 issues of capacity:
 - o Did EMF MV have capacity to enter into that **original loan and guarantee**?
 - o Did EMF BV have capacity to **assign the rights**?

Held:

- Law of incorporation determines who are the members, shareholder or directors and their rights plus existence, nature and extent of any other interest in foreign corporations, matters affecting its internal management and validity of dealings with the corporation.
- Even if unregistered no reason why cannot exercise rights under Australian law that do not arise out of any illegal act.

First issue – entering into arrangements

- The capacity of EMF NV to enter into the loan and guarantee transaction was governed by its Articles of Incorporation, as interpreted by the laws of Netherlands Antilles, its place of incorporation.
- It was argued that EMF MV lacked capacity to enter into the loan and guarantee because the articles of incorporation could not extend to an illegal activity and carrying on business in Australia without registration was an illegal activity.
- That argument was rejected because no evidence was led that when you are interpreting the powers of EMF MV under the laws of the Netherlands Antilles you read down the powers to not include illegal acts.
- EMF MV could enter into these arrangements, but separately it was committing a breach of Australian law because it was not registered under the Corporations Act.

Second issue – assigning rights

- When considering whether EMF BV could assign these rights, the argument was that EMF BV did not have capacity to assign the rights because under its articles of incorporation an approval of the general meeting was needed to assign these rights.
- By the law of Netherlands, the law of incorporation, such a requirement only has internal consequences for the corporation and cannot be relied on against third parties like PT.
- In relation to both transactions, the relevant EMF company had the capacity to enter into loan agreement and guarantee, and the assignment.

Capacity v consequences

- Whether a corporation has capacity to contract - law of the place of incorporation
- What consequences follow from a lack of capacity - proper law of the contract.

Haugesund Kommune v Depfa ACS Bank [2010] EWCA Civ 579 - discussion of relationship of role of statutes of place of incorporation in relation to capacity issue

Facts:

- Involves communes (local municipalities) in Norway
- “Zero coupon swaps agreements” between the Norwegian communes and an Irish bank.

- Communes invested the money and the investments proved disastrous. Therefore, district auditors questioned whether the local authorities had the power to conclude such transactions.
- The agreements contained English law and English jurisdiction clauses.
- Proceedings were brought in the English courts regarding the swaps.
- The municipalities in the English proceedings argued that they had no capacity to enter into the agreements.

Issue:

- Whether under a Norwegian Act the Norwegian communes had the capacity to enter into these swaps?

Held:

- Rule - Dicey: "The capacity of a corporation to enter into any legal transaction is governed both by the constitution of the corporation and by the law of the country which governs the transaction in question. All matters concerning the constitution of a corporation are governed by the law of the place of incorporation".
- Norwegian approach to capacity is different to that of an English lawyer.
- 1. The Court drew a distinction between capacity and the consequences of incapacity. Whether a corporation has capacity depends on the law of the place of incorporation. The consequences of incapacity depend on the proper law of the contract.
 - o "Once the issue of "capacity" has been decided according to the constitution of the corporation, then the consequence of the lack of "capacity" is something that is to be determined by the putative applicable law of the contract, that is English private law. The law of the place of the corporation is not involved at this stage."
- 2. In English law, entities have all the capacity of a natural person, even if their power to exercise that capacity can be limited by statute. If there are limitations in the charter, the corporation has no "power" to carry out acts which are not authorised by its charter.

Meanings

- **Capacity** - "The concept of "capacity" has to be given a broader, "internationalist", meaning and must not be confined to the narrow definition accorded by domestic English law... it should be interpreted as the legal ability of a corporation to exercise specific rights, in particular, the legal ability to enter a valid contract with a third party."
- **Corporation's Constitution** - For similar reasons, it seems to me that the concept of a corporation's "constitution" must be given a broad, "internationalist" interpretation... For the purposes of this English conflict of laws rule it is necessary to examine all the sources of the powers of the corporation under consideration. This will include any constitutional documents but also relevant statutes and other rules of law of the country where the corporation was created."

Application

- Here, the restriction under the Norwegian statute on the communes entering into loan agreements meant that the communes did not have capacity to enter into the loans.
- What the consequences of the lack of capacity are, are determined by the proper law of the contract, which here was English law. Under English law, if an entity lacks capacity, the contract is unenforceable.