ELTE LAW JOURNAL

ELTE LJ | 2023/2

ELTE
LAW

ELTE

LAW JOURNAL

2023/2

ELTE LJ

ELTE
EÖTVÖS
UNIVERSITY
PRESS

Budapest, 2023

ELTE Law Journal is a peer-reviewed periodical published twice a year under the auspices of the ELTE Faculty of Law since 2013.
The publication of this issue was supported by the ELTE Journal Development Fund (ELTE Folyóirat-fejlesztési Alap).

Contact • eltelawjournal@ajk.elte.hu
Eötvös Loránd University, Faculty of Law • 1053 Budapest, Egyetem tér 1–3, Hungary
For submission check out our submission guide at ojs.elte.hu/eltelj

Recommended abbreviation for citations: ELTE LJ

DOI: 10.54148/ELTELJ.2023.2

ISSN 2064 4965

Editorial work • ELTE Eötvös University Press
H-1088 Budapest, Múzeum krt. 4.

ELTE | EÖTVÖS UNIVERSITY PRESS

ELTE EÖTVÖS LORÁND UNIVERSITY

eltebook.hu

Executive Publisher: the Executive Director of ELTE Eötvös University Press
Layout: Andrea Balázs
Cover: Ildikó Kmotrik
Printed by: Multiszolg Ltd

Contents

Symposium

Péter Gárdos

Preface to the Contributions on the Change of Parties in Contract Law

The idea to organise a workshop on the transfer of contracts came when I started working on a paper on this subject. At first sight, it seemed that in those countries where the transfer of contracts was left unregulated, the market practice and the jurisprudence came up with solutions to cater to the needs of the parties. Based on these solutions, the parties could transfer their contractual positions.

The same was true in Hungary. Until the New Civil Code entered into force in 2014, the Old Civil Code did not regulate the transfer of contracts. Still, the courts acknowledged that by assigning all rights and receivables and transferring all obligations under the contract, the contractual position itself can be transferred to the new party entering the contract. When the New Civil Code was prepared, the legislator intended to codify the case law developed by the courts. However, since the entry into force of the New Civil Code, the courts have been struggling to apply the rules on the transfer of contracts.

In the past few decades, the UNIDROIT Principles of International Commercial Contracts and the Draft Common Frame of Reference introduced rules on the transfer of contracts. Even though these documents are typically based on detailed background materials, the same does not seem true in the case of the rules on the transfer of contracts. The preparatory materials and the commentaries to the UNIDROIT Principles and the DCFR tell very little about the considerations behind the rules.

Our workshop held in November 2022 analysed issues relating to the change of parties with an international panel: Roberta Peleggi (Sapienza University of Rome), Jan Lieder (University of Freiburg), Paul MacMahon (London School of Economics) and myself (ELTE Law School).

This issue of ELTE Law Journal publishes three articles that grew out of our discussions.

Roberta Peleggi's paper provides an overview of how Italian law regulates the transfer of contracts. The Italian experiences are especially relevant, as the Italian Civil Code was one of the first codifications in Europe that included rules on the assignment of a contract. The paper puts the Italian rules in perspective by comparing them to the solutions of the UNIDROIT Principles and their application in practice.

Jan Lieder explains how the transfer of contact is possible under German law, even though the German Civil Code does not contain rules on the transfer of contract. The paper explains the doctrinal dispute concerning the legal nature of the transfer but argues that

DOI: 10.54148/ELTELJ.2023.2.7

these positions are two sides of the same coin. The paper then explains how the case law on the transfer of contract created a flexible and reliable regime that caters to the needs of the parties.

In the third paper, I provide an overview of Hungarian law's struggle with handling the new rules on the transfer of contracts. The paper explains how the transfer of specific contracts (e.g., package travel contracts) was regulated in sectoral laws and how the courts developed a general framework for the transferability of contractual positions. The paper then introduces the rules of the New Civil Code on the transfer of contracts and explains the difficulties that the courts have encountered over the last decade. The paper argues that the primary reason for these uncertainties is that the legislator failed to clarify the legal nature of the transfer.

The comparative approach of the papers could be helpful for courts to tackle the challenges arising in the context of the transfer of contracts and could also assist legislators when regulating legal succession in the contractual position. The contributions show the importance that the rules on the transfer of contract need to be in line with the rules on transfer in general (i.e., how movable and immovable property, rights and receivables are transferred), and legal succession, and also provide examples how the various questions, such as the involvement of the party remaining in the contract, could be regulated. The paper could also assist legal professionals when faced with legal problems which their national laws fail to regulate.

Péter Gárdos*

Transfer of Contracts under Hungarian Law

Abstract

The paper explores how the transfer of contracts has evolved in Hungarian law. Even though the Civil Code of 1959 did not include rules on the transfer of contracts, the courts acknowledged that legal succession in the position of a contracting party is possible by way of a trilateral contract, where all rights under the original contract are assigned and all debts are assumed. The new Civil Code of 2013 incorporated some rules that developed in the case-law of the courts, but these rules have led to uncertainties. These can all be traced back to the fundamental question of how the transfer of contract can be described, whether it is a novation, an assignment together with an assumption of debt or whether it is a *sui generis* legal institution. This paper argues that the transfer of contract can be described as a transfer of all rights and the assumption of all debts under a contract. A law based on this interpretation can fulfil the needs of all parties involved and can fit into the system of the Hungarian Civil Code.

Keywords: transfer of contracts, legal succession, Hungarian Civil Code, assignment, assumption of debt

I Introduction

Ten years ago, in 2013, the Parliament passed an act on the new Hungarian Civil Code.[1] The Code entered into force in 2014, replacing the first Hungarian Civil Code of 1959.[2] One of the innovations of the New Civil Code was the introduction of a chapter on the transfer of contracts. Under the Old Civil Code, the courts handled the transfer of contracts without real problems by applying the rules on assignment and transfer of debt. Even though academics criticised this approach, it suited the parties' needs. Ideally, therefore, the New Civil Code's task should have been merely to formulate model rules that reduce the transaction costs of the parties without disrupting the well-developed solutions. However, surprisingly, this is not what happened.

* Dr. habil. Péter Gárdos Ph.D., associate professor, ELTE Law School. This paper was supported by the János Bolyai Research Scholarship of the Hungarian Academy of Sciences.

1 Act V of 2013 on the Civil Code (New Civil Code).

2 Act IV of 1959 on the Civil Code (Old Civil Code).

DOI: 10.54148/ELTELJ.2023.2.9

This paper will proceed as follows. Section II will provide an overview of how the courts handled the transfer of contracts. It will show, furthermore, that even though the Old Civil Code did not regulate how contractual positions can be transferred, several laws provided for the transfer of certain contractual positions. Section III will explain the rules on the transfer of contracts introduced by the New Civil Code. Section IV will provide an overview of the legislative changes that have occurred after the entry into force of the New Civil Code and explain how these changes make it difficult to understand what a transfer of contract is. Section V will explain how the transfer of contracts can be described. The paper argues that, in principle, the transaction can qualify as a transfer in the legal sense, the amendment or novation of the original contract, the combination of assignment and assumption of debt or, if none of the previous solutions is feasible, a *sui generis* transaction. The paper will argue that the contractual position can be transferred by assigning all rights and claims and assuming all debts and obligations under the contract. To reach this conclusion, the paper also explains that the New Civil Code and the legal literature interpret the scope of rights that transfer to the assignee in the case of an assignment too narrowly. The law should recognise that all rights relating to the assigned receivable transfer automatically to the assignee unless the parties agree otherwise, and all rights relating to the underlying contract can be transferred to the assignee if the parties so agree. Section VI provides an example of why it is essential to understand the legal nature of the transfer of contract. The New Civil Code copied the UNIDROIT Principles' rule on advance consent, not paying attention to the fact that, in the UNIDROIT Principles, the transfer of contract is a bilateral contract, whereas in the New Civil Code, it is a tripartite contract. The New Civil Code's rules are therefore difficult to insert into the structure of contract law. Section VII contains the summary of this paper's findings.

II Transfer of Contracts under the Old Civil Code

The Old Civil Code contained rules on the transfer of receivables[3] and the assumption of debts,[4] but it did not regulate the transfer of contracts. The lack of codified rules did not mean, however, that contractual positions were non-transferrable under Hungarian law. There were several laws that expressly provided for the transferability of certain contractual positions, and the practice also developed solutions to transfer contractual positions with regard to contracts where transferability was not provided for by law.

[3] Section 328–331 of the Old Civil Code.
[4] Section 332–333 of the Old Civil Code.

1 Transfer of Contracts Based on Legislation

Although the Old Civil Code did not regulate the transfer of contracts in general, it contained a provision that implied there could be a statutory transfer of lease contracts. If the ownership of a leased property was transferred, the lease agreement was also transferred to the acquirer.[5]

Apart from the Old Civil Code, rules on the transfer of contract were introduced in Hungary as a result of the implementation of various European Union directives. The Labour Code[6] implemented the Transfer of Undertakings Directive,[7] which provided that, in the event of a transfer of an undertaking, the transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer shall, by reason of such transfer, be transferred to the transferee.[8] The Hungarian implementing legislation of the Package Travel Directive[9] also provided for the right of the traveller to transfer the package travel contract to a third party.[10]

There were certain sectoral rules that also provided a party with the right to transfer their contractual position. To name a few examples, the Credit Institutions Act,[11] the Insurance Act[12] and the Investments Firms Act[13] all provided the regulated entity (i.e., credit institutions, insurance companies and investment firms) with the right to transfer their portfolio of contracts. These acts also ensured that these transfers did not require the participation of the party remaining in the contract.

---

5 Section (1) 432 of the Old Civil Code. This rule followed the German *Kauf bricht nicht Miete* rule of Section 566 of the *Bürgerliches Gesetzbuch*.

6 Section 36 of Act I of 2012 on the Labour Code.

7 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (Transfer of Undertakings Directive).

8 Article 3 (1) of the Transfer of Undertakings Directive.

9 Article 9 (1) of Directive (EU) 2015/2302 of the European Parliament and of the Council of 25 November 2015 on package travel and linked travel arrangements, amending Regulation (EC) No 2006/2004 and Directive 2011/83/EU of the European Parliament and of the Council and repealing Council Directive 90/314/EEC (Package Travel Directive).

10 Section 7 of Government Decree 281/2008 (XI. 28.) on package travel contracts. Until the New Civil Code entered into force, the Government Decree expressly provided the traveller with the right to transfer the package travel contract. After the New Civil Code entered into force, as the right to transfer the contract is provided by the New Civil Code, the Government Decree only requires that the organiser shall be informed of such transfer.

11 Section 17 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises.

12 Section 93 of Act LX of 2003 on Insurance Institutions and the Insurance Business.

13 Section 140 of Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers.

2 Transfer of Contracts outside the Field of Sectoral Laws

Even though the Old Civil Code did not include rules on the transfer of contracts, after Hungary's transformation to a market economy in 1989-1990, more and more contracts contained provisions allowing one or both parties to transfer their contractual positions. For example, as syndicated loans appeared on the Hungarian market, these loan agreements often provided that the creditor may transfer their position. The debtor's consent, necessary for such a transfer, was often already written into the loan agreement.

The court practice accepted without much hesitation that such a transfer was possible. Several judgments confirmed that if all three parties agree, a legal succession in a contractual position is possible. Some even explained that such a transfer is possible, as the transfer of a contractual position is nothing more than the assignment of all rights and the assumption of all obligations under the contract.

The Supreme Court, in a 2006 judgment, explained that '[t]here is no legal impediment to the contracting parties and a third party agreeing on a tripartite contract of succession covering all rights and obligations in the entire contractual subject position'.[14]

The judgment of a regional court of appeal provides a detailed explanation of how the courts approached these contracts.

> The position of a contract, with the rights and obligations arising from it, is freely transferable by virtue of freedom of contract, and the transfer of the contract results in the change of the contracting party. Although the rules of [the Old Civil Code] on assignment and assumption of debts apply to the transfer of specific claims and the assumption of certain obligations and not to the transfer of contractual positions, [the Old Civil Code] also does not prohibit the assignment and assumption of all claims and obligations arising from the contract, and therefore the so-called assignment of contracts is valid.[15]

III Transfer of Contracts in the New Civil Code

When the New Civil Code was prepared, one of the goals of the legislator was to codify legal solutions that had been developed by the courts in the previous decades.[16] The first paper issued by the drafting committee explained that

> [t]he new Civil Code has to regulate the assignment of contract that combines the legal institutions of assignment and the assumption of debt. It happens frequently in business

[14] BH 2006. 409.

[15] Szeged Regional Court of Appeal BDT 2008. 1883..

[16] See the original concept of the New Civil Code published as a special issue of Magyar Közlöny *[Official Gazette]*.

> practice that not only a claim but, with the cooperation of the contracting partner, the entire contractual position is transferred to a third party: contract assignment. In such a case, the rules on assignment and assumption of debt are combined. […] In most cases, the existing rules provide a satisfactory solution; however, it is worth considering on which points the rules on assignment and assumption of debts should be supplemented to ensure that the legal conditions for the assignment of contracts are fully met.[17]

It was no surprise, therefore, that the New Civil Code introduced rules on the transfer of contracts.

Under the New Civil Code, the assignor, the assignee and the other party may agree to transfer all the assignor's rights and obligations to the assignee.[18] This rule does not follow the UNIDROIT Principles. Whereas, under the Principles, the assignment of contract is a bilateral contract between the assignor and the assignee,[19] the transfer of contract is a trilateral contract between the party leaving the contract, the party entering the contract and the party remaining in the contract.

The legal effect of the contract is that the assignee acquires all the rights and is subject to all the obligations that the assignor had under the contract.[20] This solution is also significantly different from the solution of the UNIDROIT Principles. Under the Principles, the party leaving the contract and the party entering the contract are jointly and severally liable.[21] The party remaining in the contract has the right to discharge the party leaving the contract,[22] or to retain this party as an obligor in case the party entering the contract does not perform properly.[23]

The Code also introduced rules on set-off. The party entering the contract is not entitled to set off the claims that the party leaving the contract had against the party remaining in the contract, and *vice versa*, the party remaining in the contract may also not set off claims it had against the party leaving the contract. However, there is one exception to this rule. The party entering the contract can set off the legal predecessor's claims relating to the transferred contract, and similarly, the party remaining in the contract can set off contract-related claims.[24]

The New Civil Code also provides rules on securities. All securities securing the legal predecessor's rights transfer automatically to the legal successor. As a mirror image of this rule, the securities securing the performance of the legal predecessor's obligations cease

---

17 Magyar Közlöny *[Official Gazette]* 2002/15/II. 136.
18 Section 6:208 (1) of the New Civil Code.
19 Article 9.3.1 of the UNIDROIT Principles of International Commercial Contracts.
20 Section 6:208 (2) of the New Civil Code.
21 Article 9.3.5 (3) of the UNIDROIT Principles of International Commercial Contracts.
22 Article 9.3.5 (1) of the UNIDROIT Principles of International Commercial Contracts.
23 Article 9.3.5 (2) of the UNIDROIT Principles of International Commercial Contracts.
24 Section 6:208 (2) of the New Civil Code.

to exist unless the provider of the given security consents to the transfer of the contract.[25] The current rules were introduced in 2016. The original ones provided that all securities are terminated in the case of a transfer of contract. To limit the negative effects of such termination, the New Civil Code provided that if the original obligation was secured by way of a charge, and the provider of the security gave its consent, a new charge is established. The new charge will exist at the rank of the original charge.[26]

Like the UNIDROIT Principles,[27] the New Civil Code provides that the party remaining in the contract may give advance consent to the transfer. In such a case, the transfer shall take effect upon the notification of the other party of the assignment.[28] When giving advance consent, the party may reserve the right to withdraw it.[29] It follows, therefore, that if such a declaration is not made, consent cannot be withdrawn. The same rules apply to the providers of security. They may also give advance consent to the transfer.[30] The advance consent can only be withdrawn if such a right was upheld when the advance consent was given.[31]

The New Civil Code does not repeat the relevant rules of assignment and the assumption of debt. Instead, in line with the solution of the UNIDROIT Principles,[32] it provides that these rules apply mutatis mutandis to the assignment of contracts.[33]

Finally, the Code provides that if all the rights and obligations of a person arising from a contract are transferred to another person under a statutory provision, the rules on the transfer of contracts shall apply *mutatis mutandis*.[34]

IV Developments since the Entry into Force of the New Civil Code

Taking into account that the transfer of contracts was easily possible under the Old Civil Code and that the New Civil Code did not wish to introduce material changes in this area, it may have come as a surprise that the New Civil Code's rules led to significant controversies.

On the one hand, difficulties may have arisen from the fact that the New Civil Code and its explanatory memorandum did not make it easy to answer the question of what is the transfer of a contract.

---

25 Section 6:208 (3) of the New Civil Code.
26 Section 6:208 (3) of the New Civil Code in force between 15 March 2013 and 30 June 2016.
27 Article 9.3.4 of the UNIDROIT Principles of International Commercial Contracts.
28 Section 6:209 (1) of the New Civil Code.
29 Section 6:209 (2) of the New Civil Code.
30 Section 6:209 (3) of the New Civil Code.
31 Section 6:209 (4) of the New Civil Code.
32 Article 9.3.7 of the UNIDROIT Principles of International Commercial Contracts.
33 Section 6:210 of the New Civil Code.
34 Section 6:211 of the New Civil Code.

It appears from the legal norm defining the transfer of contract that the legislator defined the transfer of contract as a *sui generis* legal instrument. This interpretation is also supported by the explanatory memorandum of the New Civil Code, which expressly provides that the transfer of contract is not an assignment and assumption of debt but a *sui generis* legal institution.[35]

However, this interpretation seemed to be contradicted by the original rule of the New Civil Code, which provided that, in the event of a transfer of a contract, the securities cease to exist.[36] This rule, in its original formulation, implied that the transfer of a contract is a novation. The securities cease to exist because the underlying contract itself is terminated, and simultaneously a new contract is created, with the same content as the previous one, between the party remaining in the contract and the party entering the contract.

Finally, the provision that the rules on assignment and assumption of debts apply to the assignment of a contract in respect of matters not expressly regulated by the New Civil Code suggested that the transfer of contract is simply a combination of the rules on assignment and assumption of debts.

On the other hand, the uncertainty of interpretation has been significantly increased by legislative developments after 2013.

A new provision was added to the Transitional Provisions Act.[37] which expressly provided that if all the rights and obligations arising from a contract concluded before the entry into force of the New Civil Code are transferred to another person after the entry into force of the Civil Code by virtue of a statutory provision, the transfer leads to the termination of the legal relationship and the creation of a new contract between the party entering into the contract and the party remaining in the contract.[38]

As explained above, the 2016 amendment to the Civil Code[39] went in the opposite direction. The legislator amended the rule on the termination of security, thereby removing the only provision from the New Civil Code that could have been interpreted as if the legislator thought that the transfer of contract qualifies as a novation of the contract.

The courts were struggling to address certain problems arising from the contradicting rules. One of the first questions that arose was whether the territorial jurisdiction clauses in the original contract were still valid. The validity depended on the characterisation of the transfer. If it was a legal succession, the parties are still bound by it. If, however, the transfer of contract qualified as novation, the clauses in the new contracts were invalid, as in the meantime such clauses were prohibited by law.[40]

---

[35] Bill No. T/7971 p. 606, available at <http://www.parlament.hu/irom39/07971/07971.pdf> accessed 31 August 2023.

[36] Section 6:208 (3) of the New Civil Code in force between 15 March 2013 and 30 June 2016.

[37] Act CLXXVII of 2013 on the Transitional and Authorizing Provisions related to the Entry into Force of Act V of 2013 on the Civil Code (Transitional Provisions Act).

[38] Section 53/C (2) of the Transitional Provisions Act.

[39] Section 20 of Act LXXVII of 2016 on the Amendment of Act V of 2013 on the Civil Code.

[40] Section 27 (6) of Act CXXX of 2016 on Civil Procedure.

The Curia therefore turned to the Constitutional Court for the annulment of the rule introduced in the Transitional Provisions Act. However, the Constitutional Court found that Section 53/C of the Transitional Provisions Act was not unconstitutional.[41] The Curia, to solve the deadlock, published a uniformity decision[42] in which it explained that the transfer of contract under the New Civil Code results in legal succession, and therefore the continuity of the legal relationship is maintained. In addition, the Curia stated that those transfers of contract that fall under the scope of the Transitional Provisions Act also qualify as legal succession, as do the content of the contract and the rights and obligations of the parties, but, for the purposes of the Transitional Provisions Act, the contract will be regarded as a new contract between the party remaining in the contract and the party entering into the contract.[43]

V How can the Transfer of Contracts be Described?

The disputes around the New Civil Code's rules go back to the fundamental question of what a transfer of a contract is. This question needs to be raised because although we refer to the transaction as a transfer, in a strictly legal sense it is not a transfer, for the simple reason that the contractual position, in other words., the aggregate of one party's rights and obligations, is not property,[44] and therefore, under Hungarian law, it cannot be subject to a transfer in the same way one can transfer things and rights.

If it is not a transfer, how can we describe this transaction? Various explanations were made earlier in the Hungarian literature for this question: the transfer of contract can be characterised as an amendment of the underlying contract, a novation of the contract, a simple combination of assignment and the assumption of debt, or if no other solution is available, we can characterise the transfer of contract as a *sui generis* legal institution.[45]

---

41 For a critique of the decision of the Constitutional Court, see e.g., Soma Török, 'Az Alkotmánybíróság döntése fennálló szerződések jogszabály általi módosításáról és a szerződésátruházásról' [The Decision of the Constitutional Court on the amendment of existing contracts by law and transfer of contracts] (2012) 2–3 JeMa; Péter Gárdos, 'Gondolatok a szerződésátruházásról az Alkotmánybíróság határozata nyomán [Thoughts about the transfer of contracts in the light of the decision of the Constitutional Court'(2021) 7–8 Magyar Jog 427–444.

42 Uniformity decisions are binding on all courts [Section 24 (1) c) of Act CLXI of 2011 on the organisation and administration of courts.

43 See the operative part of the uniformity decision No. 7/2021.

44 Section 8:1 (1) of the New Civil Code.

45 For possible explanations in the Hungarian legal literature, see, e.g., Pál Lászlófi and László Leszkoven, 'Gondolatok a szerződés-engedményezés jogi természetéről' [Thoughts on the legal nature of the assignment of contract] (2004) 4 Polgári Jogi Kodifikáció 17–24.

1 Amendment of the Underlying Contract

One way to look at the transfer of contract is by qualifying it as an amendment to the original contract. The argument of this approach could be that the New Civil Code allows the parties to amend the terms of their contract. Such an amendment can, for example, extend to deadlines and conditions. Nevertheless, Hungarian law goes even further when it accepts that the *causa* of the contract can also be changed.[46]

If Hungarian law is so flexible concerning the amendment of the contract, can we also accept that the identity of one of the contracting parties is amended? This paper argues that this is not possible. *De lege lata*, the situation seems clear: the transfer of contract is not regulated as an amendment. However, it also seems that this solution would also be wrong *de lege ferenda*. Even though the New Civil Code is flexible concerning what element of the contract can be amended, there is one common element in all these cases: the amendment takes place between the same parties. A contract between Party A and Party B cannot be amended so that the contract remains intact, but Party B, the original contracting party, is replaced by Party C, who was previously not a contracting party.

2 Transfer of Contract by way of Novation

Another possibility is that the transfer of contract occurs by way of novation. This would mean that the contract between Party A and Party B is terminated, and at the same time, a new, identical contract comes into existence between Party A and Party C. This is the solution of English law,[47] where it is undisputed that the transfer of contract is not a transfer, in other words, not a legal succession, but a new contract comes into existence between the original party and the new party,[48] though this solution is based on the fact that English law does not recognise the assumption of debt. The burdens of a contract can only be passed on by way of novation.[49]

Under Hungarian law, handling transfers of contract as novation would fail to take into account the actual intention of the parties and would therefore be a wrong solution.

The fact that novation does not take into account the intention of the parties can easily be shown by way of an example. As it was argued above, if the transfer is novation, the securities are also extinguished. Such a solution would clearly not be in line with the parties' intentions, as they need to create and register new securities, which costs money and takes valuable time.

---

46 Section 6:191 (1) of the New Civil Code.

47 *Rasbora Ltd v JCL Marine Ltd* [1977] 1 Lloyd's Rep 645 (QBD), 650.

48 Marcus Smith and Nico Leslie, *The Law of Assignment* (OUP 2018, Oxford) 105. https://doi.org/10.1093/law/9780198748434.001.0001

49 P. P. Mitchell, 'Assignment and Novation' in Hugh Beale (ed), *Chitty on Contracts*, Vol 1, (34th edn, Sweet & Maxwell 2021, London) 22-080, 22-093.

The New Civil Code can remedy, at least in part, the problems created by handling the transfer of contract as novation. The New Civil Code's original rule, which provided that the security can be re-registered at its original ranking, is a good example of this. However, the law will not be able to remedy the commercial detriments caused by such a rule. An example of such detriment could be the costs of re-registering securities. This will make these transactions more expensive.[50]

It is true that the transfer of contract could be construed as a novation. For example, the law could provide that even though a novation occurred, this does not lead to the extinction of certain types of securities. I am simply arguing that if we try to understand the parties' intention, that intention focuses on a transfer or a legal succession and not on the termination of the original contract.

3 Transfer of Contract by way of Assignment and Assumption of Obligation

A third option is to treat the transfer of contract as nothing more than an assignment of all rights and claims and assumption of all debts under the contract. As explained above, the New Civil Code's original approach followed this principle, which was also the Hungarian courts' interpretation before the New Civil Code entered into force.

Two conceptual objections have been formulated in the legal literature concerning this approach. Both focus on the distinction between the contract and the rights and obligations arising from it. The first objection is that the assignment and assumption of debts result in a legal succession concerning certain rights and obligations but not in the transfer of the contract. The contract, so goes the argument, continues to exist between the original parties. The second objection is that the contractual position includes rights that are not transferable, such as the right to terminate the contract.[51] This paper will primarily focus on the second objection, as this is of crucial importance. If there are, indeed, rights that cannot be transferred, the transfer of contracts cannot be described as the combined application of the rules on assignment and assumption of debt.

The conceptual objections seem to be misguided, both in the case of assignment and especially in the case of transfer of contracts.

---

[50] English law avoids this problem by holding the security by a trustee on behalf of all the lenders. [Louise Gullifer and Jennifer Payne, *Corporate Finance Law – Principles and Policy* (3th edn, Hart 2020, Oxford – New York) 459].

[51] See, e.g. Lászlófi, Leszkoven (n 45) 17–24, 20; Attila Menyhárd, *Dologi jog* [Property law] (Osiris 2007, Budapest) 167; Attila Menyhárd, 'Engedményezés, jogátruházás, tartozásátvállalás és szerződésátruházás' [Assignment, transfer of rights, assumption of debt and transfer of contract] in András Osztovits (ed), *A Polgári Törvénykönyvről szóló 2013. évi V. törvény és a kapcsolódó jogszabályok nagykommentárja* [Commentary to Act V of 2013 on the Civil Code and related legislation] vol III. (Opten 2014, Budapest) 468–493.

a) Rights transferred together with the underlying claim to the assignee in the case of assignment

The starting point of our analysis concerning what rights are transferred to the assignee, together with the assigned claim in the case of an assignment should be the New Civil Code. The Code expressly states that surety, charge and interests are automatically transferred to the assignee together with the assigned right.[52] This provision correctly recognises that rights typically do not exist in themselves. Other rights are needed to provide real value to the assigned rights.

Within this group of rights, we can distinguish between rights relating to the assigned right and rights relating to the underlying contract. Although it is disputed to what extent rights relating to the assigned right transfer automatically to the assignee, there is no dispute in the legal literature that those rights that are not automatically transferred can be transferred if the assignor and the assignee so agree. An example of this could be the right to liquidated damages. Such a right, most likely, does not transfer to the assignee when the right that is secured by liquidated damages is transferred, but nothing prohibits the parties from expressly providing for the assignment of the right to liquidated damages.

It is worth noting that the rights listed by the New Civil Code that automatically transfer to the assignee may need to be extended. The law should provide, as a default rule from which the parties can deviate, that the assignment transfers all ancillary rights attached to the claim. To take interest as an example, interest is only one of the legal consequences of late performance. It is difficult to find convincing arguments why other legal consequences of the default, for example, a right to liquidated damages, to damages in general or to replacement, are not transferred automatically to the assignee. Thus, when we say that, as a consequence of an assignment, the assignee steps into the shoes of the assignor, we are not only saying that the assignee becomes the legal successor of the assignor concerning the assigned claim but also that the assignee is entitled to all the rights which the assignor had as assignee of the claim. The assignee should thus acquire the rights attaching to the assigned claim, irrespective of whether the law expressly mentions these rights. As a response to criticism in legal literature, the legislator amended the New Civil Code's rule in 2023. The new rule provides that the rights facilitating the performance and relating to the enforcement of the receivable transfer to the assignee.[53]

Moving from the rights relating to the assigned claim and turning to the group of rights relating to the underlying contract, we find an even more heterogenous group of rights. These rights typically affect the existence or the substance of another right. An example of such a right could be the right to terminate the contract from which the receivable that the parties wish to assign has arisen. It is unquestionable that, under Hungarian law, these rights

[52] Section 6:193 (3) of the New Civil Code.

[53] For an overview of the new rule see Péter Gárdos, Change of Parties in the New Hungarian Civil Code from a Comparative Perspective, Studia Iuridica Lublinensia (upcoming).

do not automatically transfer to the assignee. However, some authors argue that these rights can also not be transferred to the assignee even if the assignor and the assignee so agree.[54] Still, it is difficult to find compelling reasons why the parties cannot agree on the transfer of such rights. Take the example of an existing loan agreement. If the creditor assigns merely the receivables under the contract, the assignee would not be able to accelerate or terminate the agreement in the event of default. This result seems difficult to support; so the law should accept the transferability of these rights. Jansen and Zimmermann came to the same conclusion in their recently published Commentaries on European Contract Laws. They argue that '[g]iven the basic principle that the rules on assignment should not be determined on the basis of purely conceptual concerns, but should rather functionally address the practical needs of commerce, there is no good reason why assignments of unilateral rights and powers should not be possible under this rule'.[55]

Based on these arguments, we should conclude that all rights under a contract can be transferred to the assignee. Either these rights transfer automatically with the assignment of the receivable, or it should be acknowledged that the parties may agree to transfer these together with the assigned receivable.

b) Rights transferred together with the underlying claim to the assignee in the case of assignment

So far, this paper has focussed on the situation when the contract remains in existence between the assignor and the counterparty and only certain rights are transferred. The focus should now shift to the situation when one of the parties wishes to withdraw completely from the legal relationship with the other party by transferring its contractual position. Even if, contrary to the arguments in the previous section, one has found compelling reasons why in the case of an assignment certain rights, such as the right to terminate a contract, cannot be assigned together with a right arising from that contract, the question needs to be reformulated: Do we also find that, in the case of a transfer of contract, there is any element of the contractual relationship that cannot be transferred to the party wishing to step into the contract? It seems to be wrong to answer that question in the affirmative.

In the context of the assumption of debt, it has long been recognised in legal literature that the Civil Code accepts that any kind of debt can be assumed.[56] One might wonder why the law sets boundaries on the types of receivables that can be transferred by way of an assignment, when similar rules do not exist in the case of the assumption of debts. The explanation is fairly straightforward. The rules are different because the assumption of

[54] See above, Menyhárd, 'Engedményezés, jogátruházás, tartozásátvállalás és szerződésátruházás' (n 51).

[55] Nils Jansen, 'Assignment of Claims' in Nils Jansen and Reinhard Zimmermann, *Commentaries on European Contract Laws* (OUP 2018, Oxford) 1642. https://doi.org/10.1093/oso/9780198790693.003.0012

[56] Gyula Eörsi, *Kötelmi jog. Általános rész* [Law of Obligations. General Part.] (Nemzeti Tankönyvkiadó 1998, Budapest) 226.

debt takes place with the participation of the creditor. The legislator, therefore, basically acknowledges that if all three parties are involved, all kinds of debts may be assumed. The same should also be true in the case of a tripartite transfer of contract. Just as in the case of assumption of debts, the legislator does not say that certain debts cannot be assumed, the same does not seem justified in the case of rights either.

We see, therefore, that in the case of a transfer of the entire contractual position, no claim, right, or obligation can be found, which should be regarded as non-transferrable. If this analysis is correct, we might conclude that by assigning all rights under the contract and simultaneously with the assignment assuming all debts and obligations arising from the contract, the contractual position can be transferred. This also means that it is not required to regulate the transfer of contract as a *sui generis* transaction.

VI Clarifying the Legal Nature of the Transfer of Contract

The case law of the Hungarian courts provided a very pragmatic solution to the transfer of contractual positions. This approach was useful to cater for the needs of the parties. However, the New Civil Code also provides the opportunity to clarify the legal nature of the transfer of contract. This paper will provide one example that shows why this exercise seems inevitable.

Hungarian law, similarly to the various model laws, provides that the party remaining in the contract can give advance consent to the transfer. This rule is in line with the needs of the market. For example, syndicated loan agreements often provide that the debtor gives its consent that the creditors may transfer their contractual position.[57] The legal nature of the transfer of contracts needs to be properly understood to regulate such advance consent.

The New Civil Code regulates the transfer of contracts as a tripartite contract.[58] As explained above, the New Civil Code also ensures that the party remaining in the contract can give its consent in advance. In this case, says the Civil Code, the assignment takes effect when the party remaining in the contract is notified of the transfer.[59]

This rule seems puzzling. Consent in Hungarian contract law terminology means that a contract is concluded between two parties, and this contract will come into effect only if a third party that is not a party to the contract gives its consent.[60] In this case, however, the party giving consent to the transfer is a party to the transfer.

---

[57] Roy Goode, *Commercial Law* (2nd edn, Penguin UK 1995, London) 109; Kwan Ho Lau, 'Novation and advance consent' (2022) Cambridge Law Journal 1–29.

[58] Section 6:208 (1) of the New Civil Code.

[59] Section 6:209 (1) of the New Civil Code.

[60] Section 6:118 (1) of the New Civil Code.

The origin of the rule can easily be found. An earlier draft of the New Civil Code explained that the rule was influenced by the UNIDROIT Principles.[61] According to them, the transfer of a contract requires the consent of the party remaining party to the contract, and such consent may be given in advance. In such cases, the assignment of the contract becomes effective when a notice of the assignment is given to the other party or when the other party acknowledges it.[62]

However, the legislator seems to have failed to take into account the fact that the New Civil Code has chosen a fundamentally different solution from the UNIDROIT Principles. Contrary to the bilateral solution of the UNIDROIT Principles, the New Civil Code regulated both the assumption of debt and the assignment of contracts as tripartite contracts. As a consequence, the advance consent does not fit smoothly into the New Civil Code's system of offer and acceptance. The New Civil Code's logic would require that the first declaration made in the course of concluding a contract is an offer or an invitation to an offer.

The advance consent will not qualify as an offer for two reasons. First, offers are declarations addressed to one or more parties, but at the time of making the advance consent, the party making the declaration does not yet know who will be the party entering into the contract and therefore cannot make a declaration addressed to the other two parties. Second, offers need to determine the material terms of the contract to be concluded.[63] However, the party giving advance consent cannot determine the essential terms of the contract, as the terms of the transfer agreement will be determined by the party leaving the contract and the party entering the contract.

This uncertainty was presumably also perceived by the legislator, since the title of the Section of the New Civil Code refers to 'advance consent', whereas the text of the provision refers to an 'advanced declaration'.

Advance consent is a necessary and useful tool. The law should, therefore, recognise that the party remaining in the contract can express in advance, either conditionally or unconditionally, that it accepts the change of the counterparty. In order to fit into the system of legal declarations, the New Civil Code should make it clear that, in the case of the tripartite system of transfer of contracts, the party remaining in the contract can make an advance declaration, which is not an advance consent. This advance declaration is unique in at least two respects. First, it is a declaration that is addressed to the party leaving the contract, but at the same time, it is also a declaration not addressed in relation to the party entering into the contract. Second, even though this declaration precedes in time the declaration of the other two parties, it still does not constitute an offer.

---

[61] Péter Gárdos, 'Engedményezés, tartozásátvállalás és szerződésátruházás' [Assignment, assumption of debt and transfer of contract in Lajos Vékás (ed), *Szakértői Javaslat az új Polgári Törvénykönyv tervezetéhez* [Expert Proposal for the Draft of the New Civil Code] (Complex 2008, Budapest) 858.

[62] Article 9.3.4 of the UNIDROIT Principles of International Commercial Contracts.

[63] Section 6:64 (1) of the New Civil Code.

VII Conclusion

This paper provided an introduction to the New Civil Code's rules on the transfer of contracts. It explained that, until the New Civil Code entered into force in 2014, the courts managed to address the needs of the parties to a transfer of contract by accepting that the transfer of contract is possible by way of a combination of the rules on assignment and assumption of debt. This has led to a satisfactory result in a situation where the Old Civil Code provided no rules on the transfer of contract. The New Civil Code intended to codify the transfer of contracts in line with the solution of the courts. However, after the New Civil Code entered into force, several problems emerged in practice. These issues can be traced back to the fundamental question of what a transfer of contract is. This paper argued that the transfer of contract is not a *sui generis* transaction, but a combination of the simultaneous assignment and assumption of all rights and debts under a contract, leading the legal succession. The paper also showed that the legislator should proceed with caution when copying the solutions of other jurisdictions or harmonisation tools. The English law, where the need for advance consent first occurred, does not recognise that a legal succession in the contractual position is possible, and therefore handles a transfer of contract as novation. The UNIDROIT Principles regulate the transfer of contract as a bilateral transaction, whereas the transfer of contract is a tripartite contract under Hungarian law, which leads to the result that the well-drafted solutions of the UNIDROIT Principles cannot simply be 'copied' by the Hungarian legislator. The overall argument of the paper is that once we recognise the legal nature of the transfer of contract, it is possible to regulate it in a way that fulfils the needs of the parties to the contract and at the same time fits into the system of the New Hungarian Civil Code.

Jan Lieder*

Transfer of Contracts under German Law

Abstract

The paper analyses the historical development of the transfer of contracts under German Law, regarding the principle of succession for the assignment of claims and the assumption of debts and the influence of the German Federal Court of Justice on the transfer of shares in a company. It also provides a dogmatic framing of the subject and shows the prerequisites for a valid transfer of contracts under German Law. Additionally, the paper outlines the protection of succession in contract law and how the Draft Common Frame of Reference codified the transfer of contracts. Finally, the author argues for the statutory addition of a third variant, of private assumption of debt, which is effective without the creditor's consent.

Keywords: transfer of contracts, succession, BGB, civil law, assignment of claims, assumption of debts, protection, DCFR

I Freedom of Succession in the Transfer of Contracts

When claims are assigned or a debt is assumed, individual rights are transferred or the successor takes on individual debts.[1] When a contract is transferred *(Vertragsübernahme)*, the *entire* contractual relationship is transferred to the successor whoever fully assumes the contractual legal position of the previous contracting party.[2]

* Prof. Dr. Jan Lieder, LL.M. (Harvard), Freiburg, Germany.

1 The following part is based on Jan Lieder, *Die rechtsgeschäftliche Sukzession* (Mohr Siebeck 2015, Tübingen), 130 ff.

2 Cf. BGHZ 44, 229, 231; 95, 88, 94 ff; 96, 302, 307 f; 137, 255, 259; Knut Wolfgang Nörr in Knut Wolfgang Nörr, Robert Scheyhing, Wolfgang Pöggeler (eds), *Handbuch des Schuldrechts – Sukzessionen – Forderungszession, Vertragsübernahme, Schuldübernahme* (2nd edn, Mohr Siebeck 1999, Tübingen), § 16; Anne Röthel, *Erman BGB* (Harm Peter Westermann et al eds, 16th edn, Dr. Otto Schmidt 2022, Cologne) Vor § 414 margin no. 2; Dominik Klimke, *Die Vertragsübernahme* (Mohr Siebeck 2010, Tübingen) 3.

DOI: 10.54148/ELTELJ.2023.2.25

1 Basic Principles

The transfer of a contract was never written into codified law for historical reasons. When the German Civil Code *(BGB)* was created, a contract under the law of obligations was still regarded as a mere combination of individual claims and debts,[3] not as an organic combination of rights, legal situations and obligations as it is today.[4] Under this interpretation, the succession elements provided by the historic legislator (§§ 398 ff., 414 ff. *BGB*) were sufficient for the transfer of a contract. The explanatory memorandum for the 1st *BGB* draft states that:[5] 'For provisions that are not included, it is conceivable that the intentions of the parties that led to the novation can be solved by way of the rules on the assignment of claims and the assumption of debt.'

In addition, the legislator's restraint can be explained by the state of legal doctrine at the time. Even while the Civil Code was being enacted, there was still some debate about the 'succession character', in other words, the legal type of succession, of the assignment of claims[6] and the assumption of debts.[7] The idea that the legal relationship under the law of obligations was *iuris vinculum* had still not been completely overcome at that time and obstructed the idea that a contractual position/relationship could be transferred.

However, the recognition of the principle of succession for the assignment of claims and the assumption of debts brought a paradigm shift. The idea of a contractual relationship being an excessively personalised legal situation is now outdated,[8] as is the belief that contractual relationships are no more than a sum of individual claims and debts. Because modern legal doctrine considers contractual relationships to be an organism of rights, legal situations and obligations,[9] there is also a need for a special act of (contractual) succession that goes beyond the combination of assignment and assumption of debt, based on which entire contractual positions can be transferred.

This development was encouraged by the German Federal Court's judgments on the transfer of shares in a company, which the Second Civil Senate of the Federal Court of Justice

---

[3] Cf. Helmut Pieper, *Vertragsübernahme und Vertragsbeitritt* (Grote 1963) 13; Karl Larenz, *Lehrbuch des Schuldrechts Allgemeiner Teil* (14 edn, C.H. Beck 1987, Munich) § 35 III; Nörr (n 2) § 16; Astrid Schaffland, *Die Vertragsübernahme* (Lang 2012, Frankfurt a.M.) 31. https://doi.org/10.3726/978-3-653-01374-0

[4] See footnotes 12 and 13.

[5] Motive zum BGB, Bd. 2, p. 78: „Für die Nichtaufnahme von Bestimmungen (…) kommt in Betracht, daß dem Bedürfnisse, welches zu der mittels Wechsels des Gläubigers oder Schuldners sich vollziehenden Novation führte, im Wesentlichen durch die Vorschriften über die Zession (…) und über die Schuldübernahme (…) gedient wird"; cf. further RGZ 119, 114, 118; BGH NJW 1961, 453, 454; Siber, *BGB*, (Gottlieb Planck ed, De Gruyter) Vor § 398 Anm. 2 a; Volker Rieble, *Staudinger BGB* (Dr. Otto Schmidt 2022, Cologne) § 414 margin no. 2.

[6] See above Lieder (n 1) 108 ff.

[7] See above Lieder (n 1) 121 ff.

[8] See above Lieder (n 1) 113 ff.

[9] Busche, *Staudinger BGB* (Dr. Otto Schmidt 2022, Cologne) Vor § 398 margin no. 198, 202 f; Nörr (n 2) § 16; Larenz (n 3) § 35 III; detailed *id.*, JZ 1962, 105, 107 ff; on this development e.g. Annette Voigt, *Umwandlung und Schuldverhältnis* (R. v. Decker 1997, Heidelberg) 19 ff.

has permitted since the 1950s by way of legal succession, if this option is either provided for in the articles of association or is approved by all shareholders.[10] In its landmark ruling of 20 June 1985, the German Federal Court of Justice, following the preceding suggestions from academic literature,[11] finally expressly recognised that contracts of obligation can be transferred 'by legal succession [...] while maintaining their identity'.[12] Accordingly, the transfer of a contract is now generally recognised as an independent unwritten act of legal succession.[13] This corresponds to the requirements of the market as well as to the intention of the parties to transfer contractual positions uniformly.[14] In legal practice, there are numerous examples of transfers of contracts that far exceed the economic significance of the assumption of debt.[15] The transfer of beer supply contracts,[16] energy supply contracts,[17] credit contracts,[18] leasing contracts,[19] rental contracts,[20] heat supply contracts,[21] magazine subscriptions[22] and other successive supply contracts[23] have found their way into the German Federal Court's judgments. The transfer of contracts also plays a significant role in restructuring and reorganising companies.[24]

The recognition of the transfer of a contract as an independent act of succession constitutes the preliminary capstone of a development that removed the legal relationship

---

[10] BGHZ 13, 179, 185 f; 44, 229, 231; Herbert Wiedemann, *Die Übertragung und Vererbung von Mitgliedschaftsrechten bei Handelsgesellschaften* (C.H. Beck 1965, Munich) 51 ff; Werner Flume, *Die Personengesellschaft* (Springer 1977, Berlin) § 17 I, II; on modern legal doctrine see Karsten Schmidt, *Gesellschaftsrecht* (4th edn, Heymanns 2002, Köln) § 45 III 2 b; Matthias Habersack, *Die Mitgliedschaft – subjektives und „sonstiges" Recht* (Mohr Siebeck 1996, Tübingen) 106.

[11] See references in BGHZ 95, 88, 95.

[12] BGHZ 95, 88, 94; confirmed by BGHZ 96, 302, 307 f; 129, 371, 375; 137, 255, 258 f; cf. previously BGHZ 44, 229, 231.

[13] In general see Helmut Pieper, *Vertragsübernahme und Vertragsbeitritt* (Grote 1963, Cologne) 160 ff., 176 ff., 184 ff. and passim; as well as Busche (n 9) Vor § 398 Rn. 197; Eva-Maria Kieninger, *Münchener Kommentar zum BGB* (9th edn, C.H. Beck 2022, Munich) § 398 margin no. 4; Röthel (n 2) Vor § 414 margin no. 2 ff; Ludwig Ennecerus, Heinrich Lehmann, *Recht der Schuldverhältnisse* (Mohr Siebeck 1958, Tübingen) § 87 I; Larenz (n 3) § 35 III; Heinrich Dörner, *Dynamische Relativität: Der Übergang vertraglicher Rechte und Pflichten* (C.H. Beck 1985, Munich) 187 ff; Klimke (n 2) passim; Schaffland (n 3) 37 f. and passim; e.g. BGH NJW 1961, 453, 454; 1966, 499, 500; 1985, 2528, 2530; 1986, 2108, 2110; 1990, 1181, 1182; Susanne Heinemeyer, *Münchener Kommentar zum BGB* (9th edn, C.H. Beck 2022, Munich).

[14] Cf. early on BGHZ 13, 179; ferner Busche (n 9) Vor § 398 Rn. 199; Rieble (n 5) § 414 margin no. 17 f; Anne Röthel, Benjamin Heßeler, 'Vertragsübernahme und Verbraucherschutz – Bewährungsprobe für ein junges Rechtsinstitut' (2008) Wertpapier-Mitteilungen 1001, 1002, 1001 f; Schaffland (n 3) 37 f.

[15] Similar evaluation by Röthel (n 2) Vor § 414 margin no. 2.

[16] BGHZ 129, 371; 142, 23; BGH NJW 1991, 2903; 1995, 2290; 1996, 2094; 1998, 2286; NJW-RR 1993, 562.

[17] BGH NJW 1961, 453, 454; 1981, 1361.

[18] OLG München WM 2008, 1151; OLG Düsseldorf NJW-RR 2001, 641; cf. also BGHZ 26, 142, 147 ff.

[19] BGHZ 142, 23.

[20] BGHZ 72, 394, 396; 95, 88; 137, 255; 154, 171; BGH NJW-RR 2005, 958.

[21] BGH NJW 1981, 1361; 2012, 1718.

[22] BGH NJW 1980, 2518.

[23] BGH WM 1973, 489. – Instructive summary on the development of this line of judgments with numerous references by Nörr (n 2) § 18; see further for current judgments in Schaffland (n 3) 23 ff.

[24] Schaffland (n 3) 26 f.

under the law of obligations from the person of the contracting parties and thus led to a depersonalisation of contractual relationships. It completes – if you will – the objectification and mobilisation of property positions under the law of obligations, which began with the assignment of claims and continued with the assumption of debt.[25] The transfer of the contract is legitimised by the fundamental principle of private autonomy and the principle of freedom of succession that can be derived from it, the effects of which are not limited to legal and debt positions, but especially relate to the contractual relationship as a whole as well.[26] There are no legal obstacles to the parties' intention to achieve this outcome, since German private law, especially in view of the importance of the general concept of succession, does not contain any fundamental prohibition of a change of the contractual party that preserves the identity of the contract. If the continuity of the continuing contractual position is important to the parties, the recognition of the concept of succession cannot be avoided regarding the transfer of the contract.[27] This is even more true because the alternative solution, in the form of a cancellation and re-establishment of the contractual relationship, is associated with higher transaction costs.[28]

2 Doctrinal Issues

The legal doctrine of the transfer of contract has always been characterised by the controversy between the *fragmentation theory (Zerlegungsthese)*, which sees contract transfers as a combination of assignments of claims and assumptions of debt,[29] and the *unity theory (Einheitstheorie),* which sees it as a (uniform) succession *sui generis*, which is fundamentally different[30] from the legally regulated transfer situations.[31] The debate has

[25] Cf. Nörr (n 2) § 16; Schaffland (n 3) 34 f.

[26] Detailed Pieper (n 13) 188 ff; cf. further Nörr (n 2) 17 I, 19 I 1; Busche (n 9) Vor § 398 margin no. 197; Voigt (n 9) 34; Klimke (n 2) 5.

[27] Cf. Schaffland (n 3) 37 f.

[28] Cf. Klimke (n 2) 1.

[29] Gustav Demelius, 'Vertragsübernahme' (1922) 72 Jherings Jahrbücher für die Dogmatik des bürgerlichen Rechts, 241, 252 ff; Enneccerus, Lehmann (n 13) § 87 I 2 (p. 350); Böttger, 'Die Vertragsabtretung nach italienischem Recht' (1974) 73 Zeitschrift für vergleichende Rechtswissenschaft 1, 9; Wagemann, Die gestörte Vertragsübernahme' (2005) Archiv für die civilistische Praxis 547, 552; for judgments see RGZ 119, 114, 118; 130, 115, 118; BGH NJW 1959, 1536, 1538; 1961, 453, 454.

[30] On the basic principles Pieper (n 13) 173 ff., 176 ff; as well as BGH MDR 1958, 90; BAG DB 1973, 924; Christian Grüneberg, *Grüneberg BGB* (Christian Grüneberg, 81th edn, C.H. Beck Verlag 2022, Munich) § 398 margin no. 42; Heinemeyer (n 13) Vor § 414 Rn. 8; Kieninger (n 13) § 398 margin no. 4; Josef Esser, Eike Schmidt, *Schuldrecht, Allgemeiner Teil* (7th edn, C.F. Müller 1993, Heidelberg) § 37 IV; Larenz (n 3) § 35 III; Brecher, 'Besprechung zu Helmut Pieper, Vertragsübernahme und Vertragsbeitritt' (1964) Archiv für die civilistische Praxis 163, 519 ff; Wolfgang Pöggeler, 'Grundlagen und Probleme der Vertragsübernahme' (1995) Juristische Arbeitsblätter 641, 642 f; E. Wagner, 'Form und Beschränkung der Vertragsübernahme sowie die Einwilligung hierzu – BGH DtZ 1996, 56' (1997) Juristische Schulung 690, 692; Voigt (n 9) 29 ff., 34; Schaffland (n 3) 44 ff; see BGHZ 96, 302, 307 f; 72, 394, 395; BGH NJW-RR 2005, 958, 959; BGH NJW 2012, 1718 Tz. 33.

[31] On the significance of this controversy Dörner (n 13) 188 ff; Klimke (n 2) 21 ff., 33; on the other hand Voigt (n 9) 29 ff.

not been very fruitful to date. This is not surprising, as the two positions ultimately only emphasise the two central elements of the transfer of a contract. The dogmatic models turn out to be two sides of the same coin:

On the one hand, the unity theory correctly places succession to the contract in a wider context and considers it to be an independent dogmatic legal figure, going beyond a mere combination of assignment of claims and assumption of debts, the conclusion of which appears as a uniform legal transaction.[32] After all, the intention of the parties involved in the transfer of the contract is typically not to transfer individual rights and obligations from the contractual relationship, but to transfer the contractual relationship uniformly, as a whole.[33] The process of the transfer corresponds to the unity of the subject matter of the transfer, namely the contract.[34]

On the other hand, the recognition of succession to the contract as an independent legal concept cannot hide that the factual prerequisites and legal consequences of the transfer of the contract are mainly assessed according to §§ 398 ff. *BGB*, unless special features specific to the transfer of the contract, those resulting from the succession to the entire contractual legal position, exceptionally require a deviation from the succession provisions under the law of assignment and assumption of debt.[35]

As with the assumption of a debt,[36] the transfer of a contract is a transaction under property law;[37] it is not, as has been suggested[38] with regard to the contracting party entering into the contract, a transaction under the law of obligations at the same time. The obligation of the incoming party after the transaction is not the result of a separate contract of obligation, but is simply a consequence of the contractual position being transferred to the entering party by way of the identity-preserving succession of the incoming party to the contract. In

---

[32] Cf. just BGH NJW-RR 2005, 958, 959; Grüneberg, *Grüneberg BGB* (n 30) § 398 margin no. 42.

[33] Ambiguous Lorenz Claussen, *Gesamtnachfolge und Teilnachfolge* (Nomos 1995, Baden-Baden), 112: „Der Vertragsübergang ist weder Einzelübertragung noch Gesamtnachfolge, sondern eine Sondernachfolge eigener Art."

[34] Accurately Pieper (n 13) 184.

[35] On the whole: Nörr (n 2) § 17 III 1; Klimke (n 2) 30 ff; for example BGH NJW 2012, 1718 Tz. 33.

[36] See Jan Lieder, *Die rechtsgeschäftliche Sukzession* (Mohr Siebeck 2015, Tübingen) 122 f. https://doi.org/10.1628/978-3-16-153034-0

[37] Of the same opinion Busche (n 9) Vor § 398 margin no. 201; Grüneberg, *Grüneberg BGB* (n 30) § 398 margin no. 42; Rieble (n 5) § 414 margin no. 17 f; Klaus Schreiber, *Soergel BGB* (Wolfgang Siebert, 13th edn, W. Kohlhammer Verlag GmbH 2010, Stuttgart) Vor § 398 margin no. 5; Konrad Zweigert, 'Das Statut der Vertragsübernahme' (1958) 23 (3–4) Rabels Zeitschrift für ausländisches und internationales Privatrecht 643, 655; Ulmer/Masuch, 'Verbraucherkreditgesetz und Vertragsübernahme' (1997) JuristenZeitung 654, 655; Christian Wagemann, 'Die gestörte Vertragsübernahme' (2005) 205 Archiv für die civilistische Praxis 547, 551 f; Röthel, Heßeler (n 14) 1002; Voigt (n 9) 36 ff; Schaffland (n 3) 50; cf. judgments BGH NJW 1981, 2747; BAG NJW 1973, 822, 823; OLG Oldenburg NJOZ 2007, 5937, 5941.

[38] Hubert Kaduk, *Staudinger BGB* (Julius von Staudinger, 12th edn, Dr. Arthur L. Sellier & Co. – Walter de Gruyter & Co. 1994, Berlin) Vor § 398 margin no. 36; Larenz (n 3) § 35 III; Ulrich Hübner, 'Vertragsübernahme und Vertragsbeitritt im Grunderwerbsteuerrecht' (1994) Betriebs-Berater 2044, 2045; Michael Volmer, 'Vollzugsprobleme bei Spaltungen' (1999) Wertpapier-Mitteilungen 209, 218; leaving this question open and considering it a 'terminological question' Klimke (n 2) 78 f.

addition, only the withdrawing party to the contract actually transfers a right; not the party remaining in the contract in addition to the withdrawing party,[39] as is argued in the literature with reference to the theory of disposition[40] prevailing in the case of the assumption of debt.

3 Prerequisites for a Valid Transfer of Contract

Taking into account the fundamental guarantees of private autonomy, which, together with the principle of freedom of succession, form the legal foundation of transfers of contract, their validity depends on the consent of all persons involved in the respective transaction. It is the central consequence of freedom of contract and the freedom to choose the contracting party that no one must have a (different) contracting party imposed on them against their will[41]. This can be achieved in different ways.[42]

Either the three legal entities involved in the takeover conclude a genuine tripartite contract, by way of which the contractual position of the withdrawing party is transferred to the incoming contracting party with the continuation of the remaining party unchanged, or the withdrawing and incoming parties agree on the succession to the contract by way of a bilateral contract and the remaining party consents to the takeover. Even if the last option best reflects the successional principle of the contract takeover, there is no objective need to deny the parties the option of a genuine tripartite contract, restricting decisions generally covered by private autonomy.[43] This applies even more as this legal figure is also recognised in cases concerning the assumption of debt.[44] With a view to private autonomy, there can be no objection to structuring the transfer of the contract in a bilateral manner, contingent upon the party remaining in the contract coming to an agreement with the new contracting party with the consent of the withdrawing party or with the consent of the new contracting party with the withdrawing party.[45] Whether the parties use a tripartite agreement or a bilateral contract with conditional consent is to be determined by way of legal interpretation.[46]

---

[39] As stated above for the assumption of debt Lieder (n 36) 123 ff. applies to the transfer of a contract respectively.

[40] Klimke (n 2) 74 ff.

[41] See above Lieder (n 36) 100 ff., 126 ff.

[42] BGHZ 44, 229, 231; 65, 49; 95, 88, 93 ff; 96, 302, 308; 142, 23, 30 f; 176, 86 Tz. 16; BGH NJW 1961, 453, 464; 1998, 531, 532; NJW-RR 2005, 958, 959; NJW 2012, 2354 Tz. 7; Heinemeyer (n 13) Vor § 414 margin no. 8; Grüneberg, *Grüneberg BGB* (n 30) § 398 margin no. 42; Rieble (n 5) § 414 margin no. 4; Rohe, in Bamberger, Roth, *BGB* § 414, margin no. 27; Kieninger (n 13) § 398 Rn. 191 f; Weber in *RGRK, BGB* Vor § 398 margin no. 9, 10; Larenz, *Schuldrecht I,* § 35 III Fn. 43; Dieter Medicus, Stephan Lorenz, 'Schuldrecht I' (19th edn, C.H. Beck 2010) margin no. 800; Nörr (n 2) § 19 I 1; Pieper (n 13) 199 ff; Klimke (n 2) 36 ff; Schaffland (n 3) 102 ff; Knut Werner Lange, 'Rechtsgeschäftliche Vertragsübernahme und Insolvenz' (1999) ZIP – Zeitschrift für Wirtschaftsrecht 1373, 1374; Pöggeler (n 30) 641, 643.

[43] But see Dörner (n 13) 137 ff; correctly opposed by Nörr (n 2) § 19 I 1; Klimke (n 2) 45 ff; Schaffland (n 3) 105 ff.

[44] Detailed Klimke (n 2) 68 ff; Schaffland (n 3) 120 ff; e.g. BGHZ 137, 255, 259.

[45] Of the same opinion Rieble (n 5) § 414 margin no. 4.; Nörr (n 2) § 19 I 1; Schaffland (n 3) 103; of the same opinion Klimke (n 2) 50 ff; similar opinion apparently in BGHZ 96, 302, 309; BGH NJW-RR 2005, 958, 959.

[46] Detailed Klimke (n 2) 68 ff; Schaffland (n 3) 120 ff; for example BGHZ 137, 255, 259.

II The Protection of Succession in Contract Law

The protection of succession under the law on the transfer of a contract – just like the legal construct that is the assumption of a contract itself – has not been written into codified law.[47] In accordance with the basic doctrinal structures, the regulatory models for assignments of claims and debt assumptions must be used to determine the level of protection in favour of the remaining contracting party, which itself neither transfers its contractual legal position nor assumes an (additional) contractual position.[48] It is generally recognised that the legal effects of the transfer of a contract go beyond the mere combination of an assignment of claims and an assumption of debts. However, this unity of the object of the succession and the transaction of succession – which is supported by the parties' intentions – cannot conceal the fact that the modern interpretation of the transfer of contract is strongly based on the law of assignment and debt assumption. This is not surprising, since both areas of law contain the basic elements of a general model of succession, which provides a measure for the legal treatment of contract transfers – at least insofar as the special features specific to transfers of contracts do not require any deviations (i.e. from the fact that no individual claim or debt is transferred), but rather an entire, uniform contractual legal position.

1 Identity and Continuity of the Legal Position of the Remaining Party

Furthermore, the overriding principle of contractual identity under succession law applies.[49] To protect the interests of all parties involved, the succession to the contractual legal position does not affect the content and scope of the object of disposal, namely the contract. Because the new party to the contract acquires the contractual legal position as it existed in the person of the withdrawing party to the contract, the legal position of the other party – the remaining party to the contract – remains unchanged. Consequently, the general principles of the prohibition of deterioration and improvement under contract succession law also apply with regard to the transfer of the contract. Because of the transfer of the contract, the legal position of the remaining party may neither deteriorate in a legally relevant way, nor may it improve to the detriment of one of the other parties to the contract. Accordingly, any objections that the previous contracting parties were entitled to raise in relation to each other remain valid. In analogous application of §§ 404, 417(1)(1) *BGB*, objections may be raised against the new party to the contract even after the transfer of the contract and can be asserted by them against the remaining party.[50] This applies not only to the objection of non-performance of the contract according to § 320 *BGB*, but also to the right of retention

[47] The following part is based on Lieder (n 36) 673 ff.

[48] See above I. 2.

[49] See Lieder (n 36) 567 ff., 633 f., 665.

[50] Detailed on the whole Klimke (n 2) ff; briefly Schaffland (n 3) 83 f.

according to § 273 *BGB*, which can be asserted by the remaining party analogously to § 404 *BGB*[51] and by the transferee in analogy to § 417(1)(1) *BGB*.[52]

The temporal and factual specification of the preservation of objections are not subject to special rules. It is sufficient that the objections were created in the original contractual relationship before the transfer of the contract. If, for example, the limitation period has already started, it does not start anew by virtue of the transfer of the contract, but continues unchanged, even after the change of the contracting party.[53] Restrictions do apply to personal objections which – such as the objection of bad faith – are only based in the person of the withdrawing party.[54] They cannot be raised against the incoming party to the contract. Conversely, however, personal objections against the incoming party can arise for the first time upon their entry into the contractual relationship.

2 Legal Protections for the Uninformed Remaining Party to the Contract

In analogous application of § 407 *BGB*, the remaining party to the contract is also protected if the contract is transferred without their knowledge.[55] Admittedly, the validity of the transfer of the contract under current law depends on the consent of the remaining party to the contract, which must participate, either within the framework of a tripartite agreement of all parties or on the basis of a conditional bilateral agreement by way of consent analogous to § 415(1) *BGB*. However, the original contracting parties can – just as in the case of the assumption of debt[56] – consent to the future transfer of the contract in advance.[57] If the contract is taken over later without the remaining party becoming aware of the transaction, they are just as worthy of protection as the debtor who pays the assignor in ignorance of the change of creditor, or the creditor who performs legal acts in relation to the old debtor in ignorance of the change of debtor. Therefore, the trust of the remaining party to the contract in the unchanged continuation of the contractual legal position of its counterparty must also be protected by analogy with § 407(1) *BGB*. The new party to the contract must therefore accept both performance toward the previous contracting party and all legal transactions that improve the legal position of the remaining party, which are carried out without being

[51] Differentiating between consent and approval for the transfer of a contract: Klimke (n 2) 302 f; on parallels with the assignment of claims see Lieder (n 36) 634 ff.

[52] Joachim Gernhuber, *Das Schuldverhältnis* (Mohr Siebeck 1989, Tübingen) § 30 II 1 d; opposing opinion Nörr, (n 2) § 22 II; Klimke (n 2) 301 f; on parallels with the assumption of debt Lieder (n 36) 665 ff.

[53] Vgl. Rieble (n 5) § 414 margin no. 1 ff; Nörr (n 2) § 22 II; Klimke (n 2) 293 f.

[54] On this see Klimke (n 2) 294.

[55] Pieper (n 13) 212 f; *Dörner* (n 13) 281 f; Klimke (n 2) 313 f; cf. Busche (n 9) Vor § 398 margin no. 225 ff; Grüneberg, *Grüneberg BGB* (n 30) § 398 margin no. 44; Kieninger (n 13) § 398 margin no. 195; Esser, Schmidt (n 30) § 37 IV 2 b; Nörr (n 2) § 22 I.

[56] See Lieder (n 36) 667 f.

[57] See above I. 3.

aware of the transfer of the contract between the remaining party and the withdrawing party with regard to the transferred obligation. However, the remaining party can also choose whether to invoke the effects of good faith by analogy to § 407(1) *BGB* or whether it is better to proceed according to the true substantive legal situation. The protection of the remaining party ends when the transfer of the contract has come to their attention.

3 Contractual Succession following Notification

In the consistent development of the principles developed for the law of assignment of claims and assumption of debt, the trust of the remaining party in the notification of a transfer of the contract that actually never occurred or happened to be invalid is also protected in analogy to § 409 *BGB*.[58] The remaining party, which has no knowledge of the invalidity of any change in their contractual partner, is just as worthy of protection as the debtor in ignorance of the assignment and the creditor in ignorance of the assumption of debt. If the remaining party pays the incoming party on the basis of the alleged transfer of the contract, it is incompatible with the prohibition of deterioration under the law on transfer of contracts and the good faith of the remaining part to burden it with the risk of a double claim or the insolvency risk of the new contractual partner. Therefore, the withdrawing party who has notified the remaining party of the transfer of the contract must be held to accept the performance to the benefit of the new contracting party. Conversely, the notice of a transfer given by the party entering the contract establishes the legitimate expectation of the remaining party that it can now consider the incoming party as the new debtor. In accordance with the rules developed for the law of the assignment of claims and assumption of debt, the respective legal effects depend on whether the remaining party has been notified by the incoming party or the withdrawing party. The remaining party can only be certain in all respects if both parties involved in the transfer of the contract notify them of the transaction.

4 The Remaining Party's Right to Set-off

The general rules on the right to set-off apply to the remaining party to the contract: If the situation allowing the offsetting existed before the transfer of the contract, the remaining party may, according to the correct prevailing opinion,[59] set off against the successor by analogy with § 406 *BGB*. The opposing view, which considers the consent of the remaining party as a waiver

[58] On this and the following Dörner (n 13) 293; apparently also Esser, Schmidt (n 30) § 37 IV 2 b; opposing view Pieper (n 13) 214; Klimke (n 2) 179 ff., who also argues against the application of general rules of good faith (182 ff.); cf. further KG VersR 2003, 490, 491.

[59] Decidedly Nörr (n 2) § 22 II; equally Busche (n 9) Vor § 398 margin no. 222; Kieninger (n 13) § 398 margin no. 191; Grüneberg, *Grüneberg BGB* (n 30) § 398 margin no. 44; Esser, Schmidt (n 30) § 37 IV 2 b; same result by applying § 404 *BGB* also Dörner (n 13) 251 f; differentiating Klimke (n 2) 296 ff.: Application of § 406 BGB by analogy only with prior consent, but not if directly involved in the transfer of the contract.

of the assertion of such objections, amounts to an inadmissible fiction and should therefore be rejected.[60] Moreover, the unchanged continuance of the set-off situation – not unlike the assignment of claims – corresponds to the general principle of identity under contractual succession law.[61] Although the transfer of the contract cannot take place against the will of the remaining party under current law, the remaining party, even if it gives its consent, has no interest in sacrificing a previously existing set-off position. On the contrary, it corresponds to the idea of contractual succession underlying the assumption of the contract and the interpretation of § 406 *BGB* to preserve the set-off position once it has arisen for the remaining party to the contract. Anyone who argues that the remaining party has surrendered its defence options by participating in the transfer of the contract[62] gives credence to the opposite view, which inadmissibly assumes that the remaining party to the contract has waived its rights.

Conversely, the successor is prevented from offsetting a counterclaim to which the former contractual partner is entitled, despite the original offsetting situation by analogy to § 417(1)(2) *BGB*.[63] The successor lacks the necessary legal authority or power of disposal with regard to the counterclaim. In addition, the interests of the withdrawing party would be impaired if the successor could use the claim assigned exclusively to the previous party to the contract for its own interests.

III Transfer of Contract Within the DCFR

In contrast to the assumption of debt, the transfer of a contract has mostly been left uncodified in all but a few continental European countries; however, it is widely recognised as an institution of private law in practice and academia[64].[65] The transfer of a contract is the transfer of an entire contractual position, which is more legally complex than the assignment of an individual claim as well as the assumption of an individual liability due to its legal complexity.[66] In view of its central importance in modern business practice – the draft refers to rental, loan and employment contracts, as well as other continuing obligations[67] – the assumption of a contract has been explicitly regulated in the Draft Common Frame of Reference (DCFR). The brief model rules are based on the related provisions on assignment of claims and assumption of debts.

---

60 Previously still Pieper (n 13) 214 f.

61 Opposing view Klimke (n 2) 297.

62 Klimke (n 2) 297.

63 Nörr (n 2) § 22 II; Dörner (n 13) 251 f; Klimke (n 2) 295 f; Schaffland (n 3) 82.

64 See comparative overview in Christian von Bar, Eric Clive, *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference* (Vol. 1-6 2009) 1104 ff. https://doi.org/10.1515/9783866537279

65 The following part is based on Lieder (n 36) 1114 ff.

66 On the German legal doctrine see I.

67 v. Bar, Clive (n 64) 1102; as well as Christian von Bar, Reinhard Zimmermann, *Grundregeln des Europäischen Vertragsrechts, Teile I-III* (Sellier 2002/2005) 715.

1 The Transfer of a Contract as an Act of Legal Succession

The legal proximity of the transfer of a contract to assignment of claims and assumption of debt suggests it qualifies as a legal act of succession.[68] Art. III.-5:302(1) DCFR expresses this with sufficient clarity when it states that a contracting party can be exchanged for another person based on a legal agreement. It is therefore ultimately about the transfer of a (complex) contractual position from the previous contracting party to the contract transferee. As such, the regulatory model of the DCFR – just like the model rules on debt assumption[69] and the transfer of an individual claim[70] – deliberately decides against a solution based on novation, on the basis of which the transfer of the contract would have to be accomplished in two stages, being, (1) by the termination of the original contractual relationship and (2) by the establishment of a new contractual relationship with identical contents.[71]

The DCFR makes a convincing case for considering the transfer of a contract as an act of legal succession. This ensures a transfer of the contractual position to the successor while preserving the identity of the contract (*sukzessionsrechtliches Identitätsprinzip* – succession law identity principle[72]). In other words, the original contractual relationship continues and only undergoes a change in the contracting parties. The contract transferee enters into the (complex) contractual relationship (in the broader sense) in place of the contracting party leaving the contract[73] and thus acquires all contractual rights and obligations, with the exact content and extent to which they were previously due to the original contractual partner.

2 Participation of the Remaining Contracting Party

In accordance with the assumption of debt pursuant to Art. III.-5:203(1) DCFR, the transfer of a contract in accordance with Art. III.-5:302(1) DCFR – as previously Art. 12:201(1) Principles of European Contract Law (PECL) and Art. 9.3.3 UNIDROIT Principles of International Commercial Contracts (PICC) – requires the consent of the remaining contracting party. Although the explanatory memorandum to the draft does not provide a detailed explanation in this respect,[74] the parallels with the assumption of debt may have been decisive for the requirement of consent. This is not objectionable with regard to the overall coherence of the DCFR, and corresponds to the legal situation in all European legal systems.[75] However, within the framework of a codification of contractual assumption at

---

[68] As well as in German law; see above II. 2.

[69] Detailed Lieder (n 36) 1099 ff.

[70] Detailed Lieder (n 36) 1057 ff.

[71] Vgl. v. Bar, Clive (n 64) 1103; see also v. Bar, Zimmermann (n 67) 715.

[72] Lieder (n 36) 567 ff.

[73] On the relationship under the law of obligations cf. Larenz (n 3), § 2 V; Dirk Looschelders, *Schuldrecht, Allgemeiner Teil* (10th edn, Vahlen 2012) margin no 8; Medicus, Lorenz (n 42) margin no 8.

[74] See v. Bar, Clive (n 64) 1103.

[75] Comparative overview see v. Bar, Clive (n 64) S. 1104 ff.

national and European level, the following reform proposal for a consent-free assumption of debt and, in particular, transfer of contract, should also be considered.[76]

In parallel to the law on the assumption of debt, the contracting parties are also given the opportunity to consent to the transfer of the contract in advance (Art. III.-5:302(1) DCFR); and again, under these circumstances, the assumption of the contract only becomes effective if the remaining contracting party is notified of the subsequent agreed transfer of the contract.[77] The obligation to notify the other party is misplaced in the transfer of a contract,[78] as well as in the transfer of an individual debt.[79] The legitimate interests of the contracting party can also be guaranteed through the creation or analogous application of the provisions created for the protection of debtors in cases of assigned claims (Art. III.-5:119 DCFR).

3 Applying the Law on the Assignment of Claims and Assumption of Debt

The commitment of the DCFR's explanatory memorandum to the doctrine of unity, which is also predominant in German law,[80] and regards the assumption of contract as an act of contractual succession of its own kind and not merely – like the fragmentation doctrine – as a combination of assignment and assumption of debt.[81] The transfer of a contract is thus considered a uniform act of transfer, which covers the entire contractual construct including all rights, obligations and other legal and debt positions and is more than a mere summary of the transaction relating to individual – positive as well as negative – asset positions. However, with a view to the practical result of a contract transfer, the authors of the draft rightly recognise that the contract transfer amounts precisely to this combination of assignment and assumption of debt. Therefore, it is only consistent when Art. III.-5:302(3) DCFR – just as previously Art. 12:201(2) PECL[82] – expressly orders the application of the rules on assignment and assumption of debt, depending on whether the transfer of a right to claim or a liability is at issue.

---

[76] See below IV.

[77] As well as Art. 9.3.4 PICC and – although without explicit regulation – the comments on Art. 12:201 PECL, by v. Bar, Zimmermann (n 67) 716.

[78] Critical Remien, 'Drittbeteiligung am Schuldverhältnis im Europäischen Privatrecht' in Dirk Harke (ed), *Drittbeteiligung am Schuldverhältnis* (Springer 2010, Berlin) 97, 107. https://doi.org/10.1007/978-3-642-04450-2_5

[79] See Lieder (n 36) 1105 ff.

[80] See above I. 2.

[81] See v. Bar, Clive (n 64) 1103 f; also v. Bar, Zimmermann (n 67) 716.

[82] Art. 9.3.6 and Art. 9.3.7 PICC contain more detailed but consistent rules.

IV Reform of the Law of Transfers of Contract

In order to strengthen the freedom of succession further, a statutory addition to the law of debt and contract assumption should be added.[83] In addition to §§ 414, 415 *BGB*, a third variant of private assumption of debt, which is effective without the creditor's consent should be codified. This would be a supplement to the existing law, for which there is a considerable need in practice, particularly with regard to the transfer of contracts.

1 Amendment of the Law of Assumption of Debt

Once again, the overriding principle of freedom of succession[84] means an exception should be made from the creditor's consent requirement. This proposal for reform ensures a structural synchronisation of the law of assumption of debt and the law of assignment, and thus makes a valuable contribution to the development of the entire law of contractual succession in a way that is coherent in terms of inherent value judgments and structure. The proposed variant of debt assumption increases the ability of liabilities and contractual relationships to be circulated and, in this sense, serves to improve the security and ease of legal and commercial transactions. The creditor's interest in satisfaction, as well as the creditor's freedom to choose their counterparty, are no longer protected pre-emptively by the requirement of consent, but by succession protection provisions that apply after the fact. This proposal finds its inherent limits in personal liabilities and contractual relationships, the transferability of which is excluded according to general principles.

In order to protect the creditor's interest in satisfaction, an accessory joint liability of the old debtor should be established, similar to the transfer liability under split-up law pursuant to § 133 Transformation Act *(UmwG)*.[85,86] It should be limited to five years from the date of knowledge of the change of debtor, following which the old debtor shall be released from liability. In addition, the creditor should be granted a claim for security against the transferee in accordance with § 22 *UmwG*.[87] However, there is no need for a corresponding security claim by the transferee's existing creditors.[88]

The liability and security claims are flanked by a supplementary application of succession protection under private law. Principles such as (1) the identity principle under succession law and the prohibition of deterioration, (2) the doctrine of the frustration of purpose *(Geschäftsgrundlage)*, and (3) the right of termination for cause can be applied

[83] The following part is based on Lieder (n 36) 798 ff.

[84] See details in Lieder (n 36) 83 ff.

[85] Robert Hörtnagel, *Umwandlungsgesetz* (Schmitt, Robert Hörtnagl eds, 9th edn, C.H. Beck 2022) § 133 margin no. 1 ff.

[86] For details, see Lieder (n 36) 804 ff.

[87] For details, see Lieder (n 36) 807 ff.

[88] To this very issue, see Lieder (n 36) 809 f.

without any legislative changes. Legislative action is, however, required in the following cases: First, the continued existence of ancillary rights – contrary to § 418(1) *BGB* – should be provided for. Second, the regulatory idea underlying § 407 *BGB* with regard to the protection of creditors in the case of lack of awareness of the assumption of debt must be enshrined in law. Third, following the regulatory idea of § 409 *BGB*, the creditor of the claim is to be protected if they are notified of an assumption of debt.

2 Amendment of the Law of Assumption of Debt

The reform proposal developed for the private assumption of debt – change of debtor without obligatory creditor participation – has an effect on the transfer of contracts. Based on the regulations proposed, it should be possible to transfer a contract without the requirement of consent by the remaining party to the contract. This is supported by the principle of freedom of succession, as it also applies to the assumption of a contract.[89]

The creditor's interest in satisfaction and the principle of free choice of contracting party do not necessarily force a requirement for consent as long as the succession protection mechanisms developed for the assumption of debt are transferred to the transfer of contract. This applies in particular to the accessory joint liability of the withdrawing contracting party and the claim for security against the contract transferee. In addition, there are the usual instruments of succession protection under private law, which are aimed towards the debtor protection system under assignment law and the creditor protection system under assumption of debt law, as well as the doctrine of frustration of purpose and termination for cause. The latter rights of dissolution are of particular importance in the case of the transfer of a contract, because the change of contracting party, namely in the case of continuing obligations and successive delivery contracts, can be associated with intolerable hardship for the remaining contracting party resulting from the person of the party entering into the contract. Apart from this, the free transferability of entire contractual relationships according to the regulatory idea of § 399 *BGB* is excluded from the outset in the case of highly personal contractual positions. Moreover, excluding the remaining contractual partner's participation is intended as a supplement to the current system on contract transfer. The parties are still free to effect the transfer of the contract by means of a conditional bilateral agreement with the consent of the remaining party to the contract or by means of a tripartite transfer agreement.[90] There is immense practical need for a transfer of contract without consent.

The admission of a legal transfer of a contract without the consent of the remaining contracting party does not need to be specially codified, as long as the proposal developed for the assumption of debt is codified. The value judgments of the reformed law on the

[89] See above I.

[90] See above I. 3.

assumption of debt would then have the intended effect on the transfer of contract. In order to avoid legal uncertainties, it nevertheless seems preferable to include a brief reference to the provisions and principles of the law of assignment and assumption of debt in codified law – ideally in § 419 *BGB*, which is currently not used – as a minimum solution. This reference could be designed similarly to Art. III.-5:302 DCFR, which allows a uniform transfer of contractual relationships according to the rules of assignment of claims and assumption of debt.

Roberta Peleggi*

Assignment of Contracts: Italian Law and the UNIDROIT Principles of International Commercial Contracts in Parallel**

Abstract

In contemporary business relations, the possibility for one party to a contract to transfer all of its rights and obligations under the contract to a third party by way of a voluntary act is of great utility. While the possibility to do this generally exists in jurisdictions across Europe, the rules by which it must be done can differ under the relevant national laws, not to mention the fact that a specific legal regime is not articulated in most civil codes. Against this background, this paper compares the approaches taken in Italian law and the uniform rules elaborated at an international level in the UNIDROIT Principles of International Commercial Contracts.

Keywords: legal comparison, contract law, assignment of contracts, Italian law, UNIDROIT Principles of International Commercial Contracts

The possibility for a party to an existing contract to be substituted by a third party by way of a voluntary act (which will be referred to throughout this paper as 'the assignment' or 'transfer of a contract') has great practical and economic relevance in contemporary business relations, especially with respect to long-term contracts. While the ability to substitute a party is generally permitted in the various legal systems across Europe, such a practice is not regulated in a uniform manner, not least because it often lacks specific prescription in continental civil codes.

* Roberta Peleggi (PhD) is associate professor at University La Sapienza of Rome, Faculty of Law, Department of Legal Sciences, and editor-in-chief of the UNILEX database (www.unilex.info) (e-mail: roberta.peleggi@uniroma1.it).

** This article is based on a paper I presented at the 'Workshop on the Change of Parties', organized by the ELTE Faculty of Law in November 2022. I am grateful to Péter Gárdos for the invitation to present at this workshop.

This paper reviews the requirements for the assignment of contracts in Italian law and in the system of the UNIDROIT Principles of International Commercial Contracts 2016 ('the UNIDROIT Principles' or 'the Principles'). To this end, it will consider key aspects of the matter such as the legal nature and process of assigning a contract, the scope of its application, and the legal consequences for the parties involved.

The analysis will address Italian law first (sections I.1–5), and then turn to the Principles (sections II.1–5). This will allow similarities and divergencies between the two approaches to be grasped easily.

I The Assignment of Contracts under Italian Law

1 Introduction

It is important to note at the outset that the Italian Civil Code 1942 ('Code') contains one of the first codifications in Europe on the assignment of a contract.[1] It is therefore fair to say that it represents a model of particular importance.

Far from being comprehensive, the approach in the Code has been supplemented and enriched over time by scholars and judges' decisions in case law, whose contributions have also been essential to settling controversial aspects of the law that were left unanswered by the legislator. Furthermore, the rules on the assignment of contracts have been gradually applied to new situations that the legislator could not have imagined at the time the Code was enacted.[2]

From a diachronic perspective, it is worth recalling that the substitution of a party to a contract – like the assignment of contract right – was not permitted under classical Roman law, as it was at odds with the understanding of a contract implying a highly personal relationship between the parties and, as such, a contract being inextricably bound to the original creditor-debtor(s).[3]

---

[1] Another example is offered by the Portuguese Civil Code (see Arts. 424–427). In the Dutch Civil Code, special rules on the transfer of contracts have been inserted with the revised edition promulgated in 1992 (see Art. 6:159 BW).

[2] For example, rules dealing with the substitution of a party under contract have been applied to new situations such as the sale of shareholdings, the transfer of contracts for the performance of sporting services, and time-shares.

[3] See Heinz Kötz, 'Assignment' in Jürgen Basedow, Klaus J. Hopt, Reinhard Zimmermann with Andreas Stier (eds), *Max Planck Encyclopedia of European Private Law* (Oxford University Press 2012, Oxford, 75–78) 75. However, it should be added that, to cope with the increasing demand for the credit circulation, Roman lawyers started to use two other legal mechanisms to achieve results akin to those produced by assignment, namely, novation and procedural representation: see generally Reinhard Zimmermann, *The Law of Obligations, Roman Foundations of the Civil Tradition* (Oxford University Press 1996, Oxford) 58ff.

The Italian Civil Code of 1865, being a copy of the Napoleonic Code, did not contain general provisions on the subject,[4] and at that time no doctrinal consensus was reached on whether the transfer of a contract was actually possible as an autonomous legal act. The choice by the legislator in 1942 to include explicit rules on the matter in the new Code, as prompted by the contractual practice that had emerged especially within the trade of agricultural commodities,[5] served to overcome that uncertainty.[6]

Furthermore, this served to challenge[7] (and almost unanimously reject) the approach inspired by the German *Zerlegungskonstruktion*, under which the assignment of a contract was viewed, both theoretically and in practical terms, as the result of the simultaneous combination of legal schemes by which a transfer of rights and an assumption of obligations can be achieved: *cessione del credito* and *accollo dei debiti*, respectively.[8]

In the Code, the assignment of a contract is actually understood as a distinctive legal procedure[9] and a device of general application,[10] which allows a contract – or, more

[4] In the 1865 Italian Civil Code, the only relevant provision was Art. 1573, which dealt with the assignment of lease contracts. In France, even though the Napoleonic Code remained silent on the point, French courts (more openly than scholars) were inclined to understand the assignment of a contract *(cession du contrat)* as a legal device of general application. The recent reform of the law of obligations in France has finally introduced new rules on the matter, which partially coincide with the rules in the Italian Civil code (see Arts. 1216-1216-3 of the French Code civil).

[5] Mauro Paladini, 'Della cessione del contratto' in Emanuela Navarretta, Andrea Orestano (eds), *Commentario del Codice civile*, Vol. 3, *Dei Contratti in generale* (UTET Giuridica 2012, Milano, 255–266) 256; Antonio Albanese, 'Della cessione del contratto' in Commentario del Codice civile Scialoja-Branca (Zanichelli 2008, Bologna; Soc. ed. del Foro italiano 2008, Roma) 28ff.

[6] The Ministry's official document accompanying the enactment of the new Code ('Relazione del Ministro Guardasigilli Grandi al Codice civile del 1942') at para. 141, stated that the introduction of specific rules on the matter was to be seen as a victory of commercial practice over the rigid approach taken, so far, by legal scholarship. It is relevant to recall that the new Code brought about, at least formally, the fusion of civil law and commercial law matters into one single legal text.

[7] See Francesco Anelli, 'La cessione del contratto' in Pietro Rescigno, Enrico Gabrielli (eds), *Trattato dei contratti, I Contratti in generale*, Vol. II, (2nd edn, UTET 2006, Torino, 1309–1351) 1309ff.

[8] This opinion is expressed, for example, by Enrico Redenti, 'Dei contratti nella pratica commerciale' (CEDAM 1931, Padova) 149ff; Francesco Ferrara, *Teoria dei contratti* (Jovene 1940, Napoli), 304ff. For further consideration on the issue, see also Renato Clarizia, 'La cessione del contratto' in Pietro Schlesinger (ed), *Il Codice civile commentato* (Giuffré 1991, Milano) 6ff.

[9] In the terminology used by some of first commentators of the new provisions, the legal institution was qualified as sale of a contract ('vendita di contratto'), thus conveying the idea that the transfer could only be done for consideration: see Leonardo Mossa, 'Vendita di contratto' in *Rivista di Diritto commerciale* 1928, II, 633–643; Salvatore Puleo, *La cessione del contratto* (Giuffré 1939, Milano).

[10] See Albanese (n 5) 10. There are, however, contracts that, due to their object or the character of the parties involved, are not capable of assignment: see further consideration of this in Anelli (n 7), 1331ff.

correctly, a contractual position[11] – to circulate.[12] To put it differently, as opposed to the mere assignment of rights, or the assumption of debts, where only isolated obligations or rights are transferred, the assignment of a contract constitutes a contractual form of succession of the whole bundle of rights, duties, and legal positions, arising from one side of the relationship.[13]

This conclusion is reinforced by the fact that the rules governing the matter partially differ from those regarding the transfer of rights and assumptions of debts, even though, to solve certain issues (like, for example, a conflict among a plurality of assignees), recourse must be had to provisions on the assignment of rights.[14]

2 Notion, Legal Structure, Scope of Application

The rules on assignment of contracts ('cessione del contratto') are in Book 4 of the Code, from Art. 1406 to Art. 1410. The Code regulates contract assignment based on the parties' intention. Thus, transfers of a contract by operation of law, of which various examples are found in other Code provisions, are excluded.[15]

Whilst the heading of the first article in the Code on the matter is termed 'notion', and so suggests that it will provide a definition of the phenomenon,[16] the text focuses on the

---

[11] It has been rightfully pointed out by scholars that a contract, as a juridical fact, is not capable of being transferred: see for example Albanese (n 5) 10; Marcello Andreoli, *La cessione del contratto* (CEDAM 1951, Padova). Interestingly, both the Portuguese and the Dutch Civil codes use the expression 'assignment of a contractual position' to describe this act (see Art. 424 CC and Art. 6:159 BW, respectively). In a similar vein, Art. 1216(1) of the French Civil Code describes assignment of a contract as the transfer of the *status* of 'party' to a contract.

[12] Guido Alpa, Vincenzo Mariconda, 'Commento all'art. 1406' in *Codice Civile Commentato* (IPSOA 2013, Milano, 751–774), 751 highlight that the choice of the legislator to regulate the assignment of contracts in an express manner was due to a change in the way a contract was conceived, namely not only as the principal means by which wealth can be transferred but also as a source of wealth itself. This evolution was perfectly in tune with the process of dematerialization of economic wealth in modern capitalistic society. For similar considerations see also Albanese (n 5) 10ff.

[13] See Cesare Massimo Bianca, *Diritto Civile,* Vol. 3 – *Il Contratto* (3rd edn, Giuffré Francis Lefeuvre 2019, Milano, 673–685) 674; Giorgio De Nova, in Rodolfo Sacco, Giorgio De Nova (eds), *Il Contratto* (UTET 2016, Torino) 1729–1746, 1729–1730. Interestingly, it is argued by scholars that, since the assignee's role is that of continuing the original contract in place of the assignor, the assignee should be bound by the way in which the assigned contract was interpreted as between the assignor and the other party to the contract: see in this respect Valerio Pescatore, 'Cessione del contratto e interpretazione' in *Rivista trimestrale diritto e procedura civile 1999*, 583–604.

[14] For the assignment of rights, see Arts. 1260–1267 Civil Code; for assignment of debts, see Art. 1273 Civil Code.

[15] The legal transfer of a contract is mainly the result of the transfer of its object: see, for example, Art. 2558(1) of the Code regarding the transfer of a business, Art. 1599 of the Code regarding lease contracts, Art. 1918(1) of the Code regarding insurance contracts.

[16] Art. 1406 of the Code (Notion): 'Each party can substitute for himself a third person in the relationships arising from a contract for mutual counter performances, if these have not yet taken place, provided that the other party consents thereto' (English translation). The English versions of all provisions in the Code used in this essay are taken from Susanna Beltramo, *The Italian Civil Code and Complementary Legislation* (Thomson West 2012, St. Paul, Minn.)

effects resulting from the transfer, described in terms of a 'substitution', *viz*., a replacement, or a change of parties on either side of the relationship. It is unanimously recognised,[17] however, that the expression 'contract assignment' in Italian law covers not only the legal effects deriving from a transfer of a contract but also the juridical act itself by which a party may assign its entire contractual position to a new party who steps into the contract originally stipulated for the former.

Interestingly, the debate surrounding the correct legal structure for the assignment of a contract – a matter which is not without practical significance[18] – has continued even after the enactment of the 1942 Code. According to current scholarly opinion,[19] which is shared by the Italian courts,[20] contract assignment qualifies as an agreement that involves three parties: the withdrawing party *(assignor)*, the new party *(assignee)*, and the other original contracting party *(other party)*.[21] This means that, in order for an assignment to occur, not only is agreement between the assignor and the assignee necessary but also consent by the other party. This appears sound, as the other party is the one who remains a party to the contract and whose position is most affected by the change of the original counterparty.[22]

However, some authors who are still influenced by legal opinion developed prior to the Code being approved, hold that the assignment of a contract – if not in all cases, then in at least certain situations – qualifies as a bilateral contract (between the assignor and the assignee only), with the consent of the other party not amounting to an essential element of the transaction. Rather, the other party's consent is merely a requirement for the effectiveness of, or is a condition precedent, to the assignment (i.e., a 'suspensive condition').[23]

As far as the scope of application of the assignment of a contract is concerned, Art. 1406 of the Code, taken at face value, suggests that it can only been carried out with bilateral contracts that remain unperformed. Hence, whereas contracts involving instantaneous performance are excluded from being capable of being assigned, long-term contracts are the most typical type of contracts in respect of which assignment can occur.

---

[17] See Bianca (n 13) 673; Vincenzo Roppo, 'Il Contratto' in Giovanni Iudica, Paolo Zatti (eds), *Trattato di Diritto privato* (Giuffré 2011, Milano) 553ff.

[18] See for more details Sec. 4, below.

[19] See for example, Bianca (n 13) 680; Alessio Zaccaria, 'Cessione del contratto e garanzia della sua validità' in Rivista di Diritto civile (1958) 241ff, (258ff); Franco Carresi, 'Cessione del contratto' in *Novissimo Digesto Italiano* (UTET 1957, Torino) 147ff; Ugo Natoli, 'Alcuni aspetti della cessione del contratto secondo il nuovo codice civile' in *Giurisprudenza complementare della Corte di Cassazione* (1946) I, 314ff.

[20] See for example the decisions in the Italian Court of Cassation, 30525 (22 November 2019); and Italian Court of Cassation, 6157 (16 March 2007).

[21] The prevailing doctrine defines contract assignment as a plurilateral – or, more correctly, a trilateral or triparty – agreement where the parties do not have a common purpose, and with translative effects [see, also for further references, Clarizia (n 8) 33ff].

[22] It may indeed happen that the financial situation of the new party is not as solid as that of the assignor.

[23] See Raffaele Cicala, *Il negozio di cessione del contratto* (Jovene 1962, Napoli) 245ff. On the similar approach adopted by French law, see Olivier Deshyes, Thomas Genicon, Yves-Marie Laithier, *Réforme du droit des contrats, du règime general et de la prevue des obligations* (LexisNexis 2016, Paris) 463.

In the past and until the seventies, Art. 1406 was interpreted by commentators and applied by the Courts in this restrictive way. However, a more flexible approach has gradually prevailed, leading to an extension of the original scope of application of the practice of the assignment of a contract. Under current prevailing opinion, there are no good reasons to deny assignment where a contract entails obligations on one party only (provided that this is an onerous contract[24]),[25] and where either party has already performed its obligations partially[26] or even totally,[27] and also in relation to contracts involving obligations of a personal nature.[28]

Moreover, the assignment of a contract that has real effects has long been controversial.[29] Relying on a narrow interpretation of Art. 1406 of the Code, national courts, in agreement with some commentators, have been for a long time inclined to deny the validity of an assignment of this type of contract. The main objection is that mere consensus between the parties to the contract is sufficient for the contract to be transferred ('regola del consenso translativo').[30] However, a more liberal approach has gradually gained acceptance,[31] with the consequence that where the assignor is the buyer under the contract, the act of assignment is considered as capable in itself of producing the transfer of ownership from the assignor to the assignee.

Lastly, two other issues deserve mention. First, though it is true that, upon assignment, it is the contract in its original shape that continues to apply, case law[32] and scholars[33] acknowledge that the parties may agree on some changes to the original contract, provided

---

[24] This maybe the case in Italy for a loan or a deposit agreement.

[25] De Nova (n 13), 1735; Vincenzo Carbone, 'La cessione del contratto' in Mario Bessone (ed), *Trattato Diritto privato*, Vol. 13, (Giappichelli 2000, Torino), 294; *contra* Enrico Colagrosso, *Teoria generale delle obbligazioni e dei contratti*, (2nd edn, Ed. Stamperia nazionale 1948, Roma), 316; Franco Carresi, *La cessione del contratto* (Giuffrè 1950, Milano), 45.

[26] See for example, De Nova (n 13), 1735; contra Messineo (n 28), 47. This is the case of contracts that are to be performed over a period of time, in respect of which an assignment produces only *ex nunc* effects, meaning that it will not affect the performance of obligations that have already been made under it.

[27] Scholars emphasize, to reinforce a position in favour of the assignment of the contract, even in the case where one party has already performed all of its obligations, that due performance does not necessarily cause the contract's effects to cease. Therefore, an assignment may still be possible: see for example Alpa, Mariconda, 753–754.

[28] See for example Clarizia (n 8), 26; De Nova (n 13) 1736, Anelli (n 7) 1332. Contra Carresi (n 25) 51; Francesco Messineo, 'Il contratto in genere' in *Trattato Cicu-Messineo* (2nd edn, XXI Giuffré 1972, Milano) 39.

[29] For further references see Ilaria Riva, 'Cessione del contratto ed effetti reali' (2002) Rivista Trimestrale di Procedura Civile, 635–650; see Flaminia Besozzi, 'La cessione del contratto a effetti reali' in *Contratti* I, (2000) 979–983.

[30] From this perspective, an assignment on the part of the seller would qualify as an assignment of a right to payment, while an assignment by the buyer would simply amount to a transfer of the obligation to pay the price: see for example Messineo (n 28) 11; Giuseppe Mirabelli, *Delle obbligazioni. Dei contratti in generale* (Arts. 1321–1469), (3rd edn, UTET 1980, Torino)

[31] See the decisions of the Italian Court of Cassation (2 June 2000); Anelli (n 7) 1319 ff; 271; Besozzi (n 29) 983.

[32] See for example Italian Court of Cassation, 8098 (9 September 1990).

[33] See Bianca (n 13) 674; Roppo (n 17) 556; De Nova (n 13) 1732.

that those changes do not significantly alter the original contractual terms.[34] Second, at least according to some legal commentators and court decisions,[35] an assignment can be partial, meaning that it can be limited to certain obligations or rights under the contract.

3 Contract Assignment and Similar Figures

Leaving aside the disputed issue regarding the determination of the so-called 'causa' (cause) of the assignment of a contract which is mainly of academic relevance,[36] it is useful to distinguish assignment from other three-party legal devices in Italian law that appear functionally akin to it. These include the actions of subcontracting, contracting where persons are to be named, and contracting in favour of third persons.

In relation to subcontracting,[37] the main difference with it compared to contract assignment is the fact that with the former a new contract is formed between one of contracting parties and a new party with the same object as the first contract, in which the new contracting party, as subcontractor, assumes a new (and opposite) role compared with that it had in the first contract.

In relation to a contract for which persons are to be named,[38] it differs from a contract assignment essentially because it involves a party reserving, upon stipulation, the power to subsequently name who will acquire the quality of a party to the contract from the very beginning.[39]

---

[34] Changes significantly altering original contractual terms would be those that affect essential elements in the agreement. Those changes are precluded because the agreement would then qualify as a novation, the latter resulting in the extinction of the original contractual relationship and in the simultaneous replacement by a similar, yet new contract: see Anelli (n 7) 1327; Alpa, Mariconda (n 12) 754.

[35] In the affirmative, Bianca (13) 674; De Nova (13) 1733; Italian Court of Cassation, n. 7676 (10 July 1991) published in *Giustizia Civile, 1992*, I, 2177.

[36] Since the causa – in simplest words, the socio-economic function of the contract – is among those requirements for the contract's validity under Italian law (see Art. 1325 of the Code), it will suffice here to observe that according to prevailing opinion, the cause of contract assignment is a typical one, yet consisting either of the very transferring of the entire contractual position ('organismus') from one party to the new party [see Clarizia (n 8) 48ff], or of the subjective modification of the contractual relationship [see Guido Alpa, Andrea Fusaro, 'La cessione del contratto' in *Digesto delle discipline privastiche*, Sez. civ., II (UTET 1988, Torino) 339; Giovanni Criscuoli, 'Il negozio di sostituzione e la cessione del contratto' in *1957 Giustizia Civile* 1605; Andreoli (n 11) 29]. According to other authors, however, the causa is generic and variable, meaning that, to determine such a requirement, one should look either at the cause of the underlying assigned contract [see Emilio Betti, *Teoria generale delle obbligazioni, III*, 2 (Giuffrè 1955, Milano) 37ff; Carresi (n 19) 148] or at the concrete function that gave reason to the contract assignment under the circumstances (e.g., a sale, donation, or settlement): see Cicala (n 23) 888ff; Bianca (n 13) 677ff; Roppo (n 17) 557.

[37] It is interesting to note that the Code does not contain a general subcontracting procedure, yet it is referred to in specific instances (see Arts. 1594, 1656, 1770, and 1929 of the Code).

[38] See Art. 1401ff. of the Code.

[39] In some cases it may be difficult to distinguish between the two: see Alpa, Mariconda (n 12) 761.

Additionally, a contract in favour of a third party[40] diverges from an assignment of a contract because it does not imply the transfer of an already existing contractual position. Also, with the former, the third party ('beneficiary') remains extraneous to the contract, unlike with the proposed assignee under an assignment.

To conclude on this point, and before addressing further aspects with respect to assignment of a contract, it is significant to note that the line of demarcation between contract assignment and transfer of credits is not clear-cut. In theory, there are visible differences between the two. First, the assignment of a right/claim (i.e., a transfer of credit) has a more limited effect compared to the assignment of a contract, as the former is concerned only with isolated rights of the assignor. Further, in respect of a transfer of credit, while the ownership of a right remains with the original creditor-assignor, the possibility to enforce it is transferred to the assignee.[41] Also with a transfer of credit, importantly, the assignor can assign its claim even without the consent of the debtor,[42] and the effects on the assignee will vary depending on whether or not the assignment is made for consideration.[43] Notwithstanding all of this, there might be situations where these two actions (an assignment and transfer of credit) are very similar in character. For example, this is the case where a unilateral contract is assigned, or an assignment clause is drafted in such general terms as to allow for the transfer of all existing and future credits under the contract.[44]

4 Form Requirements and the Consent of the Other Party

Despite Art. 1407 of the Code being titled 'form', it does not require formalities to be observed. Rather, it is concerned with the modalities in which the other party's consent can be expressed.[45] It should not be neglected, however, that certain provisions in the Code and other legislation prescribe formal requirements for the validity of a contract to be assigned.[46] The prevailing opinion among scholars and in the case law is also that the transfer of an agreement must satisfy the same formal requisites, if any, as for the transfer of the contract that is being transferred.[47]

---

40 See Art. 1411-1413 of the Code.

41 See, among others, Italian Court of Cassation, 17727 (6 July 2018).

42 Cf. Art. 1260 of the Code.

43 Cf. Art. 1266 of the Code.

44 Cf. Alpa, Fusaro (n 36) 342.

45 Art. 1407(1) of the Code: 'If one party has previously consented that the other substitutes a third person for himself in the relationships arising from a contract, the substitution is valid as to him from the time when he was notified of the substitution or accepted it'.

46 This is the case, for instance, for the assignment of a contract hiring a professional football player; a contract for transfer of a business (Art. 2556 of the Code), or the transfer of shares. Furthermore, an assignment concluded by way of a gift needs to be stipulated by a public act (see Art. 782 of the Code).

47 By contrast, Art. 1216(3) of the French Civil code provides as follows: 'La cession doit être constatée par écrit, à peine de nullité'.

As to the consent of the party that remains in the contract ('the other party'), this can be given (expressly or tacitly[48] and without any prescribed form) at the same time, or after, agreement between the assignor and assigned has been reached.

Importantly, consent may be also given in advance to the assignment of a contract,[49] in which case the transfer becomes effective once the assignment has been notified to the other party, or when the other party has accepted it.[50] Notification of the other party's consent is the responsibility of the assignor or the assignee. Hence, if the other party performs its obligations *vis-à-vis* the assignor before receiving notification of an assignment, the other party will be released from its obligations under the contract validly.[51] Once the assignment has become effective,[52] the assignor is no longer a party to the contract. Accordingly, the assignor's creditors cannot pursue claims against the assignor stemming from the assigned contract.

Under the prevailing theory that considers contract assignment a triparty agreement, consent by the other party – regardless of whether it is given in advance or not – is essential. This means that completion of the contractual structure can occur either instantaneously or progressively through a process of successive formation.[53] As a corollary, before consent to a transfer is given by the other party, an assignment has no effect.[54]

Conversely, from the perspective of those who view assignment as a bilateral contract, it is natural to consider that the lack of consent by the other party may produce a transfer of the contract between the assignor and the assignee in the form of a transfer of rights and/or

---

[48] See for example Italian Court of Cassation, 6157 (16 March 2007).

[49] See Art. 1407(1) of the Code. Consent in advance can result from the insertion of a specific clause in the contract. However, when such consent is inserted in a clause to a contract between a professional and a consumer, such a clause is presumed to be unfair [see Art. 33(2) Codice della consumazione]. Sometimes consent being given in advance is understood as a pre-condition for the conclusion of the original contract.

[50] For an equivalent provision see Art. 1216(2) of the French Civil Code. Under Art. 1407(2) of the Code, a special case occurs where a clause 'to the order' (or the equivalent of this) is inserted into a document embodying all the elements of a contract ('contratto all'ordine o stabilito di commercio'). In this case, the consent or the notification to the other party is irrelevant, as an endorsement of the document causes the endorsee to substitute the endorser in the contract.

[51] The knowledge of the substitution that the assigned party derives from the performance by the assignee cannot be considered equivalent to notification.

[52] Nothing prevents the parties deciding that the effects of the assignment will take place at a later time than that at which the agreement was reached.

[53] As rightfully pointed out by scholars, progressive formation of an assignment may occur, in principle, also when the agreement is preliminarily reached between the assignor and the other original contract party, and the option remains open for the assignee to agree to the assignment: see Carresi (n 19) 149.

[54] The essentiality of the other party's consent helps to resolve in the negative the issue as to whether a provision agreed upon between the parties [for example, that the contract is personal to them) may prevent a contract from being assigned, on the premise that the contractual parties are always free to change their mind: see Carresi (n 19) 148]. Nevertheless, with respect to the prohibitions relating to the assignment of rights, Italian law proceeds from the principle that contractually agreed limitations are valid, but this kind of prohibition will not prevent the assignee from acquiring the claim, if the latter acted in good faith [see Art. 1260(1) of the Code].

an assumption of obligations.[55] However, other scholars take a middle position and propose that two situations can be distinguished depending on whether an assignment provokes strong or weak effects.[56] In the first situation, it is argued that consent is essential. This may occur, for example, where, with the assignment, the original obligations assumed by the other party are altered, or payment of a sum of money is owed to the latter in return for its consent to the transfer. The second situation would instead occur when the assignment only affects the subjective dimension of the contractual relationship. In this second case, consent by the other party is not necessary.[57]

5 The Legal Effects on the Parties Involved

The legal consequences flowing from a contract assignment on the parties involved are regulated by the Code, which has regard to the three distinct bilateral segments in which, in abstract terms, an act of assignment can be disentangled.[58]

a) The effects as between assignor and the other party

The natural outcome of a contract assignment is that the assignor is released from its obligations *vis-à-vis* the other party as from the moment when the assignment becomes effective.[59] However, the other party is free to declare a contrary intention, for example because it does not have sufficient confidence in the new party's solvency. That being the case, the other party is entitled to require performance from the assignor as a subsidiary debtor, meaning that the latter will be bound to perform the contract if the assignee fails to do so. In other words, the other party must necessarily first seek performance from the assignee before addressing the assignor.[60]

---

[55] See Cicala (n 23) 230ff. The same conclusion is, however, reached by some scholars who agree with the first approach, at least when it can be demonstrated that such a result is compatible with the parties' intent: see Alpa, Fusaro (n 36) 345.

[56] See Roppo (n 17) 558ff.

[57] As a result, if consent is lacking, the effects of a transfer of rights and/or an assumption of obligations will occur. On the contrary, if the other party's consent is given in advance, this should be understood as an authorisation of the transfer agreed upon between the assignor and the assignee only. If consent is given after that substitution has been made, it should be interpreted as approval. In a similar vein, see Bianca (n 13) 676.

[58] Art. 1408 of the Code deals with the effect as between the assignor and the other party, while Arts. 1409 and 1410 are concerned with the effects between the assignor and the assignee, and the assignee and the other party, respectively.

[59] See Art. 1408 of the Code; an implicit effect of this provision is that once assignment becomes effective, the assignor is no longer entitled to require performance from the other party. For a similar rule see Arts. 1216-1 French Code civil.

[60] Non-performance by the assignee is sufficient to trigger the ability to request performance from the assignor. However, as a corollary to the principle of good faith in contract performance, the other party can be required

Interestingly, some of those who look at an assignment as a triparty contract, maintain that the decision not to release the assignor would prevent the assignment from producing effects entirely, as it would amount to a proposal directed to both the assignor and the assignee to change the agreed terms in order to reach a new agreement. Consequently, this view requires the assignor and assignee to adhere to the assignment.[61] According to the opposite opinion, Art. 1408 would instead make sense only where the other party has consented to the assignment in advance, declaring that it does not intend to release the assignor.[62] Other authors convincingly support the view that the provision would entitle the other party to adhere to the assignment, though modifying *ex uno latere* (i.e from one side) the effects that would naturally descend from it on the assignor.[63]

b) The effects as between assignee and the other party

Under Art. 1409, the original party to a contract is entitled to claim all defenses arising from the assigned contract against the assignee that it could have raised against the assignor, regardless of whether the grounds of defence arose before or after that the assignment became effective.[64] Even if not stated in express terms, it is recognised that the other party is entitled to withhold performance, alleging that the contract is invalid, invoking a liquidated damages clause or an exemption clause in the contract, or alleging that performance was seriously defective to justify termination of the contract.[65]

As a rule, defences based on other relationships with the assignor are precluded, save that the other party has expressly reserved a right to them when it consented to the assignment of the contract.[66] One example is the defence of set-off.

Although Art. 1409 does not expressly state so,[67] most scholars and case law maintain that the assignee – which acquires all the assignor's rights to payment or other performance under the contract and all rights securing performance – can in turn avail itself of all exceptions and actions available to the assignor *vis-à-vis* the other party arising under the assigned contract.[68]

---

to compensate the assignor for any damage resulting from untimely notice, if they fail to inform the assignor of non-performance within fifteen days from the date on which non-performance has occurred.

61 See Carresi (n 19) 150; Andreoli (n 11) 66; Carbone (n 25) 330–331. 25

62 See Cicala (n 23) 211ff.

63 See Anelli (n 7) 1342.

64 Art. 1409 of the Code: 'The original party can raise against the assignee all defenses arising out of the contract but not those based on other relationships with the assignor, unless he expressly reserved a right thereto when he consented to the substitution'.

65 See Carbone (n 25) 337ff. 25

66 For a corresponding provision see Art. 427 of the Portuguese Civil Code.

67 For a different approach, see Arts. 1216-2(1) French Civil Code.

68 See Anelli (n 7) 1345; Carbone (n 25) 339. It has been established by the Courts that, as opposed to the assignee of a claim, in a contract assignment an assignee may even invoke the existence of an arbitration clause or ask for termination of the contract: see for example Italian Court of Cassation, 3034, 10 February 2020.

c) The effects as between the assignor and the assignee

Under Art. 1410 of the Code,[69] the assignor is bound to guarantee that the contract that is being transferred is valid (cd. cessione *pro soluto*). This provision, however, is not mandatory and may be excluded by the parties, even though debate exists on whether it applies both when the assignment is made for consideration and gratuitously.[70]

Even though Art. 1410 refers exclusively to the validity of the contract, the assignor's guarantee should extend to all cases where the contract turns out to be rescindable or without effects.[71] It is also up to the assignor to decide to guarantee that the contract will be duly performed ('cession pro solvendo') by the other party. By assuming such an obligation, the assignor takes the position of a surety.[72]

II The Assignment of Contracts under the UNIDROIT Principles

1 Introduction

Sponsored by a prestigious intergovernmental organisation,[73] the UNIDROIT Principles are considered one of the most successful attempts to harmonise the law of contracts at an international level.[74]

Started as a project in the 1960s under the ambitious title of 'Progressive Codification of International Trade Law', the Principles were produced by a group of independent experts coming from all major jurisdictions and geo-political areas of the world. The group was chaired by Professor Joachim Bonell.[75]

---

[69] Art. 1410 of the Code: 'The assignor is bound to guarantee the validity of the contract. If the assignor undertakes to guarantee the performance of the contract, he is liable as a surety for the obligations of the original party.'

[70] For those who contest the liberal approach, if an assignment is made gratuitously, the scope of the guarantee would be framed in the stricter limits laid down for the donor in Art. 797 of the Code: see, for example, Bianca (n 13) 679; Carbone (n 25) 348.

[71] See Carbone (n 25) 349.

[72] See Bianca (n 13) 679.

[73] The International Institute for the Unification of Private Law (UNIDROIT) was set up in 1926 as an auxiliary organ of the League of Nations. Due to the demise of the League, the organization was subsequently re-established as an independent intergovernmental organization, seated in Rome, to which 63 countries are currently members.

[74] See for example Henry D. Gabriel, 'The Role of Soft Law in Institutional International Commercial Law and Why It is a Good Idea' in UNIDROIT (ed), *Eppur si muove: The Age of Uniform Law. Essays in honour of Michael Joachim Bonell* (Rome 2016, 273–285) 284.

[75] See, for more details, Michael Joachim Bonell, *An International Restatement of Contract Law* (3rd edn, Transnational Publications Inc., Ardsely 2005, New York) 19ff.

Appearing originally in 1994, the Principles are now in their fourth edition, which was adopted in 2016.[76] Closely following the U.S. Restatements of the Laws model, they are composed of a Preamble and 211 black letter rules ('Articles'), which are subdivided into 11 Chapters, and complemented by extensive Comments and Illustrations.[77]

The Principles have been defined as a novelty with regard to their juridical nature compared to more traditional legal sources.[78] Also, they are considered an outstanding contribution to comparative legal science and global legal thinking.[79] Their content can be described as a mixture of tradition and innovation.[80] They contain, indeed, not only rules that reflect solutions found in the majority of legal systems in the world (which is defined as their 'restatement function'), but they also provide a number of solutions that break with usual paths, chosen by the drafters for being considered the most persuasive or, pragmatically suitable to respond to the special needs of cross-border relations[81] (which is called their 'pre-statement function').[82]

The rules in the Principles on the assignment of contracts – a total of seven articles – are contained in Section 3 of Chapter 9. Sections 1 and 2 deal with the assignment of rights and the transfer of obligations, respectively.[83] When deciding to draft special provisions on

---

[76] In addition to the five versions of the Principles which correspond to the official languages of the UNIDROIT (i.e. English, French, German, Italian and Spanish), the Principles have also been translated into Arabic, Chinese, Japanese, Persian, Portuguese, and Russian, among other languages. Being thus able to facilitate communication between parties from different cultural and legal backgrounds significantly, the Principles have been well defined as a contractual *Esperanto*: see Francesco Galgano, Fabrizio Marrella, *Diritto e prassi del commercio internazionale* (3rd edn, CEDAM 2011, Padova) 309.

[77] While with both the 2004 and 2010 editions, new chapters were added with a view to covering virtually all of the most important topics of general contract law, the latest edition contains only a few additions to the black letter rules and the comments aiming to adapt the Principles to the specific needs of long-term contracts (see for example, Giuditta Cordero Moss, 'The UNIDROIT Principles: Long-Term Contracts' in Pietro Galizzi, Giacomo Rojas Elgueta, Anna Veneziano (eds), *The Multiple Uses of the UNIDROIT Principles of International Commercial Contracts: Theory and Practice* (Giuffré 2020, Milano) 75ff.

[78] See Jürgen Basedow, 'Uniform law Conventions and the UNIDROIT Principles of International Commercial Contracts' (2000) 5 (1) Uniform Law Review 129–139.

[79] See Joseph M. Perillo, 'UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and a Review' (1994) 43 Fordham Law Review 281–317.

[80] See Michael Joachim Bonell, 'The Law Governing International Commercial Contracts and the Actual Role of the UNIDROIT Principles' (2018) 23 (1) Uniform Law Review 15–41, 22. https://doi.org/10.1093/ulr/uny001

[81] These include rules relating to the validity of mere agreement (see Art. 3.1.2), the effects of hardship (see Art. 6.2.3), and the possibility for the parties to agree on the duration of limitation periods (see Art. 10.2), to name a few examples that have made 'inroads' into recent reforms of domestic law.

[82] On the traditional and more innovative provisions in the Principles, see Bonell (n 75) 33ff.

[83] This structure of the Principles was intended to help with their clarity and accessibility. However, the rules in the three sections of the Principles are interrelated, thus cross-references could not be avoided. Also, like other subjects covered by the Principles in respect of which divergent national approaches exist, and the fact that terminology in this area is particularly complex, the drafters aimed to avoid using specific notions and concepts that closely resembled any particular legal system or may create confusion: see UNIDROIT 1999 Study L – Doc. 61, 1-2 *(Assignment of Contractual Rights and Duties – Position Paper).*

the assignment of contracts for the second edition of the Principles, the Working Group observed that 'The absence of such provisions is often pointed out as a regrettable gap in many civil codes, especially in the light of the solutions available in Italy, Portugal, and the Netherlands'.[84]

Interestingly, sets of rules on the assignment of contracts, though much more limited in number than in the UNIDROIT Principles, are provided both in the Principles of European Contract Law ('PECL'),[85] and the Draft Common Frame of Reference ('DCFR').[86] There are many analogies between these rules and the UNIDROIT Principles.[87] In contrast, the 1980 Vienna Sales Convention ('CISG')[88] does not contain provisions on the matter.

2 The Notion, the Scope of Application, and the Requirements

The opening provision on the assignment of contracts in the Principles usefully defines the assignment of a contract as the transfer from one person (the 'assignor') to a new party (the 'assignee') of the former's rights and obligations arising out of a contract with another person ('the other party').[89]

Bearing in mind that the UNIDROIT Principles are a soft law instrument, it comes as no surprise that transfers effected by operation of law, like those resulting from mergers or changes in the organisation of a company, do not fall within the scope of application of Chapter 9, Section 3 of the Principles.[90]

---

[84] Cf. UNIDROIT 1999 Study L – Doc. 61, 16.

[85] The Principles of European Contract law, prepared by the Commission on European Contract Law chaired by the renowned Danish scholar Ole Lando, appeared in three different editions in almost the same years as the first and second editions of the UNIDROIT Principles [for more details see Michael Joachim Bonell, 'The UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law: Similar Rules for the Same Purposes?' (1996) 1 Uniform Law Review 229–246]. The rules relating to the transfer of contracts are contained in Art. 12:201 PECL.

[86] The Draft Common Frame of Reference (the 'DCFR') prepared by the Study Group on the European Civil Code and the Research Group on Existing EC Private Law, and published in 2009 in ten Books, has a much broader coverage than the UNIDROIT Principles [see Michael Joachim Bonell, Roberta Peleggi, 'UNIDROIT Principles of International Commercial Contracts and Draft Common Frame of Reference: A Synoptical Table' (2009) 14 Uniform Law Review 437–554, https://doi.org/10.1093/ulr/14.3.437). For the assignment of contracts, see Arts. III.-5:301-5:302 DCFR.

[87] For a comparison between the rules in the UNIDROIT Principles, the European Principles and the DCFR concerning assignment of contracts, see Marcus Baum, 'Transfer of Contract' in Basedow, Hopt, Zimmermann, Stier (eds) (n 3) 1670–1673 (1671ff).

[88] United Nations Convention on Contracts for the International Sale of Goods, opened for signature on 11 April 1980 (entered into force on 1st January 1988). For its text and status see: www.uncitral.org.

[89] Cf. Art. 9.3.1 of the Principles.

[90] Art. 9.3.2 of the Principles: 'This Section does not apply to the assignment of contracts made under the special rules governing transfers of contracts in the course of transferring a business'. However, in the Official Comment, it is clarified that the rules in the Principles may be applied where certain contracts pertaining to a transferred business are assigned individually.

However, even though the Principles are primarily intended to apply to international commercial contracts, it has been persuasively argued that the nature of the contract being transferred is not significant for the purpose of an assignment within their scope. Furthermore, it is considered unnecessary for the assigned contract to state that it is governed by the Principles.[91]

According to the UNIDROIT Principles, contract assignment is based on an agreement involving three parties. It firstly requires consent between the assignor and the assignee, with an oral agreement between the two signifying such consent normally being sufficient.[92] Secondly, for a valid contract assignment to occur, approval of the other party is also required: the other party must give its consent to the transfer, without any formal requirements as to this approval needing to be observed.[93]

Resembling Art. 1407 of the Italian Code, Art. 9.3.4 of the UNIDROIT Principles provides that the other party's consent may be given in advance of an assignment, including by means of the inclusion of an assignment clause in the original contract.[94] In this case, the transfer becomes effective when it is notified to the consenting party or when the latter, through an overt sign, demonstrates it has become aware of the transfer.[95]

Where consent by the other party cannot be obtained (for a practical, strategic or any other reason), the parties have the option to agree, alternatively, on a transfer of rights, for which assent is, as a rule, unnecessary.[96] A party to a contract may also agree with a third-party that the latter will perform its own obligations under a contract.[97]

Since the application of the Principles depends on the choice of the parties, consent by the other party to the transfer needs to extend to the fact that the Principles govern

---

[91] See Francesca Mazza, 'Comment to Arts. 9.3.1–9.3.7' in Stefan Vogenauer (ed), *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* (2nd edn, Oxford University Press 2015, Oxford, 1145–1153) 1146.

[92] This follows from the fact that freedom of form is one of the basic ideas underlying the Principles. However, some formal requirements may be required due to mandatory rules contained in applicable domestic laws.

[93] Cf. Art. 9.3.3 of the Principles. Even though the transfer does not become effective until the other party gives its consent, nothing in the Principles prevents the parties on agreeing that the transfer takes effect at a later time after consent is given. Also, the validity of the consent can be challenged, under the rules in Chapter 3, Section 2, of the Principles, in situations where consent has not been freely given by the other party.

[94] As observed by Eckart J. Brödermann, *UNIDROIT Principles of International Commercial Contracts: An Article-by-Article Commentary* (Nomos/Wolters Kluwer 2018, Baden-Baden), 326, the acknowledgment of an advance consent is particularly useful when the parties, in the precontractual stage, sign a letter of intent or a Memorandum of Understanding to permit either of them to transfer the contract to another entity, also within the same group, at a later point in time.

[95] See Official Comment 2 to Art. 9.3.4.

[96] See Art. 9.1.7 *(Agreement between assignor and assignee sufficient)*: '(1) A right is assigned by mere agreement between the assignor and the assignee, without notice to the obligor. (2) The consent of the obligor is not required unless the obligation in the circumstances is of an essentially personal character'.

[97] See Art. 9.2.6 *(Third party performance)*: '(1) Without the obligee's consent, the obligor may contract with another person that this person will perform the obligation in place of the obligor, unless the obligation in the circumstances has an essentially personal character. (2) The obligee retains its claim against the obligor'.

the agreement.[98] Nonetheless, if nothing is said to the contrary, it is argued that consent to the transfer implies consent to the application of the Principles, provided that the other party had actual or constructive knowledge that the assignor and assignee agreed on their application.[99]

3 The Effects on the Parties Involved

According to Art. 9.3.5 of the Principles, more options in respect of a proposed assignment of a contract are open to the other party, which will accordingly affect the position of the assignor.[100] First, the other party may decide to discharge the assignor in full;[101] second, it may retain the assignor as a subsidiary obligor in case the assignee does not perform or does not perform properly;[102] and third, the other party may discharge the assignor with respect to certain obligations while retaining them as an obligor for others.[103]

However, if the other party does not manifest its choice by communicating it to the new party or the assignor, the default rule is that the assignor and the assignee are jointly and severally liable.[104] It is then in the interest of the assignor to obtain from the other party an express declaration of its intention.[105]

In relation to defences available to the other party against the assignee, the guiding principle is that its position must not be worsened by effect of an assignment. Art. 9.1.13 of the Principles (to which Art. 9.3.6 refers)[106] provides that the other party is entitled to

---

98 See Brödermann (n 94) 326.

99 Mazza (n 91) 1148. The other party can be said to have constructive knowledge of the choice relating to the application of the Principles if, under Art. 4.2, a reasonable person of the same quality as the other party, in the same circumstances, could not have been unaware of the assignor and the assignee's intention to have the agreement subject to the Principles.

100 This provision correlates with Art. 9.2.5 of the Principles, concerning the effects of a transfer of obligations on the original obligor.

101 See Art. 9.3.5(1) of the Principles. If the other party decides to discharge the assignor in full, any security granted by the assignor, as debtor, is extinguished, unless the asset given as security is transferred as part of a transaction between the original and the new obligor. The same holds true for a surety given from a third party, unless the third party agrees that it should continue to be available to the obligee. Conversely, if the other party wishes that such a security remains in place, it should make its declaration to discharge the original obligor dependent on the suspensive condition that the third-party consent to the viability of the security: see Mazza (n 91) 1141ff.

102 See Art. 9.3.5(2) of the Principles.

103 This results from the combination of paras. 1 and 2 of Art. 9.3.5(2) of the Principles.

104 The rules in Chapter 11 dealing with a plurality of obligors will apply accordingly. It is interesting to note that the solution proposed by PECL and the DCFR is different as both provide that the assignor is discharged upon consent by the other party to the transfer.

105 It goes without saying that the other party may well choose expressly to retain the original debtor and the new one as severally and jointly liable.

106 Art. 9.3.6(1): 'To the extent that the assignment of a contract involves an assignment of rights, Article 9.1.13 applies accordingly'.

avail itself of all substantive and procedural defences,[107] based on the assigned contract and the relevant applicable law, that it could have raised against the assignor.[108] If a defence (including a right of set-off) is successfully raised against the assignee, the latter will also have a claim against the assignor.[109]

Special attention is given to the right of set-off, since an assignment destroys mutuality as a pre-condition for this mechanism to operate. On the strength of Art. 9.1.13(2) of the Principles, the other party, as an obligor, may claim a right of set-off against the assignee, if it was entitled to do so against the assignor at the time the assignment became effective. This means that the requirements for set-off, as specified in Art. 8.1 of the Principles, must be satisfied at that time.[110]

As to the assignee (which acquires all the assignor's rights to payment or other performance under the contract and all rights securing performance),[111] it can avail itself of all defences available to the assignor against the other party.[112] However, as an obligor, it cannot exercise any right of set-off that the assignor could have raised against the other party.[113] This difference in treatment is justified by the fact that, contrary to the original party to the contract, the assignee, as a new debtor, cannot be treated as holder of a legitimate expectation as to the existence of a right of set-off against the other party. This position is also consistent with the innovative rule chosen by the UNIDROIT Principles' drafters providing that set-off has no retroactive effect.[114]

4 Partial Assignment and Conflict among a Plurality of Assignees

Like under Italian law, the Principles envisage that a contract may be assigned only in part. However, when assignment involves the transfer of an obligation other than the payment of a monetary sum, partial assignment will be allowed to the extent that performance

---

[107] The other party may, for example, invoke an arbitration clause in the contract (see Art. 9.1.13, Illustration 2 of the Principles).

[108] Art. 9.1.13: '(1) The obligor may assert against the assignee all defences that the obligor could assert against the assignor'. Except for set-off, the defence is to be considered available even if it comes into existence after that assignment became effective or was notified'.

[109] See Art. 9.1.15(d)(e).

[110] Art. 8.1 *(Conditions of Set-off)*: '(1) Where two parties owe each other money or other performances of the same kind, either of them ('the first party') may set off its obligation against that of its obligee ('the other party') if, at the time of set-off, (a) the first party is entitled to perform its obligation; (b) the other party's obligation is ascertained as to its existence and amount and performance is due. (2) If the obligations of both parties arise from the same contract, the first party may also set off its obligation against an obligation of the other party which is not ascertained as to its existence or to its amount.'

[111] See Art. 9.3.7 in combination with Art. 9.1.14 of the Principles.

[112] Art. 9.2.7(1) of the Principles: 'The new obligor may assert against the obligee all defences which the original obligor could assert against the obligee'.

[113] See Art. 9.2.7(2) of the Principles.

[114] Art. 8.5(3) of the Principles: 'Set-off takes effect as from the time of notice'.

of it is divisible, and the assignment does not render the obligation significantly more burdensome.[115]

Although quite a rare occurrence, another aspect that deserves mention – and for which the solutions in Italian law and the Principles partially diverge – concerns a potential conflict between the interests of different assignees. In principle, this conflict is resolved, within both systems, by giving priority to the first assignment of which the original debtor/the other party has been notified.[116] However, as clarified in the Official Comment to the Principles, and contrary to Italian law,[117] the Principles do not take into consideration the actual or constructive knowledge that the obligor may have had of the assignment(s) in the absence of notice of their existence being given to it. This approach is prompted by the wish to encourage giving notice as a tool to ensure more certainty in the context of international trade relations.

5 The Rules on Assignment of Contracts in Practice

As is well known, the Principles do not have the force of law by themselves; nevertheless, their 'soft' legal nature carries more advantages than shortcomings.[118]

One advantage is that, in accordance with their Preamble, the Principles may be used in different contexts and by different actors: they may apply directly to a legal relationship by the decision of either the parties or the adjudicators; they may serve as an interpretative tool (i.e., for interpreting and supplementing existing international rules or domestic laws); and they may function as a model for national and international lawmakers,[119] or for drafting contracts or specific clauses.

The UNILEX database provides a compilation of decisions handed down by arbitral tribunals and national courts worldwide that refer in some way or other to the UNIDROIT Principles.[120]

---

[115] This follows from the rule in Art. 9.1.4 of the Principles.

[116] The solution is to be drawn for the rules governing assignment of rights. For Italian law, see Art. 1265 of the Code, where it is stated that if the same claim has been the subject of more than one assignment to different persons, the first assignment of which the debtor has been notified or that which has first been accepted by him, prevails, even if it is of a later date'; for the Principles, see Art. 9.1.11: 'If the same right has been assigned by the same assignor to two or more successive assignees, the obligor is discharged by paying according to the order in which the notices were received.'

[117] See Paladini (n 5) 274; Alpa, Fusaro (n 36) 235.

[118] See, also for numerous references, Michael Joachim Bonell, 'Towards a Legislative Codification of the UNIDROIT Principles?' (2007) 12 Uniform Law Review 233–245, https://doi.org/10.1093/ulr/12.2.233

[119] For an accurate analysis of the role of the Principles as model for domestic legislators, see Angelo Estrella Faria, 'Influence of the UNIDROIT Principles of International Commercial Contracts on National Laws' in UNIDROIT (ed), *Eppur si muove*, 1318–1349.

[120] The UNILEX database, which also contains a selection of decisions relating to the CISG handed down by national courts and arbitral tribunals worldwide, is available for free at www.unilex.info.

Out of a total of 554 reported cases,[121] only a smaller number (about 90) are decisions in which the Principles have been applied as the governing law, either as exclusive source of law (and then only rarely[122]), or in conjunction with a particular domestic law or international set of rules (like, for instance, the CISG[123] or the *lex mercatoria*[124]).

Admittedly, this number might still appear rather limited, except if one considers, on the one hand, that the Principles, as a set of a-national rules, cannot be chosen as a veritable *lex contractus* in front of State courts, the traditional and still prevailing view being that the parties' freedom of choice of law for a contract is limited to a particular domestic law;[125] on the other hand, that arbitral awards – decided on the basis of applying the Principles, by the choice either of the parties or the arbitrators,[126] – remain to a large extent unpublished.

As determined from the recorded decisions, the provisions in the UNIDROIT Principles on the assignment of contracts have only been applied in a limited number of cases so far. An arbitral award made by the Permanent Court of Arbitration to solve a controversy arising from a supply contract concluded between a Lebanese company and the Food and Agricultural Organization of the United Nations (FAO) deserves mentioning.[127] In this case, the arbitral tribunal decided to apply the Principles to the merits of the dispute, on the strength of a choice-of-law in the contract asking adjudicators to decide according

---

121 Last accessed 20 February 2023.

122 See Camera di Arbitrato Nazionale ed Internazionale di Milano, 1 December 1996, http://www.unilex.info/principles/case/622; ICC International Court of Arbitration, Paris, n.8331/1996, http://www.unilex.info/principles/case/647; *Centro de Arbitraje de México* (CAM), 30 November 2006, http://www.unilex.info/principles/case/1149; *Chinese European Arbitration* Centre (CEAC), 30 April 2018, http://www.unilex.info/principles/case/2285.

123 See the relevant cases reported in UNILEX, Preamble, under issue 2.4.1; for an analysis of the relationship between the Vienna Convention and the Unidroit Principles, see Bonell, An International Restatement cit. (n 75) 318ff.; Pilar Perales Viscasillas, 'Interpretation and Gap-Falling under the CISG: Contrast and Convergence with the UNIDROIT Principles' (2017) 22 Uniform Law Review 4–28, https://doi.org/10.1093/ulr/unw060.

124 See the relevant cases reported in UNILEX, Preamble, under issue 2.1.2.

125 See Genevieve Saumier, 'Designating the UNIDROIT Principles in International Dispute Resolution' (2012) 17 Uniform Law Review 533–547, https://doi.org/10.1093/ulr/17.3.533. This results in any reference to the Principles as being considered merely as an agreement to incorporate them into a contract. Exceptions are represented by the reforms recently passed in Paraguay and Uruguay. Influenced by the liberal approach enshrined in the 2015 Hague Principles of Choice of Law in International Commercial Contracts, both the new regimes empower the parties to an international contract to choose not only a particular domestic law as the law governing their contract but also, to quote Art. 3 of the Hague Principles, the 'rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules'. For a detailed analysis of the Paraguayan legislation see José Antonio Moreno Rodriguez, 'The New Paraguayan Law on International Contracts: Back to the Past' in UNIDROIT (ed), *Eppur si muove*, 1146–1178.

126 It is worth recalling that in arbitral proceedings the arbitral tribunal may refer to the Principles whenever the parties have agreed that their relationship(s) be governed by 'general principles of law, the 'lex mercatoria' or the like, or in the lack of a choice by the parties as to the applicable law, whenever an arbitral tribunal considers them to be the most appropriate rules of law under the circumstances.

127 Permanent Court of Arbitration, 30 April 2009, https://www.unilex.info/principles/case/1881.

to 'the general principles of law to the exclusion of any national legal system'. Having to determine whether a contract had been validly transferred from a claimant to a third party, the tribunal decided no, noting that the defendant had never consented to the assignment. Regrettably, the tribunal did not expressly mention Art. 9.3.3 of the Principles in its reasons for the decision.

Another example is an arbitral award rendered by the ICC International Court of Arbitration, in which the Court had to decide, among other things, whether a party could assign a contract to a third person and, if so, when the assignment became effective *vis-à-vis* the other party. In its reasoning, the Court considered that the relevant provision in the Italian Civil Code (namely, Art. 1407), which was applicable to the merits of the dispute, embodies a 'similar mechanism of that enshrined in Arts. 9.3.3 and 9.3.4 of the Principles'.[128]

These two cases are examples of two different uses of the UNIDROIT Principles. More precisely, while in the first mentioned case the Principles provided the normative basis for the decision, the second case falls within a group of decisions – more than 100 cases reported in UNILEX[129] –, in which the Principles were not applied directly, yet were referred to as an international benchmark to corroborate solutions adopted under the applicable law. Whilst admittedly a reference in decisions to the Principles often appears to be no more than a purely ornamental remark, devoid of real impact on the final outcome of the case, their utility should not to be underestimated, especially in cases where at least one of the parties involved is confronted with a foreign law virtually unknown to it. A resonance with internationally accepted standards in a decision, such as those contained in the Principles, may, in fact, render the decision more acceptable and sound to the party whose law did not apply to determine the matter.[130]

The role that the Principles have increasingly acquired as 'global background law'[131] is testified by another range of cases – 221 decisions in UNILEX – in which they were referred to, mainly by domestic courts, to support an evolvement in the law. In other words, they were cited to add clarity to unclear aspects in the applicable law;[132] to reveal a rule implicit

[128] ICC International Court of Arbitration, 12745/2005, https://www.unilex.info/principles/case/1691.

[129] See the cases reported in UNILEX, Preamble, under issue 2.3.1.

[130] In this sense, see Olaf Meyer, 'The UNIDROIT Principles as a Means to Interpret or Supplement Domestic Law' (2016) 21 Uniform Law Review 599-611, https://doi.org/10.1093/ulr/unw051

[131] Ralf Michaels, 'The UNIDROIT Principles as Global Background Law' (2014) 19 Uniform Law Review 643-668, https://doi.org/10.1093/ulr/unu033.

[132] Rechtbank Amsterdam, 30 April 2020, http://www.unilex.info/principles/case/2259

in the applicable legal system; [133] to aid the adoption of one of several possible solutions under the applicable domestic law;[134] and even to openly revisit the current law of a country.[135]

Even though at present there are no examples of the indirect application of the rules in the UNIDROIT Principles on the assignment of contracts to develop the law of a particular jurisdiction, it may well happen that these rules will be inspirational for national courts in the near future. For example, they may inspire the courts in Hungary in the way they interpret the recently-adopted regime for the assignment of contracts.[136]

---

[133] See for example Federal Court of Australia, 8 April 2015, http://www.unilex.info/principles/case/1921

[134] This was the case in some Italian decisions relating to restitutory claims: for more details see Anna Veneziano, E. Finazzi-Agrò, 'The Use of the UNIDROIT Principles in Order to Interpret or Supplement National Contract Law' in Michele Graziadei (ed), *Annuario di diritto comparato e di studi legislativi*, Special edition (ESI 2018, Napoli, 39ff).

[135] Of relevance in this regard are some English decisions that discuss two peculiar and well-established doctrines of the law of contracts, namely: the so-called exclusionary rule (i.e., the traditional approach which opposes the examination of negotiations to interpret written contracts); and the well-known distinction between penalty clauses and liquidated damages clauses. On the first doctrine, in 2009 when the House of Lords precluded recourse to negotiations for contract interpretation, it did so by invoking the Principles in what can be termed an anti-model key. On that occasion, the Supreme Court noted that, although the Court of Appeal had previously referred to Art. 4.3 of the Principles, which allow recourse to negotiations for contract interpretation, in support of a change of approach in English law (see Proforce Recruit Limited v. The Rugby Group Limited [2006] EWCA Civ 69, http://www.unilex.info/principles/case/1119), the approach that the Principles take is not globally agreed on, but specifically reflects the French philosophy of contract interpretation, and as such is incompatible with English law (Chartbrook Limited v Persimmon Homes Limited [2008] EWCA Civ 183; [2009] UKHL 38 (http://www.unilex.info/principles/case/1373, at para 39 per Lord Hoffman). With regard to the second doctrine, recourse to the Principles again served to justify a decision not to make changes to the system, but this time on the basis of a different consideration. While recognising that the penalty rule is an antiquated doctrine of which doctrine is increasingly critical, the Supreme Court judges ruled out its abolition and this represented 'a proper course to take' (see *CavendishSquare Holding BV v El Makdessi – Parking Eye Ltd v Beavis*, [2015] UKSC 67, https://www.unilex.info/principles/case/1933). In deciding this, the Court noted that the English solution is part of a converging trend towards recognising judicial control over manifestly excessive and disproportionate penalty clauses. This trend is evident in many foreign jurisdictions, as well as in 'influential attempts to codify the law of contracts internationally, including the UNIDROIT Principles of International Commercial Contracts.'

[136] A recent survey demonstrated that while the Principles have been used as a model for the reform of the Hungarian Civil Code and are well known in the academic community, no decisions are known, to date, that refer in one way or the other to them: see Miklós Király, 'The UNIDROIT Principles as Reference for the Uniform Interpretation of National Laws: Report on Hungarian Law' in Alejandro Garro, Josè Antonio Moreno Rodriguez (eds), *The Unidroit Principles as a Common Frame of Reference for the Uniform Interpretation of National Laws,* (Springer 2021) 195ff, https://doi.org/10.1007/978-3-030-54322-8

Articles

Barbara Bazánth*

Legitimacy Concerns regarding the Application of Soft Law in International Arbitration in Connection with the Independence and Impartiality of Arbitrators

Abstract

The growing body of soft law instruments in the field of arbitration may provide us with numerous positive outcomes; however, its application has also gathered a substantial amount of criticism. The present article addresses concerns of legitimacy voiced in today's arbitral practice and the possible negative consequences of the excessive application of soft law in arbitration. In order to put these concerns into a more concrete perspective, the article discusses these legitimacy questions, focusing on soft law regarding issues of conflicts of interest and the impartiality and independence of arbitrators, and provides the reader with an outlook for the international acceptance and applicability of the International Bar Association's Guidelines on Conflicts of Interest in International Arbitration.

Keywords: soft law, arbitration, independence, impartiality, legitimacy, IBA Guidelines

I Introduction

At present, one may conclude that the influence of soft law instruments in certain fields of arbitration has almost risen to the level enjoyed by other rules of international arbitration. Although this growing body of law may provide us with numerous positive outcomes, its application has gathered a substantial amount of criticism in the past years. The present

* Barbara Bazánth LL.M (NYU) M1 (Panthéon-Assas) is a PhD candidate at the International Law Department of ELTE Law School and a Legal Officer at the Council of Europe (e-mail: barbara.bazanth@gmail.com). The views expressed in this article are the author's own and do not necessarily reflect the position of any entity with which the author is associated.

article intends to analyse the concerns over legitimacy as voiced in today's arbitral practice and the possible negative consequences of the excessive application of soft law in arbitration.

To address these concerns, the article starts by defining what is understood today as soft law in general, and then specifically in the sphere of arbitration. Afterwards, it proceeds to address the possible concerns of legitimacy raised in the legal scholarship, discussing the application of soft law instruments in arbitration. In order to put these concerns into a more concrete perspective, the article will discuss these legitimacy questions, focusing on the impartiality and independence of arbitrators, and will provide the reader with an extensive outlook for the international acceptance and applicability of the International Bar Association's Guidelines on Conflicts of Interest in International Arbitration, as well as for the relevant case law of Hungarian courts.

II On Soft Law in General

We cannot find a widely and generally accepted definition of the 'soft law'; the term lacks precision and is to some extent even misleading.[1] Nevertheless, 'soft law norms' are generally understood to be norms which cannot be enforced through public force[2] and have extra-legal binding effect.[3] As *Lüth* and *Wagner* observed, soft law refers to 'quasi-legal instruments which do not have any legally binding force, or whose binding force is somewhat "weaker" than the binding force of traditional law, which is in contrast often referred to as "hard law"'.[4]

Several types of documents fall under this category, including resolutions of international organisations, codes of conduct and recommendations, non-binding agreements, programmes of action, reports adopted by international agencies or at international conferences, texts of treaties not yet in force or not binding on a specific actor, and interpretative instruments pertaining to international conventions.[5] These instruments are considered to be sources of international law, but only as subsidiary means for the determination of the rules of law within the meaning of Article 38(1)(d) of the Statute of the International Court of Justice.[6] Their purpose, therefore, is to serve as secondary sources for interpreting the primary rules of international law.

As *Gabrielle Kaufmann-Kohler* explains, the term 'soft' can refer to various characteristics of the norm: it may indicate that it is too vague to be applied to specific facts,

---

[1] Daniel Thürer, 'Soft Law' (2009) Max Planck Encyclopedia of Public International Law [MPEPIL] para 36. https://doi.org/10.1093/law:epil/9780199231690/e1469

[2] Gabrielle Kaufmann-Kohler, 'Soft Law in International Arbitration: Codification and Normativity' (2010) Journal of International Dispute Settlement 283, 284, https://doi.org/10.1093/jnlids/idq009

[3] Thürer (n 1) para 5.

[4] Felix Lüth, Philipp K. Wagner, 'Soft Law in International Arbitration – Some Thoughts on Legitimacy' (2012) STUDZR 409, 411.

[5] Thürer (n 1) para 2.

[6] United Nations, Statute of the International Court of Justice, 18 Apr. 1946, Article 38 (1) (d).

that it cannot be a basis for a cause of action, or that its support lacks any binding character.[7] However, it certainly does not mean that it lacks any kind of normative character.[8] Its normativity is often called 'soft normativity', and it depends on whether or not the rules are codified in a code, their degree of influence on judicial practice, and their recognition or reference by tribunals.[9] Nevertheless, pursued objective of soft law is most commonly to assemble the existing, scattered elements of norms, and thereby creating new ones.[10]

III Soft Law Instruments in the Field of International Arbitration

One of the most important fields of law where soft law provides valuable guidance is arbitration.[11] Its main purpose is to assist and instruct arbitrators and other practitioners in the event of deficiencies in the applicable law. Most often, and also most relevantly, soft law is made by non-State actors.[12] Many international institutions provide important guidance on certain practical aspects of arbitration, including the International Bar Association, the UNCITRAL, or the International Chamber of Commerce.[13] These institutions influence the development of international law by promoting the exchange of information between practitioners and codifying arbitral rules with the aim of filling the gaps of existing international law. This goal is adequately mirrored in the term 'best practices,' referring to soft law specifically in the sphere of arbitration.

Soft law in arbitration is composed of two types of rules, procedural soft law on the one hand and substantive soft law on the other.[14] Although both are valuable sources, substantive soft law norms were originally intended to be applied to commercial transactions in general. These sets of rules include the UNIDROIT Principles of International Commercial Contracts, the OECD Principles of Corporate Governance and trade customs. Regarding arbitration more specifically, procedural codes of conduct are regularly referred to in arbitral proceedings, even when the parties did not set them out in their arbitral agreements. The above referred gap-filling function of soft law instruments is especially relevant regarding

---

7 Kaufmann-Kohler (n 2) 284.

8 Kaufmann-Kohler (n 2) 284.

9 Kaufmann-Kohler (n 2) 315.

10 David Arias, 'Soft Law Rules in International Arbitration: Positive Effects and Legitimation of the IBA as a Rule-Maker' (2017–2018) 6 Indian Journal of Arbitration Law 29–41, 30.

11 Gary B. Born, International Commercial Arbitration (The Netherlands, 1852, 2nd edn, 2014); Arias (n 10) 31; Elina Mereminskaya, 'Results of the Survey on the Use of Soft Law Instruments in International Arbitration' Kluwer Arbitration Blog 6 June 2014 <https://arbitrationblog.kluwerarbitration.com/2014/06/06/results-of-the-survey-on-the-use-of-soft-law-instruments-in-international-arbitration/> accessed 15 February 2023.

12 Kaufmann-Kohler (n 2) 285.

13 Van Vechten Veeder, 'Procedural Soft Law in International Arbitration' (2019) Max Planck Encyclopedia of Public International Law [MPEPIL] para 14.

14 Lüth, Wagner (n 4) 411; Kaufmann-Kohler (n 2) 286.

procedural materials, as they complement arbitration rules guiding the dispute, but might not cover certain important questions of law.[15]

The most outstanding examples of this are the UNCITRAL Model Law on International Commercial Arbitration, which seeks to develop domestic commercial arbitration rules,[16] the UNCITRAL Arbitration Rules, containing procedural rules for ad-hoc arbitration,[17] the IBA Rules on the Taking of Evidence in International Commercial Arbitration[18] and the IBA Guidelines on Conflicts of Interest in International Commercial Arbitration (IBA Guidelines or Guidelines), which incorporate national standards on independence and impartiality, and illustrate them with specific examples to ensure that arbitrators act impartially.[19] These Guidelines will be further discussed in the context of the interaction between soft law and the impartiality and independence of arbitrators.

IV Concerns of Legitimacy regarding the Application of Soft Law Rules in Arbitral Adjudication

Legitimacy is 'the right to rule,' as a consequence of which the addressees of legal norms and the decisions of international institutions regard the authority of the tribunal to be justified, and obey its rules and decisions.[20] One must note that concerns of legitimacy in the matter at hand concern the application of the norm not its creation.[21] Just as much as in litigation in general, in the field of arbitration more specifically, *consistency, certainty* and *predictability* are the key elements of building a legitimate adjudication system.[22] Although these principles are safeguarded differently by or even within countries, they often share common

---

15 Gregory C. Shaffer, Mark A. Pollack, 'Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance' (2010) 94 Minnesota Law Review 706–799, 721.

16 G.A. Res 40/72, United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, U.N. Doc. A/RES/40/72 (Dec. 11, 1985), amended by G.A. Res 61/33, U.N Doc. A/RES/61/33 (Dec. 18, 2006).

17 United Nations Commission on International Trade Law, UNCITRAL Arbitration Rules, <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/uncitral-arbitration-rules-2013-e.pdf> accessed 15 February 2023.

18 IBA Working Party Commentary on the New IBA Rules of Evidence in International Commercial Arbitration.. (2000) Bus Law Int'l 2, 14.

19 Anne K. Hoffmann, 'Duty of Disclosure and Challenge of Arbitrators: The Standard Applicable Under the New IBA Guidelines on Conflicts of Interest and the German Approach' (2005) 21 Arbitration International 427–436, https://doi.org/10.1093/arbitration/21.3.427; David A. Lawson, 'Impartiality and Independence of International Arbitrators – Commentary on the 2004 IBA Guidelines on Conflicts of Interest in International Arbitration' (2005) 23 ASA Bulletin 22, https://doi.org/10.54648/asab2005003

20 Harlan G. Cohen, Andrea Føllesdal, Nienke Grossman, Geir Ulfstein, *Legitimacy and International Courts* (Cambridge, 2018).

21 Lüth, Wagner (n 4), 419.

22 Susan D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions' (2005) 73 Fordham L Rev. 1521, 1584.

features and can be assured through the appropriate interpretation of soft law arbitration instruments, among the sources of international law.

On one hand, these rules and methods may establish objective mechanisms for determining, for instance, the impartiality and independence of arbitrators, ensuring the transparency of proceedings, and providing for the review of decisions.[23] They protect the legitimacy of the proceedings and their outcomes. On the other, however, inconsistencies in this process contribute to the fragmented nature of the international arbitration regime.[24] A substantial proportion of such inconsistencies arise from the application of soft law instruments, such as codes and guidelines prepared, for instance, by the International Bar Association (IBA), and the author will address the potential negative consequences.

At the outset, the adoption of soft law instruments results in some kind of a normative confusion regarding their optional application and its unpredictable outcome. This means that actors in the arbitral sphere can never be sure of the degree of normativity of such instruments in the given case, and whether the tribunal will apply them in the absence of other binding materials. The test of this normativity lies in court practice: whether courts refer to these soft law rules, and what they pronounce to be their value.[25]

As *Gabrielle Kaufmann-Kohler* stresses, there may be instances where the parties are adjudged by the standards set by these soft law codes and guidelines, as can be assessed from the tribunals' awards, without their being explicitly invoked in the submissions of the parties.[26] This is rooted in the wide procedural discretion of the arbitrators,[27] but results in the impairment of and derogation from the arbitration agreement, therefore the parties' right to decide on the rules and circumstances of arbitration.[28]

An additional criticism regarding soft law is it can make the system less flexible, because while soft law rules may increase the certainty of the proceedings, including more and more rules on the procedure of the tribunal,[29] this increase may be accompanied with the loss of procedural flexibility. A leading author in this regard, *William Park*, views this effect as desirable, as it balances efficiency with the fairness of the proceedings, by jokingly citing

---

[23] Nathalie Bernasconi-Osterwalder, Lise Johnson, Fiona Marshall, 'Arbitrator Independence and Impartiality: Examining the Dual Role of arbitrator and counsel' (2011) 12 International Institute for Sustainable Development (IISD) 1.

[24] Miluše Hrnčiříková, 'The Meaning of Soft Law in International Commercial Arbitration' (2016) 16 International and Comparative Law Review 97, 104, https://doi.org/10.1515/iclr-2016-0007

[25] Kaufmann-Kohler (n 2) 297; Decision of the Swiss Federal Court of 22 March 2008. ASA bull, 26. (2008) 565–579.

[26] Kaufmann-Kohler (n 2) 297; Lüth, Wagner (n 4) 418.

[27] Lüth, Wagner (n 4) 418.

[28] William Park, 'The Procedural Soft Law of International Arbitration: Non-Governmental Instruments' in Loukas Mistelis, Julian Lew (eds), Pervasive Problems in International Arbitration (The Netherlands, 2006, 141) 144.

[29] Arias (n 10) 35.

the example of a chef who aimed to provide fine dining and 'might fail either by making customers wait too long or by serving junk food instead of a gourmet meal'.[30]

The above concern for flexibility brings about another frequently criticised aspect, namely the prospective *judicialisation* of arbitral proceedings,[31] in that, due to the proliferation of soft law rules in the field of arbitration, the arbitral dispute resolution system takes on a different procedural character, and as a result resembles litigation.[32] Arbitration was originally created to exclude this procedural and highly formal system of litigation, allowing the parties themselves to shape the arbitral proceedings they wish to have as deciding their dispute. As a consequence, the more procedural rules we have, the more arbitral autonomy is constrained by them. This is especially relevant in the event described by *Kaufmann-Kohler*, namely when autonomy is at peril from the tribunal's application of these rules without the explicit agreement of the parties.[33] Nevertheless, scholars such as *Park* regard consistency as a primary value rather than a stricter arbitral process.[34]

Another legitimacy question arises when the soft law instrument contradicts the underlying applicable procedural rules chosen by the parties. This possibility was analysed by *Lüth* and *Wagner*, who reflected on the potential clash of rules on impartiality in the IBA Guidelines, and the obligation of disclosure prescribed in the ICC Arbitration Rules.[35] Although these disputable scenarios are less likely to occur, they manifest the inconsistencies in this regard.

As we can see, a number of concerns that can have negative consequences may be seen as germane to the legitimacy of the arbitral process as a consequence of the proliferation of soft law codes and regulations. These concerns relate to the application of these rules, and involve uncertainty over their normativity, the flexibility of the arbitration regime, risks of the judicialisation of arbitration, and contradictions with institutional rules. They are implicitly present in the specific context of arbitrator impartiality and independence. introduced in the coming sections of this article.

---

30 Park (n 28) 142.

31 Günther J. Horvath, 'The Judicialization of International Arbitration: Does the Increasing Introduction of Litigation-Style Practices, Regulations, Norms and Structures into International Arbitration Risk a Denial of Justice in International Business Disputes?' in Stefan Michael Kröll, Loukas Mistelis et al (eds), *International Arbitration and International Commercial Law: Synergy, Convergence and Evolution* (Alphen van den Rijn: Kluwer Law International 2011, 251–271).

32 Park (n 28) 146., paras 7–18.; 'University of Virginia's 12th Sokol Colloquium' in Richard Lillich, Charles Brower (eds), *International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Leiden, 1993).

33 Lüth, Wagner (n 4), 418.

34 Park (n 28) 147, para 7–21.

35 Lüth, Wagner (n 4) 421.

V A Concrete Example: Rules on the Independence and Impartiality of Arbitrators

The principle that a judicial institution shall be independent and impartial is firmly emphasised in all legal systems. It is likewise a core principle in the field of arbitration that arbitrators must be independent and impartial of the parties at the time of appointment and for the duration of the proceedings.[36] Impartiality requires that an arbitrator is free from bias due to preconceived notions regarding the dispute, or any other reason that may result in favouring one party over the other,[37] whereas independence reflects the lack of a pre-existing relationship between the arbitrator and the parties.[38]

The integrity of the arbitral process has a number of guarantees, one of the most prominent being the impartiality and independence of the arbitral tribunal.[39] For this reason, arbitral institutions and other international organisations started to codify the rules on impartiality and independence in order to clarify the existing and developing standards in international law.[40] Among the most prominent ones, we recognise the American Bar Association and American Arbitration Association Code of Ethics for Arbitrators, the International Bar Association Rules of Ethics for International Arbitrators (IBA Code of Ethics), the IBA Guidelines on Conflicts of Interest, the International Bar Association Guidelines on Party Representation in International Arbitration and the Burgh House Principles on the Independence of the International Judiciary. The eminent role of these documents among soft law instruments, and in international arbitral practice in general, cannot be disputed, as they provide utterly valuable input for filling the gaps in the regulation of impartiality rules.

The IBA Guidelines focus on the question of disclosure of potential conflicts of interest by an arbitrator and were designed as an expression of best practices in the field of international arbitration.[41] The Guidelines apply to international commercial arbitration as well as to international investment arbitration, and are quite influential at a time when

---

[36] Lawson (n 19).

[37] Margaret L. Moses, The Principles and Practices of International Commercial Arbitration. (3rd edn, Cambridge, 2017) 140–141.

[38] Nigel Blackaby, Constantine Partasides, Redfern and Hunter on International Arbitration (6th edn, Oxford, 2015) 255.

[39] Sharanya Shivaraman, 'Relationship between the Arbitrators and their Law Firm: A case for Dynamic Application of the IBA Guidelines on Conflicts of Interest', Kluwer Arbitration Blog, 19 June 2018 <https://arbitrationblog.kluwerarbitration.com/2018/06/19/relationship-arbitrators-law-firm-case-dynamic-application-iba-guidelines-conflicts-interest/> accessed 15 February 2023; Lawson (n 19) 23; Leela Kumar, 'The Independence and Impartiality of Arbitrators in International Commercial Arbitration' SSRN, 24 April 2014., <https://ssrn.com/abstract=2428632> accessed 7 February 2023.

[40] Kaufmann-Kohler (n 2) 286; Arias (n 10) 30.

[41] IBA Guidelines, 11., para 4.; Mark R. Joelson, 'A critique of the 2014 international bar association guidelines on conflicts of interest in international arbitration' (2015) 26 (3) The American Review of International Arbitration 483, https://doi.org/10.54648/asab2016046

challenging arbitrators' decisions and applications for the annulment of awards on the basis of arbitrator bias have increased.[42] They are considered as providing the relevant criteria for assessing the impartiality and independence of a challenged arbitrator.

However, a number of concerns were raised by legal scholarship and jurisprudence regarding their application.

The first is rooted in their soft law character, subjecting the IBA Guidelines to a major limitation regarding their invocation. Arbitral tribunals have ruled differently on whether the Guidelines are to be followed or not. The ICC International Court of Arbitration explicitly stated that the articles do not bind the Court; any reference to them, even by the Court itself, does not mean an acceptance of their normative status.[43] This is further mirrored in the statistics published by the ICC which showed that, of the analysed cases from between 2012 and 2015 only 28.4% of them referred to the IBA Guidelines.[44]

The soft character of the Guidelines was reflected in the case of *W Limited vs. M SDN BHD.*[45] The UK High Court of Justice ruled on the challenge of an arbitrator claiming apparent bias, based on an alleged conflict of interest regarding regular legal services rendered by the law firm of the arbitrator to an affiliate of one of the parties in question. Although the court referred to item 1.4 of the red list in the IBA Guidelines as covering the situation, it decided that there were no doubts as to the independence of the arbitrator. This suggests that situations described in the lists of the IBA Guidelines do not necessarily result in the partiality and therefore the disqualification of an arbitrator. Since each factual situation is different and is to be assessed on a case-by-case basis,[46] the listing cannot be comprehensive and all-embracing.[47]

Similarly, US courts and tribunals refused to rely on the Guidelines on several occasions, despite the fact that the parties before them had made explicit references to them. This was the case on the appeals stage in the *Aimcor* case, where, despite the fact that the District Court relied on them, the Court of Appeals adopted a different standard of disclosure from that set out in the Guidelines.[48] In the *HSN Capital LLC (USA) v Productora y*

---

[42] Margaret Moses, 'The Role of the IBA Guidelines on Conflicts of Interest in Arbitrator Challenges' Kluwer Arbitration Blog, 23 November 2017, <https://arbitrationblog.kluwerarbitration.com/2017/11/23/role-iba-guidelines-conflicts-interest-arbitrator-challenges/> accessed 15 February 2023.

[43] Anne Marie Whitesell, 'Independence in ICC Arbitration: ICC Court Practice concerning the Appointment, Confirmation, Challenge and Replacement of Arbitrators' (2007) 36 ICC International Court of Arbitration Bulletin; Jason Fry, Simon Greenberg, 'Appendix: References to the IBA Guidelines on Conflicts of Interest in International Arbitration When Deciding on Arbitrator Independence, ICC Cases' (2009) 20 ICC International Court of Arbitration Bulletin 33.

[44] Arbitrator Challenges Under the ICC Rules and Practice. 8., ICC Digital Library.

[45] *W Limited v M SDN BHD*, Case No CL-2015-000344, [2016] EWHC 422, para 36.

[46] Bernasconi-Osterwalder, Johnson, Marshall (n 23) 31; IBA Guidelines, part I (6)(a).

[47] Joelson (n 41) 1.

[48] *Applied Industrial Materials Corp v Ovalar Makine Ve Ticaret Sanayi*, 492 F.3d 132, C A 2 (N Y) (9 July 2007).

Comercializador de Televisión SA de CV ICC arbitration, the US District Court in Florida also refused to accept the Guidelines despite the respondent's express reliance on them.[49]

Moreover, a vast number of interpretative and codificatory uncertainties surround the IBA Guidelines. The impartiality standard applicable in international arbitration is codified differently in different instruments, and law and practice in commercial and investment arbitration in fact establish differing tests through interpretation. The Guidelines provide us with the wording 'justifiable doubts,' worded also to mean the mere appearance of a standard of bias. The UNCITRAL Model Law[50] applies the justifiable doubts test as interpreted for instance in the case of *AWG Group Ltd. v Argentine Republic*,[51] and the heavy burden on the challenging party posed by the ICSID Convention[52] certainly requires more than justifiable doubts, as interpreted in the case of *Suez and Others v Argentine Republic*.[53] Due to these differences, the Guidelines and codes can hardly provide assistance for one another and reflect the heterogenous acceptance of the different standards.[54]

Regarding questions of interpretation, arbitral tribunals tend to interpret the impartiality standard codified in the IBA Guidelines differently due to the ambiguous wording of the article, the open-ended list of scenarios for disclosure, and the lack of any guidance as to the effect of those disclosures on the outcome of challenges and annulments.

The Guidelines provide that an arbitrator is impartial if 'facts or circumstances exist, or have arisen since the appointment, which, from the point of view of a reasonable third person having knowledge of the relevant facts and circumstances, would give rise to justifiable doubts as to the arbitrator's impartiality or independence'.[55] The article continues by defining justifiable doubts as 'doubts [which] are justifiable if a reasonable third person, having knowledge of the relevant facts and circumstances, would reach the conclusion that there is a likelihood that the arbitrator may be influenced by factors other than the merits of the case as presented by the parties in reaching his or her decision'.[56]

The above wording, however, causes confusion as to whether mere apparent bias is enough to disqualify an arbitrator, or such bias must in some way be further justified to

---

[49] *HSN Capital LLC (USA) v Productora y Comercializador de Televisión SA de CV (Mexico)*, 2006 WL 1876941 (M D Fla) (5 July 2006).

[50] UN Commission on International Trade Law, UNCITRAL Model Law on International Commercial Arbitration 1985 (UN Doc A/40/17) with amendments adopted in 2006 (Model Law).

[51] *AWG Group Limited v Argentine Republic* (Decision on a Second Proposal for the Disqualification of a Member of the Arbitral Tribunal, 12 May 2008) UNCITRAL Arbitration, 22.

[52] *ICSID Convention, Regulations and Rules.* Washington, D.C., 2003.

[53] ICSID Case No. ARB/03/19, 29, *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v Argentine Republic* (Decision on a Second Proposal for the Disqualification of a Member of the Arbitral Tribunal, 12 May 2008).

[54] Bernasconi-Osterwalder, Johnson, Marshall (n 23) 18.

[55] IBA Guidelines, General Standard 2, paragraph b).

[56] IBA Guidelines, General Standard 2, paragraph c).

raise legitimate concerns. This confusion translates into frequent controversies about the applicability of IBA standards.

In most cases the standard of justifiable doubts has been interpreted as meaning apparent bias and not actual bias.[57] In the *Case of I ZB*, the German Federal Supreme Court found that the judge was disqualified for objective reasons and this was irrespective of whether bias actually occurred.[58] The tribunal in *Vivendi v Argentina* also had to rule on impartiality and, by way of relying on the IBA Code of Ethics, adopted the appearance of bias standard.[59]

However, the Guidelines were also invoked during the challenge procedure of Judge Greenwood in the course of the *Mauritius v United Kingdom* arbitration, where the Permanent Court of Arbitration reflected on their value by stating that rules adopted by non-governmental institutions such as the IBA Guidelines do not form part of a general practice accepted as law, nor do they fall within any other of the sources of international law enumerated in the ICJ Statute.[60] In line with the arguments of the United Kingdom, the PCA denied the application of the apparent bias standard and stated that a party challenging an arbitrator must demonstrate and prove that there are justifiable grounds for doubting the independence and impartiality of the challenged arbitrator.[61]

As seen from the above, the international jurisprudence regarding the IBA Guidelines and the standards included therein – although generally reflecting its best practice status – tends to follow an explicitly case-by-case approach. This, willingly or not, results in removing a level of practical uniformity and normativity from the IBA Guidelines. Despite this, there are a number of states where the Guidelines are incorporated into national legislation, and domestic court practice makes consistent reference to them in a high number of states.

---

[57] Otto L. O. De Witt Wijnen, Nathalie Voser, Neomi Rao, 'Background Information on the IBA Guidelines on Conflicts of Interest in International Arbitration' (2004) 5 (3) Bus. L. Int'l 433; *Pullar v United Kingdom*, no. 20/1995/526/612, 10 June 1996, §§ 30, 33; *Vito G. Gallo v Government of Canada* (Decision on the Challenge to Mr. J. Christopher Thomas, QC, 14 Oct. 2009) NAFTA/UNCITRAL, 19.

[58] Susanne Keck, Niharika Dhall, 'Setting Aside of Arbitral Award Due to Improper Constitution of the Tribunal' *Kluwer Arbitration Blog*, 27 August 2015, <https://arbitrationblog.kluwerarbitration.com/2015/08/27/setting-aside-of-arbitral-award-due-to-improper-constitution-of-the-tribunal/> accessed 15 February 2023.

[59] ICSID Case No. ARB/97/3, 20, Compañiá de Aguas del Aconquija S.A. and *Vivendi Universal S.A. v Argentine Republic (formerly Compañía de Aguas del Aconquija, S.A. and Compagnie Générale des Eaux v Argentine Republic)* (Decision on the Challenge to the President of the Committee, 3 October 2001).

[60] *Chagos Marine Protected Area Arbitration (Mauritius v United Kingdom) (Reasoned Decision on Challenge)* (2011), para 167.

[61] *Chagos Marine Protected Area Arbitration (Mauritius v United Kingdom) (Reasoned Decision on Challenge)* (2011), para 167.

VI An International Outlook on the Acceptance and Application of the IBA Guidelines

Arbitration rules and case law both provide useful guidance, as well as some clarity as to the application of the IBA Guidelines and the considerations that arbitrators should bear in mind with regard to their compliance with their duty of independence and impartiality. As will be seen below, three categories may be distinguished based on the general pattern of compliance by States with the IBA Guidelines and their implementation: (1) countries whose national legislation and institutional rules have been based on or refer to the IBA Guidelines, (2) countries whose legislation does not reflect or explicitly refer to the Guidelines, but where they are applied in practice, and (3) those without any general reliance on them.

1 States whose National Regulations and Institutional Rules are Based on or Refer to the IBA Guidelines

There are a number of states whose arbitration laws are based on or explicitly make reference to the IBA Guidelines with respect to the rules on arbitrator impartiality and independence and ethical expectations formulated towards arbitrators. As regards, for example, the practice of the *Russian Federation,* mention must be made of the Rules on Impartiality and Independence of Arbitrators adopted by the Russian Chamber of Commerce and Industry on 27 August 2010 (Russian Rules). Although the rules are non-binding, they seek to take into account the best practices of arbitration in the material area, in particular the IBA Guidelines,[62] and were endorsed by the International Commercial Arbitration Court at the Russian Chamber of Commerce and Industry, and by the management board of the Russian Centre for Assistance to Arbitration.[63] The adoption of the Russian Rules followed a number of cases in which Russian courts annulled arbitral awards on the grounds of alleged bias or lack of impartiality on the part of an arbitrator, such as in *Yukos Capital v Rosneft*, where four awards issued by the International Court of Commercial Arbitration of the Moscow Chamber of Commerce were set aside for the failure of a party-nominated arbitrator to disclose that he had spoken at conferences co-sponsored by the law firm of Yukos Capital.[64]

---

[62] As the Russian Rules on Impartiality and Independence of Arbitrators has been adopted in 2010, it must be noted that it incorporates the 2004 version of the IBA Guidelines on Conflicts of Interest in International Arbitration.

[63] *IBA Arbitration Country Guide* prepared by the Arbitration Committee of the International Bar Association – Russian Federation, 10. The IBA Arbitration Country Guides are accessible at: <https://www.ibanet.org/LPD/Dispute_Resolution_Section/Arbitration/Arbcountryguides#arbitrationguides> accessed 15 February 2023.

[64] Patricia Nacimiento, 'Recognition and enforcement of annulled arbitral awards – the Yukos Capital decision' *Kluwer Arbitration Blog*, 14 October 2009, <https://arbitrationblog.kluwerarbitration.com/2009/10/14/recognition-and-enforcement-of-annulled-arbitral-awards-the-yukos-capital-decision/> accessed 15 February 2023.

Similarly, the corresponding regulation of *India* also incorporates the main findings of the IBA Guidelines.[65] The amendments to the Indian Arbitration and Conciliation Act of 1996 directly adopted the international best practices included in the IBA Guidelines in 2015.[66] The amendment not only attempted to strengthen the neutrality of arbitrators but, by listing the grounds and circumstances that would give rise to justifiable doubts as to the independence or impartiality of an arbitrator, it also explained the circumstances under which such arbitral appointments may be challenged.[67]

The IBA Guidelines have been increasingly recognised in *Japan* since their first introduction in 2004. The Japan Association of Arbitrators, which was established to provide professional training to arbitrators and promote the application of arbitration in Japan, published a Code of Ethics for arbitrators in 2008[68] and also substantively amended its institutional arbitration rules in order to change the scope of arbitrators' duties to ensure impartiality. As for the relevant Japanese jurisprudence, mention must be made of a case before the Supreme Court of Osaka, in which the court has overturned the decision of the Osaka High Court regarding the extent of disclosure by arbitrators in the event of a possible conflict of interest, as required by both Japan's Arbitration Act and international best practice under the IBA Guidelines.[69]

Further addressing the Asian continent's arbitral practice, namely that of *Vietnam*, *Malaysia* and *China*, one may observe that the relevant regulations of all of these States and their local arbitration institutions reflect the general principles related to impartiality, independence and disclosure of conflicts contained in the IBA Guidelines. For instance, the guidelines provided for arbitrators by the Vietnam International Arbitration Centre were drafted by way of referring to and adopting some parts of the IBA Guidelines.[70] The Guidelines have also been frequently discussed and used in Malaysian practice and jurisprudence. Both the Pertubuhan Arkitek Malaysia and the Kuala Lumpur Regional Centre for Arbitration (KLRCA) have specific declaration forms to be submitted by all arbitrators before their appointment, and the KLRCA's Code of Conduct for Arbitrators incorporates the IBA Guidelines on Conflict of Interest as a point of reference.[71] The general principles stipulated in the IBA Guidelines are also reflected in the ethical codes of Chinese local arbitration institutions. The CIETAC Code of Ethics for Arbitrators contains separate provisions resembling the Red List and the Orange List of the IBA Guidelines.[72]

---

[65] *IBA Arbitration Country Guide* – India, 13.

[66] The Ordinance of the President of India issued on 23 October 2015 amending the Arbitration and Conciliation Act, 1996.

[67] Apoorva J. Patel, 'Evaluating the reforms to India's arbitration regime' IBANet, 6 January 2017., <https://www.ibanet.org/Article/Detail.aspx?ArticleUid=d4f5de8f-5df2-4f59-8f74-6ebf766323dd> accessed 7 February 2023.

[68] I*BA Arbitration Country Guide* – Japan, 11.

[69] Supreme Court Third Bench decision on 12 December 2017, Case No. Heisei 28 (Kyo) 43.

[70] *IBA Arbitration Country Guide* – Vietnam, 14.

[71] *IBA Arbitration Country Guide* – Malaysia, 14.

[72] I*BA Arbitration Country Guide* – China, 12.

Courts and tribunals in *Switzerland* also frequently rely on the Guidelines. In 2008, the Swiss Federal Supreme Court reflected on the IBA Guidelines, stating that although they do not have the same value as statutory law, they nevertheless constitute a valuable tool to influence the practice of Swiss institutions and courts.[73] In another notable case, the Swiss Federal Supreme Court examined a possible failure of disclosure on the part of an arbitrator of a Swiss law firm and in acquitting him, it cited the Green list of the IBA Guidelines to argue that the circumstance in question was not a ground to challenge the arbitrator.[74] In 2021, the legislative revisions to Chapter 12 of the Swiss Private International Law Act reinforced party autonomy and codified leading Federal Supreme Court decisions. Article 179(6) now regulates the arbitrator's duty to disclose, without delay, any facts which could raise legitimate doubts regarding independence or impartiality.[75] Article 180 codifies the grounds for challenging an arbitrator, including circumstances that give rise to justifiable doubts as to the arbitrator's independence or impartiality. These modifications embody the principles of the IBA Guidelines that had already been referenced by courts.

As for *Finland's* stance with regard to the IBA Guidelines, the Finnish Code of Judicial Procedure contains specific rules on conflict of interest of arbitrators, and the circumstances deemed relevant in this regard are mostly the same as the circumstances mentioned in the IBA Guidelines. Furthermore, in the guidelines provided to arbitrators by the Arbitration Institute of the Finland Chamber of Commerce, the IBA Guidelines are explicitly referenced as an instrument to be followed when assessing possible conflicts of interest.[76]

2 Countries where the IBA Guidelines are Commonly Referred to in Jurisprudence

In the second category, we may find states whose relevant legislation is not explicitly based on or referring to the IBA Guidelines but in principle correlates with the directions set out in the IBA Guidelines and its jurisprudence makes reference to them. Certain notable examples will be examined in more detail below.

Colombian jurisprudence reflects on international best practices in the material area.[77] A notable example is in *Tampico Beverages Inc. v Productos Naturales de la Sabana S.A. Alquería* decided by the Colombian Supreme Court in 2017. Alquería requested the denial of the enforcement of an arbitration award based on the circumstance that Tampico's counsel was an arbitrator in a previous ICSID case in which its party-appointed arbitrator was counsel. The Supreme Court first had recourse to the Colombian Arbitration Act,

[73] *IBA Arbitration Country Guide* – Switzerland, 11.

[74] Decision n. 4A_386/2015 of the Swiss Federal Supreme Court, 7 September 2016.

[75] Catherine Anne Kunz, Courtney Furner, 'International Arbitration 2022 – Switzerland, International Arbitration Laws and Regulations 2022' (ed. Joe Tirado Garrigues).

[76] *IBA Arbitration Country Guide* – Finland, 11.

[77] *IBA Arbitration Country Guide* – Colombia, 8.

in connection with which it noted that its relevant article[78] does not provide for specific grounds for challenging arbitrators. In the absence of such an explicit legal basis, the Supreme Court went on to examine relevant international standards. It noted that the IBA Guidelines reflect the practice of the arbitral community, which indicates that these guidelines are frequently used by arbitral institutions, and concluded that none of the situations listed in the Guidelines were met in the material case.

The IBA Guidelines are frequently followed by Italian arbitration practitioners as well.[79] Pursuant to the 2016 Report on the Reception of the IBA Arbitration Soft Law Products in Italy, the IBA Guidelines were referenced in 53 percent of relevant arbitral cases and practitioners frequently consulted the Guidelines when deciding on questions of disclosure.[80] As to the application of the Guidelines in national jurisprudence, however, there appear to be not much relevant case law where the IBA Guidelines were directly applied.[81]

Besides the above-detailed examples, arbitral practice in several other States consistently shows the Guidelines' wide acceptance and reliance on them. The table below provides the reader with a summary of the reception and handling of the IBA Guidelines among the members of the international community.

Country name	**Status of the IBA Guidelines as referenced in the IBA Arbitration Guides**	**Relevant national legislation stipulating the impartiality and independence of arbitrators**
Australia	The Guidelines are frequently used and cited by arbitrators and counsel.[82]	International Arbitration Act of 1974 and its revision of 2010
Austria	The Guidelines are referred to in practice from time to time.[83]	Sections 587-588 of the Law of 1 August 1895 Austrian Code of Civil Procedure, RGBl. Nr. 113/1895 as amended by the 2013 Amendment to the Austrian Arbitration Act
Belgium	Arbitrators tend to refer to the specific lists included in the Guidelines.[84]	Belgian Law on Arbitration included as Title I VI in the Belgian Judicial Code

[78] Colombian Arbitration Act (Law No. 1563), Article 75.

[79] *IBA Arbitration Country Guide* – Italy, 13.

[80] IBA Arbitration Guidelines and Rules Subcommittee, Report on the Reception of the IBA Arbitration Soft Law Products, 16 September 2016, <https://dernegocios.uexternado.edu.co/wp-content/uploads/sites/2/2016/09/IBAsoftlawArbproducts-ArbGuidelinesandRulesSubcommittee-2.pdf> accessed 15 February 2023, para 120.

[81] Report on the Reception of the IBA Arbitration Soft Law Products (n 80) para 167.

[82] *IBA Arbitration Country Guide* – Australia, 8.

[83] *IBA Arbitration Country Guide* – Austria, 10.

[84] *IBA Arbitration Country Guide* – Belgium, 12.

Country name	Status of the IBA Guidelines as referenced in the IBA Arbitration Guides	Relevant national legislation stipulating the impartiality and independence of arbitrators
Brazil	Grounds in the Brazilian Code of Civil Procedure are similar to the red and orange lists, and it is common for the parties, arbitral institutions or the tribunal to refer to the Guidelines as relevant authority.[85]	Brazilian Arbitration Act – Federal Law n. 9307/1996
Bulgaria	The standards established by the Guidelines are generally applied in Bulgaria.[86]	International Commercial Arbitration Act of 1988
Canada	The Guidelines are frequently consulted by tribunals and courts.[87]	Code of Civil Procedure
Chile	The Guidelines are commonly used in international arbitrations with seat in Santiago, Chile.[88]	Code of Civil Procedure, 1902
Croatia	The Guidelines are taken into account.[89]	Croatian Arbitration Act Official Gazette no. 88/2001
Ecuador	The Guidelines are followed by the arbitral institutions.[90]	Constitution of Ecuador; Arbitration and Mediation Law
Denmark	The Guidelines are widely recognised and applied.[91]	Danish Arbitration Act
England and Wales	The Guidelines are commonly used and courts derive assistance from them when considering a challenge.[92]	Arbitration Act 1996; Solicitors' Code of Conduct 2011; Barristers' Code of Conduct 2000
Germany	The Guidelines influenced German arbitration case law and are recognised by German courts.[93]	German Code of Civil Procedure
Ghana	The Guidelines are sometimes used.[94]	Alternative Dispute Resolution Act

[85] *IBA Arbitration Country Guide* – Brazil, 14.
[86] *IBA Arbitration Country Guide* – Bulgaria, 10.
[87] *IBA Arbitration Country Guide* – Canada, 11
[88] *IBA Arbitration Country Guide* – Chile, 13
[89] *IBA Arbitration Country Guide* – Croatia, 10.
[90] *IBA Arbitration Country Guide* – Ecuador, 11.
[91] *IBA Arbitration Country Guide* – Denmark, 7.
[92] *IBA Arbitration Country Guide* – England and Wales, 10.
[93] *IBA Arbitration Country Guide* – Germany, 10.
[94] *IBA Arbitration Country Guide* – Ghana, 6.

Country name	Status of the IBA Guidelines as referenced in the IBA Arbitration Guides	Relevant national legislation stipulating the impartiality and independence of arbitrators
Greece	It is quite common to use the Guidelines as a guide.[95]	Law 2735/1999 on International Arbitration; Greek Code of Civil Procedure
Hong Kong	There is no requirement to use the Guidelines, but parties may agree to apply them.[96]	The Hong Kong Arbitration Ordinance
Hungary	The Guidelines are usually followed.[97]	Act LX of 2017 on Arbitration
Indonesia	Most professional arbitrators are cognisant of the Guidelines and tend to respect them.[98]	Law Number 30 Year 1999 – Arbitration Law
Ireland	The Guidelines are widely used.[99]	Arbitration Act of 2010
Lebanon	In substance, the Lebanese Code of Civil Procedure mirrors the Guidelines, which serve as a useful source and are consulted in practice[100]	Lebanese Code of Civil Procedure
Lithuania	The Guidelines are commonly applied in practice.[101]	Law on Commercial Arbitration
Luxembourg	The Guidelines are commonly used as reference.[102]	Luxembourg New Code of Civil Procedure
Mexico	It is common that arbitral tribunals and arbitration institutions take the Guidelines into consideration[103]	Commerce Code
Netherlands	The Guidelines are applied in international arbitrations seated in the Netherlands, and used as guidance in domestic arbitrations.[104]	2015 Amendment of the Dutch Arbitration Act

[95] *IBA Arbitration Country Guide* – Greece, 8.
[96] *IBA Arbitration Country Guide* – Hong Kong, 11.
[97] *IBA Arbitration Country Guide* – Hungary, 9.
[98] *IBA Arbitration Country Guide* – Indonesia, 10.
[99] *IBA Arbitration Country Guide* – Ireland, 7.
[100] *IBA Arbitration Country Guide* – Lebanon, 8–9.
[101] *IBA Arbitration Country Guide* – Lithuania, 10.
[102] *IBA Arbitration Country Guide* – Luxembourg, 12.
[103] *IBA Arbitration Country Guide* – Mexico, 10.
[104] *IBA Arbitration Country Guide* – Netherlands, 9.

Country name	Status of the IBA Guidelines as referenced in the IBA Arbitration Guides	Relevant national legislation stipulating the impartiality and independence of arbitrators
Romania	The Guidelines are followed voluntarily by the arbitrators.[105]	Romanian Civil Procedural Code
Nigeria	The Guidelines are often used as guidance.[106]	Arbitration and Conciliation Act, Cap A19, Laws of the Federation of Nigeria, 2004
Peru	The Guidelines are employed as illustrative criteria.[107]	Arbitration Act Legislative Decree 1071 of 2008
Poland	The Guidelines are generally adopted in practice.[108]	Code of Civil Procedure of 1964
Portugal	The Guidelines are referenced in several state court decisions.[109]	Portuguese Arbitration Law
Scotland	Regard is commonly had to the Guidelines.[110]	Arbitration Act of 2010
Senegal	The Guidelines have recently been used as best practice.[111]	Decree No 98-492; Arbitration Act No 98-30 dated 14 April 1998
Singapore	The Guidelines are frequently referred to.[112]	The Arbitration Act and the International Arbitration Act
South Africa	The Guidelines are increasingly followed.[113]	Arbitration Act of 1965
South Korea	The Guidelines gained increasing prominence and influence, and the judicial standards appear to be largely consistent with them.[114]	Korean Arbitration Act
Spain	The Guidelines are frequently followed.[115]	Arbitration Act 60/2003 of 23 December

[105] *IBA Arbitration Country Guide* – Romania, 8.
[106] *IBA Arbitration Country Guide* – Nigeria, 10.
[107] *IBA Arbitration Country Guide* – Peru, 10.
[108] *IBA Arbitration Country Guide* – Poland, 10–11.
[109] *IBA Arbitration Country Guide* – Portugal, 12.
[110] *IBA Arbitration Country Guide* – Scotland, 11.
[111] *IBA Arbitration Country Guide* – Senegal, 7.
[112] *IBA Arbitration Country Guide* – Singapore, 11.
[113] *IBA Arbitration Country Guide* – South Africa, 9.
[114] *IBA Arbitration Country Guide* – South Korea, 8.
[115] *IBA Arbitration Country Guide* – Spain, 13.

3 Countries with Generally No Reliance on the IBA Guidelines

Third, one may identify countries with no specific rules or codes of conduct concerning conflicts of interest for arbitrators and generally no reliance on the IBA Guidelines. Pursuant to the country-specific reports prepared by the Arbitration Committee of the IBA in which the Association specifically analysed the practice of States in connection with the IBA Guidelines, Argentina,[116] Egypt,[117] the Czech Republic,[118] El Salvador,[119] France,[120] New Zealand,[121] Saudi Arabia,[122] Thailand,[123] Turkey,[124] Ukraine,[125] the United Arab Emirates,[126] the United States[127] and Venezuela[128] do not generally apply or rarely apply the IBA Guidelines in their corresponding jurisprudence.

VII An Outlook on Hungarian Practice

In the following section, the article will provide the reader with a glimpse into how the IBA Guidelines are reflected on in Hungarian arbitral and judicial practice. The lack of independence or impartiality is a ground for challenging arbitrators under the arbitration procedure set out in the Hungarian Arbitration Act. If the arbitrator does not accept the challenge, or if one of the parties believe that the arbitral process or the outcome of the arbitration was influenced by certain conflicts of interests, such a claim can be brought before a civil court. Accordingly, the IBA Guidelines was referenced in several court cases concerning the annulment of arbitral awards.

In case Gfv. 30.141/2010/24, the Supreme Court has deemed the IBA Guidelines to be an internationally accepted document in the field of arbitrator impartiality. The case concerned an arbitration between two companies regarding their sale and purchase agreements for certain real estate, and the request for annulment submitted against the arbitral award of the Hungarian Chamber of Commerce and Industry, and the second instance court decision confirming the award. The claimant, when arguing for the partial and dependent conduct

[116] *IBA Arbitration Country Guide* – Argentina, 11.
[117] *IBA Arbitration Country Guide* – Egypt, 9.
[118] *IBA Arbitration Country Guide* – Czech Republic, 9.
[119] *IBA Arbitration Country Guide* – El Salvador, 8.
[120] *IBA Arbitration Country Guide* – France, 9.
[121] *IBA Arbitration Country Guide* – New Zealand, 12.
[122] *IBA Arbitration Country Guide* – Saudi Arabia, 14.
[123] *IBA Arbitration Country Guide* – Thailand, 9.
[124] *IBA Arbitration Country Guide* – Turkey, 11.
[125] *IBA Arbitration Country Guide* – Ukraine, 11.
[126] *IBA Arbitration Country Guide* – United Arab Emirates, 12.
[127] *IBA Arbitration Country Guide* – United States, 9.
[128] *IBA Arbitration Country Guide* – Venezuela, 10.

of the judges in the arbitral proceedings as a basis for annulment, argued that Hungarian court practice has adopted and followed the practice of the IBA.[129] When addressing the claimant's submission, the Supreme Court stated that the IBA Guidelines assist courts in deciding on which connections arbitrators must disclose, and although the IBA Guidelines is not a legislative act, they serve as guidance for judges to decide on arbitrators' obligation of disclosure.[130] In its reasoning, the Supreme Court did not reject the lower courts' and the claimant's reliance on the IBA Guidelines and did not object to its applicability; it only contested how lower courts applied its relevant provisions.[131]

This decision was later reaffirmed in case Gfv. 30.299/2012/12 of the new Supreme Court of Hungary (the Curia). The case likewise concerned a request for annulment on the basis of the arbitrators' impartiality and independence. When addressing whether membership of the same Bar Association is a fact to be disclosed, the Curia stated that although the IBA Guidelines do not contain legislative provisions, as a document based on international arbitration practice, it may help courts in deciding whether the appointed arbitrator should have disclosed a particular relationship to the parties.[132] Consequently, if the arbitrators in a particular case considered that, although they are members of the same Bar Association, they are not in a close or dependent relationship with the parties' legal representatives and the nature of their relationship does not affect their independence and impartiality, such a distant relationship need not be disclosed.[133]

BH 2013.100., a judicial decision of principle status adjudicated upon by the Curia in 2013, has provided similar conclusions. The case concerned an arbitration regarding the claimant's request for the repayment of a certain instalment of the purchase price under the sale and purchase contract between the parties, and the respondents' request for annulment of the judicial decision annulling the arbitral award. Similarly to the previous case, the case turned on arguments regarding the partiality and dependence of one of the arbitrators on the bases of his membership of the same Bar Association as one of the legal representatives and in the Hungarian Academy of Sciences as one of the respondents. Despite flagging the non-binding nature of the IBA Guidelines, a Hungarian court once again stressed their importance and influential role, and applied their provisions when dealing with a request for annulment. As the Curia stated, the IBA Guidelines are intended to assist arbitrators in particular in deciding when to decline an arbitrator appointment, and which of their relationships with the parties they should disclose.[134] It may also assist courts in assessing whether a failure to disclose a relationship is contrary to the requirements of a fair hearing.[135]

---

[129] Supreme Court of Hungary Gfv. 30.141/2010/24, 8.
[130] Supreme Court of Hungary Gfv. 30.141/2010/24, 10.
[131] Supreme Court of Hungary Gfv. 30.141/2010/24, 11.
[132] Curia of Hungary, Gfv. 30.299/2012/12, 10.
[133] Curia of Hungary, Gfv. 30.299/2012/12, 10.
[134] BH 2013.100., 1, 4.
[135] BH 2013.100., 1, 4.

The Guidelines were further invoked in case Pfv. 20.757/2017/7, where the Curia as a court of review adjudicated the claimants' claim against the Metropolitan Court of Budapest for compensation for damages caused by judicial proceedings. The claimants alleged that the Metropolitan Court failed to correct the shortcomings of the arbitral tribunal regarding the unlawful conduct of arbitrators. Lower courts extensively argued with references to the Guidelines, and notably did so without mentioning the legal character of the document. The Curia has nevertheless affirmed such arguments and upheld the decision in force.

Echoing the above decisions, and applying the IBA Guidelines when deciding on obligations of disclosure, and issues of independence and impartiality, Hungarian courts have consistently made reference to the document in their further decisions on arbitral annulment requests and relating claims.[136] The fact that courts applied the guidance of the IBA despite the recurring explicit reference to the non-binding nature of the Guidelines shows the stark importance of soft law instruments as a special, distinct and constant source of influence in the field of international arbitration. Nevertheless, it likewise shows the ambiguous and paradoxical status of these soft law instruments as Hungarian courts – and as shown above, international arbitral tribunals – apply them despite (and right after) noting their unenforceable and non-binding nature.

VIII Conclusion

As we have seen, the field of international arbitration evolved greatly in the past years, which resulted – among other things – in the accelerated growth and increased significance of soft law instruments. Although this article mainly focused on procedural soft law instruments, it is worth mentioning that soft law today also occupies several other rapidly developing fields, such as environmental law and sustainable development.

Although the value and contribution of these tools are indisputable, their application seems to blur the line between binding and non-binding norms in international law. As for procedural soft law instruments, such documents created by non-state actors are generally aimed at filling the void left by sovereign states for the parties to agree upon. However, in many instances, the void remans unfilled by the parties themselves in a concrete case, and the application of the soft law rule occurs without a normative obligation being initiated by the parties. This results in normative confusion regarding the status of these instruments, and questions the process and line between soft and hard rules of arbitration and international law.

This article aimed, firstly, at highlighting these legitimacy concerns, namely certain confusions about the normativity of soft law instruments, the flexibility of the arbitration

[136] Gfv. 30.099/2011/7., Gfv. 30.016/2012/10., Gfv 30.021/2012/3., Gfv. 30.262/2013/5.

regime, risks of the judicialisation of arbitration and contradictions between soft law instruments and institutional rules. Secondly, the article proceeded to identify the concerns in a specific field, that of the impartiality and independence of arbitrators. Based on the findings in the second part of the present article, it can be concluded that the IBA Guidelines are frequently applied and a very useful tool for identifying potential conflicts of interest. Nevertheless, even when referenced by tribunals, their normative status and the exact basis for their reference remains unclear.

Pursuant to the international outlook in Part VI above, the reader can become familiar with the three categories in which the reception of the IBA Guidelines within certain states can be distinguished. We can see that even if there are only a few countries explicitly basing their arbitral regulations on the Guidelines or whose arbitral institutions build upon these principles, and there are certain States whose reliance on them is absent, the majority of States at least adopts and follows them in practice as guidance for the application of rules on impartiality and independence in their national legislation. One of such states is Hungary, whose judicial stance on the IBA Guidelines was introduced in Part VII. However, it must also be borne in mind that the application of the IBA Guidelines is dependent on certain limitations, and contributes to the inconsistencies and legitimacy concerns echoed in legal scholarship regarding international arbitration.

Accordingly, the negative concerns, most importantly concerns regarding the legitimacy of the arbitral process, must be addressed. Without such legitimacy, the parties may lose confidence in the arbitral system, and the intended efficiency and certainty of the process will decline due to an increase in challenges to arbitrators and awards. Additionally, as pointed out by *Vera Korzun* in her article on soft law in the investment law context, 'a threat of conversion of soft law into hard law [...] may deprive states a choice in designing legal agreements'.[137]

Addressing these concerns, discussions by the IBA regarding the international status of the Guidelines are recommended so that a more consistent and unified approach is taken as regards the level of normativity represented by the standards in light of the above-mentioned extensive international practice for their application. Such discussions should pay particular attention to providing judges and arbitrators with more guidance as to the effective but also mindful application of the Guidelines and other soft law instruments, addressing the paradoxical practice of applying such rules in parallel with pointing to their non-binding nature.

[137] Vera Korzun, 'Enforcing Soft Law in International Investment Arbitration' (2023) 56 (1) Vanderbilt Journal of Transnational Law 63.

Shady Mawad*

Legal Analysis of Export Subsidies under the Agreement of Subsidy and Countervailing Measures

Abstract

Export subsidies, for several decades now, have attracted significant attention due to their undesirable impacts on international trade. In the Uruguay Round 1994, the World Trade Organization (WTO) generated the Agreement on Subsidies and Countervailing Measures (ASCM) which contains global rules to regulate the different types of subsidies and to offset their adverse effects on other WTO Members. This paper, through its three sections, therefore aims to provide a legal analysis of the provisions of export subsidies contained in Articles 3 and 4 of the ASCM. By doing so, this paper answers the question of whether the ASCM is sufficient to cease the distortive effect of the export subsidy. To that end, doctrinal legal research has been conducted through analysis of the black letter of law and the case laws. In conclusion, the ASCM succeeded in giving the export subsidies *per se* prohibited nature, either in law or in fact. Unfortunately, the mere repayment of the amount of the subsidy is not always a sufficient remedy. As such, punitive countermeasures must be introduced to implement remedial provisions and to deter export subsidies.

Keywords: Agreement on Subsidy and Countervailing Measure, export subsidy, remedies, subsidy withdrawal, WTO Dispute Settlement Body.

I Introduction

Over half a century ago, most countries have witnessed a great escalation in the proportion of their imports or exports relative to domestic production for domestic consumption. From an economic perspective, the theory of comparative advantages, which was introduced by

* Shady Mawad (LL.M) is a PhD Candidate at the University of Szeged, Faculty of Law and Political Science, Department of Private International Law and International Commercial Relationships.

Adam Smith and David Ricardo, perhaps explains why international trade has a crucial role in boosting the world economy. This suggests that every country is capable, based on its national resources, of producing particular commodities at relatively competitive prices. Thus, every country exports the commodities of which it has a surplus and imports other commodities that are produced in another country at more affordable prices and can meet its market demands. Thus, this theory stands as a basis for the ongoing tendency of countries to subsidise their exports.[1]

Moreover, the theory of Economic Regulation, which is also known as Economic Interventionism, justifies the growing involvement of the government in the market. The government intervenes in the market either (1) to limit or eliminate market failures or inequitable market practices, by controlling the prices of essential utilities such as electricity and gas, or by imposing or removing restrictions on economic activities, for example, taxes, tariffs and quotas,[2] or (2) to enhance domestic production or to favour certain products or undertakings over other (foreign) competitors. According to the World Trade Organization (WTO), the latter non-tariff measure is known as a 'subsidy'. It is noted that subsidies, particularly 'export subsidies', are most likely to have a distortion effect on the free market.[3]

However, the need for solid international rules in order to regulate the application of subsidies effectively has been necessary due to the failure of the Subsidy Code 1979 in this regard.[4] The WTO Agreement on Subsidies and Countervailing Measures (ASCM), which entered into force in 1995, therefore provides a set of rules for the operation of subsidies in the goods sector and for the application of remedies to offset their harmful commercial effects. This Agreement defines 'subsidy' as a financial contribution by the government or any public body that conferred a benefit to a specific enterprise or industry or group of enterprises or industry or to a specific geographic area.[5]

Furthermore, the ASCM classifies a given subsidy based on its market distortion effects into three categories, which have different disciplines. First is the prohibited category: due to their direct trade-distorting effect, Member States are forbidden to provide any subsidy contained in this category. It involves two kinds of subsidies, as subsidy contingent upon export performance (export subsidy) and upon the use of domestic over imported goods

---

[1] OECD, *Globalisation, Comparative Advantage and the Changing Dynamics of Trade* (OECD Publishing 2011, Paris) 11.

[2] Christopher Decker, *Modern Economic Regulation: An Introduction to Theory and Practice* (Cambridge University Press 2015) 3, https://doi.org/10.1017/CBO9781139162500

[3] Ludwig Von Mises, *Interventionism: An Economic Analysis* (Liberty Fund, Incorporated 2011) 59.

[4] The Subsidy Code was not accepted and implemented by all the contracting parties to the GATT. It was a multilateral agreement, in which only those countries that wanted to participate in it did so. This flaw limits the effectiveness of the Code, especially if the dispute is between a contracting party and a non-contracting party. Richard H. Snape, *Export-promoting Subsidies and what to Do about Them* (World Bank Publications 1988) 22.

[5] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, *Marrakesh Agreement Establishing the World Trade Organization,* Annex 1A, 1869 U.N.T.S. 14 (entered into force 1 January 1995) [Hereinafter the ASCM] articles 1–2.

(domestic content subsidy).[6] In contrast, goods in the non-actionable category are not banned, and Member States are allowed to grant them. This category includes three types of subsidies, for research activities, for disadvantaged regions and for the adaptation of existing facilities to meet environmental requirements.[7] In the middle, there is the actionable category which covers every other specific subsidy: as far as they cause trade adverse effects, they can be challenged before the WTO Dispute Settlement Body (DSB).[8]

However, the export subsidy is the centre of attention of this paper as long as it has been one of the commercial policies that have received significant consideration at the international level. Governments provide export subsidies to domestic exporters with the intention of improving competitiveness through lower production costs or increased export quantities through monetary incentives. Nonetheless, the utilization of these subsidies has raised apprehension due to their potential to distort trade patterns, create inequitable advantages, and instigate trade disputes between countries. As such, it is worth stating that the prohibition of export subsidies was not innovated by the ASCM, but was first introduced in the 1960s under Article 16 of the General Agreement on Tariffs and Trade (GATT). Further developments came with the Tokyo Round negotiations (1973–1979), through the Subsidies Code, till it had found its current upgraded and comprehensive form under the ASCM. Therefore, this paper examines the provisions of the export subsidy set out in the ASCM. By doing so, this paper answers the question whether the ASCM is sufficient to cease the distortion effect of the export subsidy. To that end, doctrinal legal research has been conducted through analyses of the black letter of law and the case laws.

This paper contains, in addition to the introduction and conclusion, six sections. A brief discussion about the definition of 'subsidy' in the context of the ASCM is done in the second section. The third and fourth sections gradually analyse the occasions in which the export subsidy exists and highlight the pass-through approach stipulated through the Illustrative List of Export Subsidies. Finally, the fifth section examines the effectiveness of the remedies in case of illegal export subsidy.

II The Definition of 'Subsidy' – in a Nutshell

The starting point of the discussion is the definition of 'subsidy'. Unlike the GATT 1949 and the Subsidy Code 1979, Article 1 of the ASCM presents the first universal definition of 'subsidy' as a financial contribution by a government or public body that conferred a benefit. Three cumulative elements must be met in order for a subsidy to exist. Firstly, the financial contribution may take various forms. The basic form is the transfer of state funds or liabilities, either in cash or in kind, such as grants, loans, equity infusions, and

[6] Art 3 of the ASCM.
[7] Art 8 of the ASCM.
[8] Art 5 of the ASCM.

loan guarantees.[9] Additionally, the other form is tolerance in the collection of government revenue. The revenue resources can be divided into two main categories: (1) taxes or tariffs and (2) non-tax revenue, including fees that are charged for the enjoyment of certain services, such as issuing a passport or driving licence, waiver of fines and penalties, and others. The financial contribution materialises when the government forgives or does not collect these dues.[10] Moreover, the government might participate in economic activities that go beyond the public purpose of its infrastructure for the sake of the interest of private undertakings. For instance, port services provided to a single importer or exporter, or purchasing goods at artificial prices.[11]

Secondly, the subsidy must be provided by the 'government or any public body'. The meaning of public body, but separate from the government has been controversial. According to the case law, it can be noted that the common characteristic of these two bodies is either 'Public Purpose', 'Public Activity', or 'Public Authority'. The Appellate Body (AB) in the *US- Anti-Dumping and Countervailing Duties (China)* found that 'public body' is 'an entity that possesses, exercises, or is vested with government authority'.[12] Undoubtedly, no one can deny the importance of the AB's finding, which arguably is consistent with the wording and context of the ASCM, but also the 'authority' test imposed through this definition will likely be more difficult to implement than the 'control' criterion established by the Panel.[13]

Accordingly, the financial support issued by private enterprises does not reach the level of subsidy according to the ASCM. One exception can be found is when a government directs or entrusts a private body in order to conduct any of the above activities.[14] Hence, the financial support is conveyed indirectly from the government to the private actor through a private intermediary (financial institution). It is worth mentioning that various scholars, including Flett, Jessen and Talaber-Ritz, argue that the scope of the WTO subsidy is wider (more comprehensive) than European state aid. That is understandable, because the latter limits the existence of the aid to situations that entails a cost to the government, then excludes financial support provided by the private actors from being an aid.[15]

---

[9] Art 1.1.(a).1. i of the ASCM.

[10] Art 1.1.(a).1. ii of the ASCM.

[11] Art 1.1.(a). 1.iii of the ASCM.

[12] Appellate Body Report, *United States (US) – Anti-Dumping and Countervailing Duties (China)*, WT/DS379/AB/R, 11 March 2011, Para 317.

[13] The Panel adopted the approach that public body includes any entity controlled by the government and ownership is sufficient evidence for such control. Francois-Charles Laprévote and Sungjin Kang, *Subsidies Issues in the WTO – An Update* European State Aid Law Quarterly, Vol 10 (Lexxion Verlagsgesellschaft mbH 2011) 448. https://doi.org/10.21552/ESTAL/2011/3/245

[14] Art 1.1.(a).1. iv of the ASCM.

[15] James Flett, Anders C. Jessen and Klara Talaber-Ritz, *The Relationship between WTO Subsidies Law and EC State Aid Law*, EC State Aid Law, International Competition Law Series, Vol 36 (Kluwer Law International 2008) 441.

Thirdly, the existence of financial contribution by the government is not sufficient, by itself, to comprise a subsidy, but a benefit in the account of the recipient is a major element to determine the subsidy practices. Unfortunately, the ASCM is silent about the definition of 'benefit' and the method to calculate its amount. It merely provides extensive guidelines for such a calculation through Article 14. Accordingly, there are two main requirements that any methodology to calculate benefit must meet: 1) legal nature, which means it should be created by a legal instrument of the investigating Member, such as legislation or regulation; 2) transparency and clarity regarding the application. However, the AB, in the *Canada–Soft Lumber* dispute, concluded that the terminology 'benefit' within the meaning of Article 1.1(b) of the ASCM shall be interpreted as every advantage that results from the governmental financial contribution and places the recipient in a better economic situation than in the case of the absence of such contribution.[16] Consequently, every financial contribution by the government that does not improve the market conditions available to the recipient falls outside the spectrum of the ASCM.[17] Moreover, in the case where the recipient of financial support is other than the beneficiary then the benefit shall not pass through the recipient (for example upstream) unless the producer of the final product (downstream) itself received the input at terms advantageous to the market.[18]

Furthermore, one of the essential differences between the WTO Subsidy and European State Aid is that the latter is generally prohibited, and the pre-acceptance of the European Commission must be obtained for granting such aid.[19] Therefore, the existence of the above-mentioned elements is not sufficient to render a subsidy illegal, but the constitutive element has to be fulfilled, which is specificity. Thus, only a 'specific subsidy' can be disputed and subject to countervailing measures under the ASCM.[20] Hence, it should be said that specificity is an essential requirement for the application of the WTO subsidy disciplines, but not for the subsidy existence itself. Moreover, Article 2 of the ASCM brings out some general principles, according to which the subsidy is deemed to be specific to a certain enterprise or industry or group of enterprises or industries. At the head of the line, specificity shall be proved only by positive evidence.[21] Besides, the subsidy is not specific if it is provided based on objective criteria or conditions that are neutral and equivalent to all enterprises.[22] Over and above, a subsidy is specific when the granting authority limits its availability to

---

[16] Panel Report, *United States – Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada*, WT/DS257/R, 29 August 2003, Paras 4.205 – 4.206.

[17] Staff of IMF, OECD, World Bank, and WTO, *Subsidies, Trade, and International Cooperation* (IMF 2022) 33.

[18] Sophia Müller, *The Use of Alternative Benchmarks in Anti-Subsidy Law, A Study on the WTO, the EU and China* (Springer 2018) 217. https://doi.org/10.1007/978-3-319-77613-2

[19] *Consolidated version of the Treaty on the Functioning of the European Union* [2012] OJ C326/47, art 107.1.

[20] Art 1.2 of the ASCM.

[21] Art 2.4 of the ASCM.

[22] Footnote 2 of the ASCM. Objective criteria are based on quantifiable factors that can be assessed and verified objectively, without any subjective bias or discrimination, such as export volume, employment numbers, or investment levels.

certain enterprises situated within a designated geographical area.[23] In this kind of subsidy, the specificity criterion, based on which the eligibility of enterprises or industries arises, is the location, which is why it is called a 'regional subsidy'. As such, it is worth noting that a regional subsidy exists even if it is provided to all enterprises in a fixed region, as long as the enterprises located outside that region are not entitled to such subsidy.[24]

On the other hand, there is an irrefutable presumption on the specificity of both export-contingent subsidies and subsidies contingent upon the use of domestic products over imported products (classified as prohibited subsidies under Article 3 of the ASCM). The complaining Member has no obligation to submit any evidence on the specificity regarding these two kinds of subsidies.[25] That is also clear from the language of Article 4.1 of the ASCM, which allows Members that only have evidence of the existence of prohibited subsidies, to enter immediately into consultation with the granting Member.

III When does the Government Financial Contribution Constitute an Export Subsidy?

This question arises especially after knowing that it is not sufficient for the export subsidy to exist the mere fact that the subsidy is granted to an undertaking that carries out the export transactions, but other conditions should be met.[26] Hence, government support constitutes an export subsidy when two conditions are fulfilled: firstly, it meets the meaning of subsidy within Article 1 of the ASCM as explained above; secondly, it meets the 'export contingency' test as clarified in Article 3.1. (a) of the ASCM. Some scholars hence argue that an exchange rate supported by the government is not considered, by itself, contingent on exports as long as it applies across the board and includes not only investors (exporters) but also a wide range of beneficiaries such as tourists.[27]

To begin with the language of Article 3.1. (a) that states 'subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I'. Various points need to be highlighted, in particular, the terms 'in law' and 'in fact'. On the one hand, export subsidy exists in law, when the government's financial contribution is granted to facilitate exportation by means of law, such as regulations, legislation, etc. In this way, the wording of the legislation, for example, that establishes the

[23] Art 2.2 of the ASCM.

[24] The Panel, like the US, contested the EC's interpretation of Article 2.2, as specificity must include both geographical region and the subset of enterprises within that region. Panel Report, *European Communities (EC) and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R, 30 June 2010, Para 7.1223.

[25] 'Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.' Art 2.3 of the ASCM.

[26] Footnote 4 of the ASCM.

[27] Dominic Coppens, *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints* (Cambridge University Press 2014) 584, https://doi.org/10.1017/CBO9781139046589

measure in question, expressly demonstrates the existence of the export condition.[28] For instance, this term contained in implementing regulation serves as clear evidence on export contingency in law: 'the only way to import any motor vehicles duty-free is to export, and the amount of import duty exemption allowed is directly dependent upon the number of exports achieved'.[29]

Furthermore, the AB highlighted that it is not mandatory for the legal instrument to contain an *expressis verbis* on export performance in order for the contingency in law to exist. Instead, contingency can also be acquired through the interpretation of the words that are used in the measure.[30] Here, the best example is the *United States (US) – FSC* dispute, in which the taxpayers can benefit from the tax exemption provided for in the Extraterritorial Income Exclusion Act (the ETI Act) when the income from certain types of transaction involves 'qualifying foreign trade property' (QFTP). The ETI Act defines the QFTP as the property that must be 'held primarily for sale, lease, or rental, in the ordinary course of trade or business for direct use, consumption, or disposition outside the United States […]'. That means the property, which is produced within the U.S., shall be exported in order to be eligible for the tax exemption (fiscal subsidy). In other words, using the phrase 'use […] outside the United States' necessarily implies the exportation of the property from the United States (the place of production) to the place of use.[31]

On the other hand, the export subsidy can appear without being introduced in a legal instrument, but the practice and the actual facts should instead demonstrate that boosting the export transactions or export earnings is the essential goal behind the governmental financial contribution.[32] Moreover, the AB, in *EC-Large Civil Aircraft,* has evolved the *de facto* test as 'is the granting of the subsidy geared to induce the promotion of future export performance by the recipient?'. By way of explanation, a comparison must be made between the anticipated export sales of the subsidised product that resulted from granting the subsidy, and the situation in the absence of the subsidy. Hence, the test is positive if the comparison shows that, by granting the subsidy, the recipient has been motivated to increase its exports in a way that does not reflect the conditions of supply and demand in the ordinary domestic and export markets. That means trivial promotion of export sales does not necessarily indicate the existence of an export subsidy because such a promotion can occur under normal market conditions. In the words of Lester, a *de facto* export contingency exists when the subsidy motivates producers to export their products instead of selling them domestically. As a result,

---

[28] Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R, 31 May 2000, para 100.

[29] Ibid, para 104.

[30] Ibid, para 100.

[31] Appellate Body Report, *United States – Tax Treatment for 'Foreign Sales Corporations'*, WT/DS108/AB/RW2 (Art 21.5), 13 February 2006, para 116.

[32] Footnote 4 of the ASCM.

export sales become higher than and favoured over domestic sales.[33] Arguably, a scholar like Steger called for a more consistent interpretation of the *de facto* export contingency.[34] However, the author of this article stands on the side of the test developed by the Panel. The determination of the *de facto* contingency should therefore be on a case-by-case basis as long as it is derived from the actual facts, which are unlimited and unpredictable, that cannot be covered by a fixed term. Hence, while applying this test, the panel should examine every circumstance surrounding the subsidy measure that might help to understand the measure's design, structure and modalities of operation in an objective manner.[35]

Furthermore, the next phase dives into the meaning of what the black-text call, the 'contingency upon export performance' test. Indeed, the WTO DSB provides a comprehensive explanation of the 'contingency' test. Initially, the Panel, in *Australia-Automotive Leather*, relied on the New Shorter Oxford English Dictionary to explain the ordinary meaning of the term 'contingent' as 'dependent for its existence on something else', 'conditional; dependent on, upon'.[36] Afterward, the Panel referred to footnote 4 of the ASCM, which is an integral part of Article 3.1(a), which interprets and replaces the term 'contingent' with 'tied to'. Additionally, as the Panel and the AB agreed in the previous dispute[37] the term 'tied to' was simplified as 'restrain or constrain to or from an action; limit or restrict as to behaviour'. Thus, the meaning of the term 'contingency' or 'conditionality' or 'tied to' is equivalent to an undeniable connection between the grant of a subsidy and export performance.[38]

In practice, the Panel decided that the loan[39] granted by the Australian government to Howe[40] did not constitute a subsidy contingent upon export performance due to the absence of a specific connection between the grant of subsidy and the export performance. The

---

[33] Simon Lester, 'The problem of subsidies as a means of protectionism: Lessons from the WTO EC – AIRCRAFT case' (2011) 12 Melbourne Journal of International Law 345–372, 358.

[34] Debra Steger, 'The Subsidies and Countervailing Measures Agreement: Ahead of its Time or Time for Reform?' (2010) 44 (4) Journal of World Trade 779–796, 785.

[35] Panel Report, *European Communities (EC) and Certain member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R, 18 May 2011, paras 1045–1051.

[36] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, 25 May 1999, para 9.55.

[37] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, 2 August 1999, para 171.

[38] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, 25 May 1999, para 9.55.

[39] The loan contract provides for a fifteen-year loan of $A25 million by the Government of Australia to Howe/ALH. Howe/ALH is exempted from paying any interest for the first five years. Unlike the other ten-year period, Howe is required to pay interest on the loan based on the rate for Australian Commonwealth Bonds.

[40] This dispute concerns financial assistance in the form of loan provided by the government of Australia to Howe, a wholly-owned subsidiary of Australian Leather Upholstery Pty. Ltd., which is owned by Australian Leather Holdings, Limited ('ALH'), part of which is owned by Schaffer Corporation, Ltd. Howe is the only dedicated producer and exporter of automotive leather in Australia. Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, 25 May 1999, para 2.1.

panel asserted that neither the design of the loan payment, nor the repayment provisions nor any other terms in the loan contract would tie the loan to the export performance. In contrast, the US complainant argued that exporting is the only way for Howe to maintain its production and sales levels and be able to remain in business and pay off the loan. That means 'if Howe does not export, the Australian government will not be repaid'.[41] This argument was rejected by the Panel, because Howe has full discretion to choose the source of funds, whether exportation or domestic sales, that will be used to repay the loan. Besides, export performance is not a provision contained in the loan contract and there is no evidence to prove that the Australian government expected at the time the loan was entered into that export sales would generate the funds to repay the loan. Therefore, this potential export earning is insufficient to conclude that the loan was contingent in fact upon anticipated exportation or export earnings.[42]

Consequently, the definition of the term export subsidy, which was evolved by the DSB, is very broad and the legal tests on the existence of export subsidy are hardly compliant with the policies and programmes of the WTO Members. This argument was established by Annand, Buckingham, and Kerr on the basis that the decisions of the DSB were not built on appropriate and solid economic principles, but were more literal definitions instead. The DSB did not take into consideration the economic realities of international trade. Those scholars therefore questioned whether the Members would approve that, based on this new international legal standard and the extensive spectrum of export subsidies, their national marketing schemes may be illegal.[43]

IV Illustrative List of Export Subsidies, Pass-over Approach

When analysing export subsidies, Annex I of the ASCM (which includes numerous forms of export subsidies titled 'Illustrative List of Export Subsidies'[44]) must be examined. Two significant points must be highlighted concerning this Annex. First, Annex I is not an exhaustive list which means the twelve items listed therein are just examples of export subsidies. That can be understood clearly from the language of Article 3.1, which states 'including those illustrated in Annex I'. The dictionary meaning of the term 'illustrate' is to serve as an example. Accordingly, the existence of export subsidy is not limited to this Annex, but rather includes any other measure that falls within the meaning of Articles 1 and 3.1 combined.[45]

---

41 Ibid, para 9.74.

42 Ibid, para 9.75.

43 Mel Annand, Donald F. Buckingham, William A. Kerr, *Export Subsidies and the World Trade Organization* (Estey Centre for Law and Economics in International Trade 2001) 150.

44 This list was originated by the GATT working party in 1960, then enclosed to the Subsidy Code 1979. Müller (n 18) 20.

45 Annand, Buckingham, Kerr (n 43) 60.

The second pertinent point is whether every export subsidy is a prohibited subsidy, considering that every item listed in Annex I is qualified as an export subsidy. Deductively, every item at hand is a prohibited export subsidy. This outcome suggests that the challenged subsidy is prohibited merely when it falls within the scope of Annex I, without any need to establish that it constitutes an export subsidy according to Article 3.1. If so, the complaining Member can pass over the 'contingency' test by demonstrating that the challenged measure is an item contained in this illustrative list. For emphasis, the Panel, in *Korea – Measures Affecting Trade in Commercial Vessels,* underlined that 'Given the per se nature of the items set forth in the Illustrative List, no further separate analysis of the programme under Articles 1 and 3 would be necessary'.[46]

However, the author of this paper partially argues for the above Panel's finding on the basis that if the complainant Member could jump over Article 3.1 because the measure is contained in the illustrative list, it cannot for any reason ignore Article 1 of the ASCM. That is because only the measure that fulfils the requirements of Article 1 can be subject to the WTO subsidy disciplines, only then it can be prohibited under Article 3.1.[47] Article 1 is therefore the first step for validating and implementing the other provisions contained in the ASCM regardless of, as the panel claimed, 'the historical context of the Illustrative List, in the sense that it was first drafted before the definition of "subsidy" set forth in the SCM Agreement was introduced'.[48]

Moreover, footnote 5 of the ASCM must be paid great attention, due to the exemption of the prohibition of export subsidy, or, as it was named by the European Community (EC) 'a safe haven'.[49] Footnote 5 states that 'Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement'. In simple words, if any item of Annex I is explicitly deemed not to be classified, for certain reasons, as an export subsidy then it will never be prohibited, neither under Article 3 nor any other provisions of the ASCM.

Undoubtedly, Item K in Annex I is the best example to explain the meaning of footnote 5. On one side of the coin, Item K considers export credits at rates lower than those that should usually be paid to be an export subsidy. On the other side of the coin, the second paragraph of item K denies this classification when the grant of the export credits is organised under and confirmed by an international agreement, such as The Arrangement on Officially Supported Export Credits concluded by the Organization for Economic Co-operation and Development (OECD). The EC, as a third party, in *Canada–Civil Aircraft* therefore declared that, in order to avoid a ban on export credits, every export credit activity must be in conformity with

[46] Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, 7 March 2005, para 7.204.

[47] Dominic Coppens, *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints* (Cambridge University Press, 2014) 118.

[48] Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, 7 March 2005, footnote 126.

[49] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, 14 April 1999, papa 7.11.

the OECD Guidelines.[50] Additionally, the EC asserted that the broad interpretation of the exemption is not warranted, so it should be interpreted narrowly.[51]

V Remedies

Generally, the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) applies to all disputes that arise from the violations of the WTO law and obligations contained therein.[52] This document establishes the Dispute Settlement Body, which consists of a panel and Appellate Body, which adopt decisions and recommendations in a given dispute and observe their implementation. The decision of the DSB is binding on the Member States.[53] Besides, some special or additional rules and procedures on the settlement of disputes contained in various WTO Agreements shall be taken into consideration due to the doctrine of *Lex specialis.*[54] Head of the list, the Agreement on Subsidies and Countervailing Measures contains Articles 4.2 through 4.12 on remedies of prohibited subsidies.[55] From the establishment of the WTO until 2021, a total of 42 disputes on subsidies have been commenced, and some of which have been proceeded under the Articles in question.[56]

According to the procedures contained in the ASCM, disputes are initiated when a WTO Member dispatches a formal request for consultation, which includes the available evidence regarding the existence and nature of the prohibited export subsidy, to the member whose measure is challenged.[57] In this consultation, the Members shall discuss, without delay, the disputed matters with the aim of reaching a mutually agreed solution.[58] Usually, if consultation is successful, the mutually agreed solution should be attained within 30 days.

---

[50] Ibid, paras 7.11–7.15.

[51] Ibid, para 7.21.

[52] *Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes*, Apr. 15, 1994, *Marrakesh Agreement Establishing the World Trade Organization*, Annex 2, 1869 U.N.T.S. 401, 33 I.L.M. 1226 (entered into force 1 January 1995) [hereinafter DSU] Art 1.1.

[53] Zoltan Vig, 'Interstate Relations' in Z. Fejes, M. Sulyok, A. Szalai (eds), *International Economic and Financial Organizations* (Iurisperitus Kiadó 2019) 140.

[54] This doctrine states that, if two laws govern the same factual situation, the applicable law shall be the law governing a specific subject matter *(lex specialis)*, instead of the law governing only general matters. Federico Ortino, and Ernst-Ulrich Petersmann (eds), *The WTO dispute settlement system 1995–2003*, Vol 18 (Kluwer Law International BV 2004) 332.

[55] Appendix 2 of the DSU.

[56] The World Trade Organisation (WTO) (official website), *Dispute settlement activity – some figures*, Chart 3 <https://www.wto.org/english/tratop_e/dispu_e/dispustats_e.htm> accessed 24 August 2022.

[57] Art 4.2 of the ASCM.

[58] Art 4.3 of the ASCM.

If not, either party may request the establishment of a panel to start the litigation procedure before the WTO DSB.[59]

Moreover, the Panel shall examine the evidence at hand, and shall permit the parties to submit any other arguments and evidence that can demonstrate their claims as to whether or not the measure in question is a prohibited export subsidy. For achieving achieve that goal, the Panel may request the assistance of the Permanent Group of Experts (PGE), which should deliver its binding final report within the time-period fixed by the Panel.[60] Afterward, the Panel shall submit its final report to the parties, and shall circulate it to all Members within 90 days of the date of the establishment of the Panel's terms of reference.[61] Subsequently, the DSB shall adopt the Panel's report within 30 days of the date of circulation to all Members. However, the Panel's report might not be adopted by the DSB in two situations: (1) the DSB decides by consensus not to do so, or (2) one of the parties to the dispute decides to appeal against it.[62] In the latter case, the Appellate Body will issue its final decision within 30 days from the date when the party to the dispute formally notifies its intention to appeal. It should be noted that this time-period can be extended upon a written request that expresses the reasons for the delay along with the estimated time of submission.[63]

Furthermore, the remedies for a prohibited export subsidy fall into two main categories, as detailed below.

1 Withdrawal of the Subsidy

Whenever the Panel found that the challenged measure constitutes an export subsidy, it shall rule that the subsidy must be withdrawn by the subsidising Member within a specific time-period.[64] That is exactly what happened in the *Brazil-Aircraft* dispute, when the Appellate Body upheld the original panel's recommendation, which asserted that some of Brazil's measures constituted prohibited export subsidies, and therefore must be withdrawn.[65] Because of this, Brazil, as defendant, modified the measures at hand in order to be consistent with Article 3.1(a) of the ASCM. In return, Canada, as the complainant, argued that Brazil's modification to its export subsidy programme remained prohibited export subsidies, and did not bring it into compliance with the mentioned provision.[66]

---

[59] Art 4.4 of the ASCM.
[60] Art 4.5 of the ASCM.
[61] Art 4.6 of the ASCM.
[62] Art 4.8 of the ASCM.
[63] Art 4.9 of the ASCM.
[64] Art 4.7 of the ASCM.
[65] Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/RW (Art 21.5 DSU), 21 July 2000, para 82.
[66] Ibid, para 20.

However, the meaning of the term 'withdrawal' has been controversial due to the silence of the ASCM. Several questions were then raised by Peter Stoll and Michael Koebele in this regard, and left unanswered[67] such as what withdrawal covers and whether the mere modification of an export subsidy is sufficient to render the measure compatible with the ASCM. In other words, shall the withdrawal include both the retrospective (existing) and the prospective (future) benefit?

In the course of examining the meaning of 'withdrawal' of a subsidy, the Appellate Body opined that the ordinary meaning of 'withdraw' is to 'remove' or 'take away' and as 'to take away what has been enjoyed; to take from.' This definition suggests that the 'withdrawal' of a subsidy means the 'removal' or 'taking away' of that subsidy. Hence the continued payments under an export subsidy measure are prohibited and are not consistent with the obligation to 'withdraw' prohibited export subsidies. The modification of the measure through decreasing the rate of the export subsidy is not enough to meet the meaning of the term 'withdraw' under Article 4.7 of the ASCM.[68] According to this prospective interpretation, it is understood that no future payment can be made under the prohibited programme.

However, how about the previously conferred benefit resulting from granting the export subsidy, whether the subsidy, which was already disbursed, should be given back or not? The Panel examined this question in the *Australia- Leather exports* dispute. It asserted that 'In our view, if the term "withdraw the subsidy" can properly be understood to encompass repayment of any portion of a prohibited subsidy, "retroactive effect" exists'.[69] The author of this paper agrees with the panel's finding for two major reasons:

a) The aim behind this remedy is to remove the adverse effect caused by the prohibited export subsidy. As such, this goal will not only be achieved by terminating the effect of the measure in the future, but also by repaying the full amount of the financial contribution that constituted the measure because of which the adverse effects firstly occurred. Moreover, Singh relies on the AB's statement and emphasises that the adverse effects could be caused by subsidies granted before entering the ASCM into force for as long as the Member has maintained the subsidy programme after the enforcement of the ASCM.[70] The interpretation of 'withdraw the subsidy' which encompasses the repayment for a previous damages is then consistent with the objective and purpose of the ASCM. Particularly, in the case of the one-time subsidy contingent in fact on export performance, where the remedy of withdrawal of

---

[67] Peter-Tobias Stoll, Michael Koebele, 'WTO – Trade Remedies' in Rüdiger Wolfrum (ed), *Max Planck Commentaries on World Trade Law*, Vol 4, (Brill 2008) 494.

[68] Ibid, para 45.

[69] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW (Art 21.5 DSU), 21 January 2000, para 6.22.

[70] Gurwinder Singh, *Subsidies in the Context of the WTO's Free Trade System A Legal and Economic Analysis* (Springer 2017) 122–123, https://doi.org/10.1007/978-3-319-62422-8

subsidy will be meaningless if its effect of was limited to the future event and ignored the past event.[71]

b) If the subsidising Member did not withdraw the prohibited export subsidy, the complaining Member is permitted to take an appropriate countermeasure (to be discussed later) to offset the adverse effect that occurred in the past, not in the future. It is then appropriate for the first remedy to have either the same or a greater effect but not lower than the second remedy. This opinion is justified based on part III of the ASCM on 'actionable subsidies'. According to Article 7 of the ASCM, when the challenged subsidy has caused adverse effects to the interests of the complaining Member, the subsidising Member shall 'take appropriate steps to remove the adverse effects or shall withdraw the subsidy'.[72] If not, the complaining Member may impose a countervailing measure.[73] In both cases, the aim is to compensate the adverse effect, and withdrawal of the subsidy is an alternative to some other action. Thus, repayment of the subsidy would certainly accomplish the mission of withdrawal of the subsidy by a subsidising Member, accordingly removing the adverse effect on trade.

2 Take 'Appropriate Countermeasures'

If the time-period specified in the report of the DSB terminates without the illegal export subsidy being withdrawn by the defending Member, the complaining Member may be permitted (authorised) to adopt an appropriate countermeasure unless the DSB decides by consensus to reject the request.[74] According to the DSU, the countermeasure, informally known as 'retaliation', means the right of the complaining Member 'to suspend the application to the Member concerned of concessions or other obligations under the covered agreements'.[75] The purpose of the countermeasure can be either to enforce the recommendation and rulings of the BSD, or to rebalance mutual trade benefits.[76]

Unfortunately, this countermeasure, as a remedy for non-compliance, has been criticised from various perspectives. By way of illustration, retaliation through establishing new trade barriers contradicts the idea of liberalisation emphasised by the WTO, due to the economic harmful effect, especially on the price of the products, on both the targeted Member and the

---

[71] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW (Art 21.5 DSU), 21 January 2000, para 6.38.

[72] Art 7.8 of the ASCM.

[73] Art 7.9 of the ASCM,

[74] Art 4.10 of the ASCM.

[75] Art 22.2 of the DSU.

[76] The World Trade Organisation (WTO) (official website), *The process – Stages in a typical WTO dispute settlement case*, <https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s10p1_e.htm> accessed 24 August 2022.

Member imposing these measures.[77] Moreover, these measures are, more likely, insufficient to achieve the above-mentioned goals. For instance, banning a developed country from accessing the market of a small country, whose economy heavily relies on and was adversely affected by an prohibited export subsidy provided by the former, can have worth economic consequences than the subsidy itself.[78] This argument was emphasised by Panagariya who examined the policy of interventions on behalf of export interests and concluded that every country, in particular those with a small economy, attempts to retaliate against export subsidies with similar export subsidies or tariffs will only hurt itself.[79]

Furthermore, another essential question in this regard is when the countermeasure is considered 'appropriate' for the purpose of Article 4. To begin with footnotes 9 and 10 of the ASCM that refer to the term 'appropriate' as 'this expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited'. Besides, the Arbitrators in *the US – upload cotton* defines the 'appropriate countermeasure' as

> Countermeasures, in order to be 'appropriate', should bear some relationship to the extent to which the complaining Member has suffered from the trade-distorting impact of the illegal subsidy. Countermeasures are in essence trade-restrictive measures to be taken in response to a Member's application of a trade-distorting measure that has been determined to nullify or impair the benefits accruing to another Member.[80]

Indeed, this explanation is consistent with the general principles set out in the DSU, which informs that the level of the concessions shall be equal to the level of nullification and impairment caused by the illegal measure.[81] That is understandable from the meaning of the term compensation under the WTO law. Hence, the term compensation here does not refer to payment for trade lost, but is rather a direct remedy, mainly to ensure a rebalancing of trade concessions or that an economic injury caused is resolved.[82]

---

[77] The World Trade Organisation (WTO) (official website), *The process – Stages in a typical WTO dispute settlement case*, <https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s10p1_e.htm> accessed 24 August 2022.

[78] Tsai-yu Lin, 'Remedies for Export Subsidies in the Context of Article 4 of the SCM Agreement: Rethinking Some Persistent Issues' (2008) 3 (1) Asian Journal of WTO & International Health Law and Policy 21–50, 42. <https://ssrn.com/abstract=1140593> accessed 24 August 2022.

[79] Arvind Panagariya, 'Evaluating the Case for Export Subsidies' (2000) (Policy research working paper 2279), Development Research Group, 3. <https://ssrn.com/abstract=629126> accessed 09 February 2023.

[80] Decision of the Arbitrator, *United States – Subsidies on Upland Cotton*, WT/DS267/ARB/1 (Art 22.6 DSU) 31 August 2009, Para 4.87.

[81] Article 22.4 of the DSU.

[82] Article 18 (provisional measures) and Article 19 (CVDs) of the ASCM. See also DSU Article 6.7 for possible mutually agreed non-monetary compensation.

Moreover, the European Community, in the *US – FSC case,* requested authorisation to suspend concessions based on the amount of subsidy allocated by the US which is approximately $4,043 million. In return, the US argued that the appropriate countermeasure should be assisted based on the effect of the subsidy on European trade, which is about $1,100 million, but not based on the amount of subsidy.[83]

On this point, the Panel indicated that such countermeasures are 'aimed at inducing or securing compliance with the DSB's recommendation'.[84] Besides, there is nothing in the context of the ASCM which suggests entitlement to manifestly punitive measures.[85] The appropriate countermeasure should therefore be determined based on the effect of the subsidy on European trade, regardless of the amount the subsidising party paid while conducting the illegal action.[86] By doing so, the trade benefit between the Members concerned has been balanced, as if the US had withdrawn the illegal subsidy from the beginning.

Concisely, the author of the paper supports the viewpoint that, for a better implementation of the remedy to subsidy, it is not sufficient for the countermeasure to meet only the 'appropriateness' or 'not to be disproportionate' test. 'Punitive countermeasures' should be introduced as a possible approach that puts greater pressure on defending governments to withdraw an export subsidy within a dispute settlement mechanism. This approach can be justified on the basis of the *per se* nature of the prohibited export subsidy, which requests stricter subsidy discipline than the actionable subsidy. Additionally, enforcing the countermeasure, in itself, is a sanction for non-compliance with the DSB recommendation.[87] So how it is possible for a sanction measure not to include the meaning of punishment? The 'appropriateness' test should therefore take not only the adverse effects caused by the export subsidy into account, but also the fact the subsidising Member is guilty of acting in breach of the ASCM and then the DSB recommendation.

VI Conclusion

Although some economists believe in the existence of the universal benefits that can be obtained through export subsidies in specific circumstances, almost all the WTO Members agree that export subsidy is one of the unfair trade practices that distort international

[83] Decision of the Arbitrator, *United States – Tax Treatment for 'Foreign Sales Corporations'*, WT/DS108/ARB (Art 22.6 DSU) 30 August 2002, para 6.37.

[84] Ibid, para 5.52.

[85] Ibid, para 5.62.

[86] Ibid, paras 6.10, 6.28.

[87] 'The expected punishment of a CVD leads all countries to lessen their use of subsidies'. Brian Kelly, 'The Pass–Through of Subsidies to Price' (2014) 48 Journal of World Trade, 3. Available at SSRN: <https://ssrn.com/abstract=2335157> accessed 24 August 2022.

trade.[88] The prohibition of the export subsidy was therefore first introduced in the 1960s under Article 16 of the GATT. The Tokyo Round negotiations subsequently, escalated this prohibition until it reached its current upgraded form under the ASCM.

This paper examined and highlighted the great achievement of the ASCM, which could not be reached through the GATT and Subsidies Code before. Along with the findings of the DSB, it succeeded in giving export subsidies a *per se* prohibited nature, either in law or in fact. Based on the *per se* prohibited nature, WTO members are not required to submit any evidence on the adverse effect in order to win the dispute and to retaliate against the subsidising Member to offset their loss. On one hand, this *per se* prohibited nature of the export subsidies has explained the prompt dispute settlement procedure under Article 4 of the ASCM. On the other hand, this success is not complete when it comes to the remedy provisions that are supposed to reimburse the adversely affected Member. Hence, the essential criticism of remedies is that retaliation through establishing new trade barriers (suspension of the concessions or other obligations) contradicts the idea of liberalisation, as emphasised by the WTO. Moreover, the modification of an illegal export subsidy is not considered a remedy, nor is the mere repayment of the amount of the subsidy sufficient to prevent developed countries from granting export subsidies because the benefit conferred from the subsidy might be greater than the amount of which. Accordingly, in order to effectuate the remedial discipline and deter the illegal export subsidies, punitive countermeasures must be introduced.

[88] John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* (MIT Press 1997) 279.

Note

Lajos Vékás

In Memoriam Jürgen Basedow (1949–2023)

Professor Jürgen Basedow, Emeritus Director of the renowned Max Planck Institute for Foreign and International Private Law in Hamburg, member of several scientific societies for German and European private law and honorary doctor of several universities, passed away suddenly and unexpectedly on 6 April 2023.

Professor Basedow left us an extremely rich scientific legacy. He wrote seminal works on private international law, international economic law and comparative private law, and important studies in the field of the unification of private law. Besides antitrust law, insurance law and transport law, he was also at home with international family law and European private law. He wrote his PhD thesis on problems of international family law; his habilitation work was on transport law, and his LLM studies at Harvard Law School turned his interest towards international antitrust law. He also worked on practical issues regarding the latter field, serving as a member and then chairman of the German Antitrust Committee (Deutsche Monopolkommission) between 2000 and 2008. His research in this area has resulted in a monograph (*Weltkartellrecht*, 1998) and a volume of studies (*Mehr Freiheit wagen*, 2002). He was interested in the process of unifying European private law from the very beginning, back in the 1980s. He co-edited with Klaus Hopt and Reinhard Zimmerman *The Max Planck Encyclopedia of European Private Law* (2011), first published in German (2009). Basedow summarised his research into the problems of European private law in a major monograph published in 2021, *EU Private Law – Anatomy of a Growing Legal Order*. Private international law was a particular focus of his academic interest: he initiated the publication of the *Encyclopedia of Private International Law* in four volumes (2017), and he was one of the co-editors-in-chief of this major undertaking. A highpoint in Basedow's career was the *Hague Cours Général* in 2012. It was published in 2015 under the title *The Law of Open Societies – Private Ordering and Public Regulation in the Conflict of Laws*. He was also a member of the *Groupe européen de droit international privé.*

For decades, Professor Basedow maintained an intense scientific relationship with the professors of private law and private international law in our Faculty. We regularly held joint conferences on issues of mutual interest, alternately in Budapest and Hamburg. In 2007, Professor Basedow was elected an honorary member of the Hungarian Academy of Sciences. We cherish his memory with deep gratitude.

DOI: 10.54148/ELTELJ.2023.2.107

ELTE LAW JOURNAL

CONTENTS