

## **TOWARD HARMONIZATION AND CERTAINTY IN CHOICE-OF-LAW RULES FOR INTERNATIONAL CONTRACTS: SHOULD THE U.S. ADOPT THE EQUIVALENT OF ROME I?**

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Most courts and commentators have rejected the relatively simple and mechanical choice-of-law rules of the first Restatement of Conflict of Laws. Those rules sometimes resulted in the application of the law of a state or nation with no interest in the dispute and with little relationship to the issues, the parties, or the parties' expectations about applicable law. The effort to find suitable replacement rules, however, has resulted in a patchwork of approaches within the United States, many of them typified by the flexible and multi-faceted approach of the second Restatement of Conflict of Laws<sup>1</sup> or the homeward-looking test of the Uniform Commercial Code.<sup>2</sup>

The needs of parties to commercial contracts would be better served with simple, certain, predictable, and globally uniform choice-of-law rules. The choice-of-law rules set forth in the European Community's Rome I<sup>3</sup> Regulation offer these benefits in international contract disputes, along with special protections for consumers and employees and with adequate "escape hatches" to vindicate public

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<sup>1</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 6(2), 188 (1971) (in the absence of a statutory or effective contractual choice of law, pointing to the local law of the jurisdiction with the "most significant relationship to the transaction and the parties," in light of seven factors and five points of contact).

<sup>2</sup> U.C.C. § 1-301(b) (2009) (providing that in the absence of party choice, the forum state's UCC "applies to transactions bearing an appropriate relation to this state"). As proposed in 2001, section 1-301 of revised Article 1 incorporated each state's non-UCC choice-of-law rules. U.C.C. § 1-301(d) (2009). Because those states adopting revised Article 1 universally rejected the new choice-of-law rules, in 2008 the American Law Institute resolved to revise § 1-301 to incorporate the same conflicts rules stated previously in U.C.C. § 1-105. *See Meetings & Events: Actions Taken*, ALI, (May 21, 2008) available at [http://www.ali.org/index.cfm?fuseaction=meetings.annual\\_updates\\_2008](http://www.ali.org/index.cfm?fuseaction=meetings.annual_updates_2008).

<sup>3</sup> Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), 2008 O.J. (L 177/6) [hereinafter Rome I].

policies of overriding importance in the international sense. Other countries, including the United States, should consider adopting the equivalent of Rome I for international contracts to achieve maximum certainty, predictability, and uniformity in choice of law in the absence of contractual choice.

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## INTRODUCTION: CERTAINTY AND PREDICTABILITY IN COMMERCIAL CONTRACT LAW

Under “ancient concepts of freedom of contract,”<sup>4</sup> parties to a legally enforceable contract act as “private legislators,”<sup>5</sup> freely and voluntarily shaping their rights and obligations, often displacing default rules that might otherwise apply under the law.<sup>6</sup> This essential<sup>7</sup> policy of freedom of contract and respect for the autonomy of the parties is reflected in the plainest terms in Article 1134 of the French Civil Code (“*Code Civil*”). This provision, as translated into English, provides that good-faith agreements “take the place” of the law for the contracting parties.<sup>8</sup>

The first sentence of Article 1152 of the *Code Civil* provides a strong example of the legal basis for the parties’ contractual expectations by directing a court to enforce the terms of a contractual damages clause strictly according to its terms<sup>9</sup>: “When an agreement provides that he who fails to execute it shall pay a sum certain by way of damages, there may not be awarded to the other party a greater or lesser sum.”<sup>10</sup>

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<sup>4</sup> *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 11 (1972).

<sup>5</sup> PETER NYGH, *AUTONOMY IN INTERNATIONAL CONTRACTS* 2 (1999) (“The nineteenth century introduced an emphasis on the parties as private legislators in their contractual relationships.”).

<sup>6</sup> *See, e.g.*, U.C.C. § 1-102(3) (1977); U.C.C. § 1-302 (2009) (with some exceptions and limitations, permitting variation of the terms of the UCC by agreement); United Nations Convention on Contracts for the International Sale of Goods, art. 6, Apr. 11, 1980, 1489 U.N.T.S. 3 [hereinafter CISG] (permitting parties to “vary the effect of any of its provisions” with a limited exception stated in art. 12).

<sup>7</sup> NYGH, *supra* note 5, at 2 (“freedom of contract is an essential part of the market economy”); *see also* P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 398–412 (1979) (freedom of contract in nineteenth century English contract law coincided with liberal theories of political freedom and free market economy, but was tempered with equitable doctrines or protective legislation).

<sup>8</sup> “*Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites.*” CODE CIVIL [C. CIV.] art. 1134 (Fr.). As translated by Professor Crabb, the full text of Article 1134 reads:

“Agreements legally made take the place of law for those who make them. They may be revoked only by mutual consent or for causes which the law authorizes. They must be executed in good faith.” THE FRENCH CIVIL CODE 221 (John H. Crabb trans., 1995).

<sup>9</sup> C. CIV. art. 1152 (Fr.). This first sentence constituted the full text of Article 1152 as enacted in 1804: “*Lorsque la convention porte que celui qui manquera de l’exécuter payera une certaine somme à titre de dommages-intérêts, il ne peut être alloué à l’autre partie une somme plus forte, ni moindre.*” *Id.* art. 1152; *see also* Cour de cassation [Cass.] [supreme court for judicial matters] com., Nov. 21, 1967, No. 65-13412, Bull. civ. I, No. 337 (Fr.) (applying pre-amendment art. 1152 as written, to require enforcement of a penalty clause without judicial adjustment).

<sup>10</sup> THE FRENCH CIVIL CODE, *supra* note 8, at 223.

The parties' confidence that courts will respect party autonomy and enforce contractual rights and obligations provides a foundation for the parties' reliance on promises of future performance, empowering them to commit to their own performances, preparations, and planning.<sup>11</sup> To protect party expectations and facilitate reliance, legal systems have traditionally placed especially great weight on certainty and predictability in their bodies of contract law.<sup>12</sup>

However, these values of certainty and predictability have long been supplemented and moderated in our common law system by the felt need for a measure of equity and flexibility to do justice in exceptional cases.<sup>13</sup> In the twentieth century, many legal systems appropriately shifted the balance away from maximum party autonomy to provide special legal protections for vulnerable parties—such as consumers, employees, and purchasers of insurance—who typically do not bargain on equal footing with their counterparts in the contract and are often presented with non-negotiable adhesion contracts.<sup>14</sup> In keeping with this

<sup>11</sup> See, e.g., *Planned Parenthood of S.E. Pa. v. Casey*, 505 U.S. 833, 855-56 (3d Cir. 1992) (explaining that public reliance on precedent is given special weight in the doctrine of *stare decisis* in the commercial context, because “advance planning of great precision is most obviously a necessity” in that context).

<sup>12</sup> See, e.g., NYGH, *supra* note 5, at 2 (“An international contract, like any other contract, requires certainty.”); Lutz-Christian Wolff, *Hong Kong's Conflict of Contract Laws: Quo Vadis?*, 6 J. PRIVATE INT'L L. 465, 482 (2010) (“Predictability and thus legal certainty must . . . be one of the main concerns of any rule of law-based system.”).

<sup>13</sup> See, e.g., EUGENE F. SCOLES ET AL., *CONFLICT OF LAWS* 6 (4th ed. 2004); ATIYAH, *supra* note 7, at 414-15 (discussing the sometimes wavering judicial application of the early English equitable practice of relieving parties from the oppressive effects of penal bonds, an early form of contractual penalty clause); *Ricketts v. Scothorn*, 57 Neb. 51, 77 N.W. 365 (1898) (applying a novel form of the equitable doctrine of estoppel—now popularly known as promissory estoppel—to enforce a promise in the absence of consideration).

<sup>14</sup> See, e.g., U.C.C. § 2-302 (2009) (authorizing courts to deny enforcement to unconscionable contracts or contract provisions); RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1979) (advancing rule that a provision beyond the reasonable expectations of a party can be excluded from a standard-form contract); *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388 (1984) (en banc) (applying the principle of section 211 of the second Restatement to protect the interests of even a commercial party presented with a standard-form umbrella insurance policy); HOWARD J. ALPERIN & ROLAND F. CHASE, *CONSUMER LAW* (1986) (examining statutory and regulatory law addressing consumer transactions); Cristina Poncibò, *Some Thoughts on the Methodological Approach to EC Consumer Law Reform*, 21 LOY. CONSUMER L. REV. 353 (2009) (critiquing current proposals for greater harmonization of late twentieth century European consumer law, and comparing the system of federal and state consumer protection laws in the United States); *Petermann v. Int'l Bhd. of Teamsters*, Local 396, 174 Cal. App. 2d 184, 344 P.2d 25 (1959) (recognizing liability for discharging an employee in violation of public policy, even though the employment contract was generally terminable at will); see also Rome I, *supra* note 3, art. 5-8 (providing special choice-of-law rules for transnational passenger, consumer, insurance, and employment contracts, thus limiting party autonomy in those transactions).

movement, amendments to Article 1152 of the French *Code Civil* in 1975 and 1985 added new language permitting the judge to moderate a manifestly excessive penalty clause or an unreasonable limitation on liability.<sup>15</sup>

Accordingly, special rules and sometimes flexibility in the rules are necessary to achieve justice and fairness in the kinds of contractual relationships in which unregulated freedom of contract would frequently result in abuses. The need to accommodate strong local policies favoring such protections complicates the search for simplicity, certainty, and harmonization in substantive contract law.

Nonetheless, in most areas of commercial contracting, where the need for special protective regulation is less compelling than in consumer transactions, certainty achieved through harmonization of governing laws is a laudable and theoretically feasible goal. Moreover, even if substantive commercial contract laws are destined to remain fragmented for the foreseeable future, States can achieve greater certainty through the global adoption of a choice-of-law convention that points clearly and predictably to a governing domestic law. In either case, contracting parties with comparable bargaining power can easily identify default rules that will apply to their contracts, can choose to draft around many of them by framing their obligations or by choosing a different domestic governing law, or at least can assess their risks if they allow the default rules to apply. Special provisions in such a convention can also add certainty and predictability to contracts that warrant special protections for vulnerable parties, by pointing dependably to the law that vindicates the expectations of the vulnerable party, coupled with restrictions on the parties' ability to override the default rule in ways that would defeat those expectations.

This article begins by explaining why harmonization of substantive contract law will remain incomplete for the foreseeable future, and by acknowledging the benefits of robust and universal

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<sup>15</sup> “Néanmoins, le juge peut, même d’office, modérer ou augmenter la peine qui avait été convenue si elle est manifestement excessive ou dérisoire. Toute stipulation contraire sera réputée non écrite.” C. CIV. art. 1152 (Fr.). Professor Crabb translates this supplemental provision to read: “Nevertheless, the judge, even on his own motion, may moderate or increase the penalty which had been agreed upon, if it is manifestly excessive or pitiful. Any contrary stipulation will be considered not written.” THE FRENCH CIVIL CODE, *supra* note 8, at 223. Interestingly, a preliminary draft of the original Article 1152 authorized judges to reduce damages in a contractual damages clause if they obviously exceeded actual damages, but objections to that draft, based on respect for party autonomy, prevailed. DENIS MAZEAUD, LA NOTION DE CLAUSE PENALE 295–96 (1992).

enforcement of party choice of law, before it tackles the main topic: choice of law in the absence of contractual choice by the parties. On that topic, it reviews the history of U.S. and European approaches to choice of law, argues that the Rome I regulation represents the best approach yet devised, illustrates Rome I's limited public policy escape hatch in a hypothetical dispute for the enforceability of a penalty clause, and concludes with a recommendation for universal adoption of the equivalent of Rome I.

## I. REDUCING RISKS THROUGH HARMONIZATION OF CONTRACT LAW

### A. INTERNATIONAL SALES—THE CISG

In the field of international commercial sales contracts, substantial harmonization of the law—at least in text if not in application—has been achieved through widespread adoption of the United Nations Convention on International Sales of Goods (CISG).<sup>16</sup> When it applies<sup>17</sup> to matters in dispute in an international commercial<sup>18</sup> sales transaction, the CISG displaces the application of state contract

<sup>16</sup> U.S. Ratification of 1980 U.N. Convention on Contracts for the Int'l Sale of Goods, 52 Fed. Reg. 40 (Mar. 2, 1987) (codified at 15 U.S.C.A. app. (Supp. 1987)). The United States and most of its significant trading partners are among the more than 70 countries that are now signatories to the CISG, with the notable exception of England. See *CISG: Table of Contracting States*, PACE L. SCH. INST. OF INT'L COM. L. (Feb. 23, 2011) <http://www.cisg.law.pace.edu/cisg/countries/cntries.html>. The CISG became effective January 1, 1988. *Valero Mkt. & Supply Co. v. Greeni Oy & Greeni Trading Oy*, 373 F. Supp. 2d 475, 479 (D.N.J. 2005) (citing to 15 U.S.C. app. at 332).

<sup>17</sup> The CISG applies most directly when each of the parties to the sales contract has its place of business in a different ratifying country. CISG, *supra* note 6, art. 1.1(a). The CISG may also apply if only one of the parties has its place of business in a ratifying country, but the forum's choice-of-law rules point to the law of that ratifying country, which law includes the CISG. *Id.* art. 1.1(b); see also *id.* art. 10 (providing a test for determining the applicable "place of business" when a party does business in more than one place). Thus, for example, if a party with its place of business in the ratifying country of France contracts with a party with its place of business in the non-ratifying country of England, the CISG will apply if the forum's choice-of-law rules select the domestic law of France as the applicable law. The United States, however, declared a reservation to the CISG under Article 95, permitting it to adopt the CISG without Article 1.1(b). See *Valero Mkt. & Supply Co.*, 373 F. Supp. 2d at 482 (explaining that the reservation was inapplicable because Finland and the United States were both signatories to the CISG). Thus, if one of the parties has its place of business in the United States, then the CISG will apply only if the other party has its place of business in a ratifying country, thus satisfying Article 1.1(a). *Id.*

<sup>18</sup> The CISG generally does not apply to sales "of goods bought for personal, family or household use." CISG, *supra* note 6, art. 2(a).

law<sup>19</sup> and eliminates the uncertainty inherent in judicial choice of local law.

By enhancing predictability regarding the content of governing law, the CISG can help parties to assess the costs and risks of entering into an international commercial sales contract, thus facilitating commercial exchanges. This certainty in the content of applicable law will increase over time with the accumulation of published interpretations of the CISG by judges, arbitrators,<sup>20</sup> and the CISG Advisory Council,<sup>21</sup> and as attorneys gain experience with its provisions.<sup>22</sup> Additionally, the CISG reduces or eliminates the costs of litigating the choice-of-law issue once a dispute arises, costs that are increasingly significant to the extent that the forum's choice-of-law rules are flexible or uncertain and thus invite reasonable dispute in a substantial portion of cases.<sup>23</sup> Finally, the CISG adds certainty about applicable law without unduly intruding on matters of special concern to signatory countries, because it does not apply to most consumer

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<sup>19</sup> In the United States, the CISG is federal law, *see* 15 U.S.C. app. (Supp. 1987), and thus supplants otherwise applicable state contract law—such as the UCC—in transactions and on issues to which it applies. *Valero Mkt. & Supply Co.*, 373 F. Supp. 2d at 479 n.7 (citing to Richard E. Speidel, *The Revision of UCC Article 2, Sales in Light of the United Nations Convention on Contracts for the International Sale of Goods*, 16 Nw. J. Int'l L. & Bus. 165, 167 (1995)).

<sup>20</sup> *See CISG Database*, PACE L. SCH. INST. OF INT'L COM. L. (Feb. 5, 2010) <http://www.cisg.law.pace.edu/cisg/text/digest-toc.html> (collecting judicial and arbitration decisions interpreting the CISG). Courts in one signatory country are not bound by the judicial interpretations of the CISG from another country, and any court will have an inevitable tendency to read the CISG through the lens of its own legal system, at least initially. The CISG, however, specifically directs the forum to consider the “international character” of the CISG and “the need to promote uniformity in its application.” CISG, *supra* note 6, art. 7(1). Courts thus should consider interpretations of the CISG from other jurisdictions to avoid stratification through conflicting interpretations influenced by local law.

<sup>21</sup> *See* CISG ADVISORY COUNCIL, <http://www.cisgac.com> (last visited May 31, 2011).

<sup>22</sup> This training should begin in law school, with at least some mention and brief examination of the CISG in the first-year Contracts course, and with the offering of an elective course that provides more substantial coverage. *See* Peter L. Fitzgerald, *The Int'l Contracting Practices Survey Project*, 27 J.L. & COM. 1, 19–22 (2008) (describing a survey that shows increased coverage of the CISG in law school courses in Contracts and Sales over the last ten years).

<sup>23</sup> SCOLES ET AL., *supra* note 13, at 3 (most conflicts problems in the United States end up in litigation”); *see id.* at 47 (citing to sources supporting the proposition that, because of complexity and indeterminacy in U.S. conflicts rules, “American conflicts law is litigation-oriented”); *Valero Mkt. & Supply Co.*, 373 F. Supp. 2d at 479 (citing to Caroline Delisle Klepper, *The Convention for the International Sale of Goods: A Practical Guide for the State of Maryland and its Trade Community*, 15 MD. J. INT'L L. & TRADE 235, 237 (1991) for the proposition that two goals of the CISG are “reducing forum shopping” and “reducing the need to resort to rules of private international law”).

transactions<sup>24</sup> or to issues of property rights in goods,<sup>25</sup> the validity of the contract or any of its provisions,<sup>26</sup> or liability for death or personal injury caused by goods.<sup>27</sup>

The CISG, however, authorizes parties not only to supersede individual default rules with terms of their agreement, but also to opt out of the CISG entirely: “The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.”<sup>28</sup> Such “opting out” leaves the parties free to choose a governing domestic law and to exclude the CISG.<sup>29</sup>

In this author’s view, U.S. attorneys are too quick to opt out of the CISG, perhaps because they are relatively comfortable with the Uniform Commercial Code (UCC)—despite criticism of some of its provisions<sup>30</sup>—and are unduly anxious about an international convention that, although incorporated into US domestic law,<sup>31</sup> most attorneys did

<sup>24</sup> CISG, *supra* note 6, art. 2(a) (excluding sales of “goods bought for personal, family or household use,” unless the seller lacked reasonable notice of the consumer nature of the transaction).

<sup>25</sup> *Id.* art. 4(b).

<sup>26</sup> *Id.* art. 4(a).

<sup>27</sup> *Id.* art. 5.

<sup>28</sup> *Id.* art. 6.

<sup>29</sup> To opt out with certainty, parties should expressly exclude the CISG and in addition should indicate a choice of a particular country’s domestic law. Simply choosing a domestic law will not necessarily implicitly opt out of the CISG, because the CISG is incorporated into the domestic law of a ratifying state. *See BP Oil Int’l, Ltd. v. Empresa Estatal Petroleos de Ecuador*, 332 F.3d 333, 337 (5th Cir. 2003) (in the absence of an express exclusion of the CISG, contractual choice of Ecuadoran law did not opt out of the CISG, because the CISG is incorporated into the law of Ecuador); *Valero Mkt. & Supply Co.*, 373 F. Supp. 2d at 480–82 (discussing *BP Oil* and other cases to the same effect, and stating in dictum that—even if the agreement had been modified to choose New York law as the applicable contract law—such a choice would include the CISG, except for Part II, which had not been adopted by Finland); Fitzgerald, *supra* note 22, at 12 & nn.62–64.

<sup>30</sup> *See, e.g.*, Corneill A. Stephens, *Escape from the Battle of the Forms: Keep it Simple, Stupid*, 11 LEWIS & CLARK L. REV. 233, 253 (2007) (“Current § 2-207 is irreparably fraught with problems and inconsistencies. Cases and commentators are hopelessly divided on when it should be applied, how it should be applied, and how it should be interpreted.”); Linda J. Rusch, *The Relevance of Evolving Domestic and International Law on Contracts in the Classroom: Assumptions About Assent*, 72 TUL. L. REV. 2043, 2047 & n.9 (1998) (collecting articles supporting the proposition that § 2-207 is “one of the most frequently criticized” sections of the currently effective Article 2); John E. Murray, Jr. & Harry M. Flechtner, *The Summer, 1999 Draft of Revised Article 2 of the Uniform Commercial Code: What Hath NCCUSL Rejected?*, 19 J. L. & COM. 1, 44 (1999) (explaining that the delivery term definitions in current U.C.C. §§ 2-319 to 2-324 are “out of date with commercial practice,” *quoting* U.C.C. § 2-309 cmt. 1 (2002)). *But cf.* Morris G. Shanker, *Contract by Disagreement!? (Reflections on UCC 2-207)*, 81 COM. L.J. 453, 453 (1976) (finding a consensus in the literature that section 2-207 “is a mess,” but blaming confusion on faulty reading and interpretation rather than on poor conception or drafting).

<sup>31</sup> *See supra* note 19.



not study in law school and have not encountered to any significant degree in practice.<sup>32</sup> A lawyer provides a U.S. client with inadequate representation by opting out of the CISG without first gaining familiarity with the CISG and making a reasoned assessment about whether the CISG would better serve the client's interests than would the UCC or other chosen law.<sup>33</sup> For example, if counsel for a seller cannot negotiate a clause that supersedes the UCC's extremely demanding perfect tender rule,<sup>34</sup> the protections of the CISG's fundamental breach rule<sup>35</sup> may be reason enough to quietly allow the CISG to apply, or at least to refrain from giving away bargaining chips to insist on application of the UCC.

Of course, if parties take the time to opt out of the CISG, they likely will also expend the time and resources to achieve certainty by contractually choosing a non-CISG body of domestic law, and perhaps will additionally agree on a forum with expertise in applying that body of law. If so, widespread application of the CISG will reduce risks and costs in a more limited fashion: Counsel for parties that deal with enterprises in a number of signatory countries can avoid spending the resources required to investigate and assess the risks presented by application of any of a number of foreign laws, or they can avoid spending bargaining chips to secure an agreement to apply local law rather than foreign non-CISG law. Instead, counsel on both sides of the transaction can allocate their resources more efficiently to the task of mastering a single convention—incorporated into domestic law—whose default terms will give way to superseding contract provisions when the default terms are not optimal for a particular transaction or a client. If the parties instead

<sup>32</sup> See generally Fitzgerald, *supra* note 22, at 7–10 (describing a 2006 survey which showed that a substantial percentage of attorneys and judges had little or no familiarity with the CISG); see also Lisa Spagnolo, *Green Eggs and Ham: the CISG, Path Dependence, and the Behavioural Economics of Lawyers' Choices of Law in International Sales Contracts*, 6 J. PRIVATE INT'L L. 417 (2010) (offering a variety of reasons for irrationally opting out of the CISG, including unfamiliarity with the CISG).

<sup>33</sup> See Spagnolo, *supra* note 32, at 436 (arguing that opting out simply to avoid an unfamiliar law amounts to "an abdication of professional responsibility"); JOSEPH F. MORRISSEY & JACK M. GRAVES, INTERNATIONAL SALES LAW AND ARBITRATION: PROBLEMS, CASES, AND COMMENTARY 48 n.6 (2008) (explaining that an attorney who loses a lawsuit for failure to realize that the CISG applies could be subject to a legal malpractice lawsuit).

<sup>34</sup> Prior to acceptance in a single installment contract, and subject to seller's cure, buyer may reject entire delivery if the goods "fail in any respect to conform to the contract." U.C.C. § 2-601 (2009)

<sup>35</sup> CISG, *supra* note 6, art. 25 (describing a breach as fundamental if it foreseeably results in substantial deprivation of contractual expectations); *id.* art. 46(2) (providing that a buyer may demand substitute goods only if seller's nonconforming delivery amounts to a fundamental breach); *id.* art. 49(1) (providing that a buyer may avoid the contract only for seller's fundamental breach or for failure to deliver within certain time limits).

opt out of the CISG, and if they do so without specifying an applicable non-CISG domestic law, then opting out has increased uncertainty and the associated risks and costs to a much greater degree.

Still, the CISG alone cannot eliminate uncertainty about applicable law. For one thing, it applies only to sales of goods, narrowly defined.<sup>36</sup> Moreover, even for international commercial sales contracts, which lie generally within the scope of the CISG, the CISG appropriately excludes certain issues of local concern from its application.<sup>37</sup> Beyond those exclusions, the CISG concedes that its provisions contain gaps so that the CISG may not expressly address issues that fall within “matters governed by [the] Convention.”<sup>38</sup> When such issues cannot be “settled in conformity with the general principles on which [the CISG] is based,” those unaddressed issues are governed by the domestic law that results from application of “rules of private international law,”<sup>39</sup> the civil law term for rules of conflict of laws. Finally, just as some parties will opt out of the CISG under Article 6 without specifying their choice of non-CISG domestic law, parties who allow the CISG to apply are even more likely to forget to specify the domestic law that will apply to issues not addressed by the CISG.

### B. NON-SALES TRANSACTIONS—A MODERN *LEX MERCATORIA*?

Harmonizing contract law applying to non-sales transactions is a more elusive goal. Although English common law has incorporated many principles of *lex mercatoria*,<sup>40</sup> the legal systems of the world do not recognize a binding body of international customary law governing commercial contracts.<sup>41</sup>

<sup>36</sup> In addition to excluding consumer sales, the CISG excludes goods sold by auction or by authority of law, and it excludes electricity, ships and aircraft, and securities and negotiable instruments from its concept of goods. *Id.* art. 2. It also excludes contracts that include a sale of goods but that are preponderantly for the supply of services, or in which the buyer supplies a substantial part of the materials necessary for the seller’s production of the goods. *Id.* art. 3.

<sup>37</sup> See *supra* notes 24–27 and accompanying text; see also CISG, *supra* note 6, arts. 12, 96 (permitting signatory countries to retain their statutes of frauds or other requirements for written documents); *id.* art. 28 (permitting courts to apply local restrictions on specific performance).

<sup>38</sup> CISG, *supra* note 6, art. 7(b).

<sup>39</sup> *Id.*

<sup>40</sup> KURT LIPSTEIN, PRINCIPLES OF THE CONFLICTS OF LAWS: NATIONAL AND INTERNATIONAL 18 (1981) (noting that Lord Mansfield partially incorporated the law merchant into English law); SCOLES ET AL., *supra* note 13, at 7 n.3. “*Lex mercatoria*” refers to an international customary commercial law administered by medieval merchant courts prior to the incorporation of some of its principles into English common law. *Id.*

<sup>41</sup> See, e.g., NYGH, *supra* note 5, at 62 (explaining that commentators have argued against judicial enforcement of party choice of the *lex mercatoria* “because the content of the *lex mercatoria* is

The UNIDROIT Principles of International Commercial Law (the “Principles”) hold themselves out as a model for a modern *lex mercatoria*<sup>42</sup> and show some promise as a comprehensive<sup>43</sup> blueprint for an international convention<sup>44</sup> governing commercial contracts for non-sales transactions or for particular issues not addressed by the CISG.

The Principles seek to bridge diverse legal traditions, address electronic contracting, and propose sensible solutions to legal questions. For example, the Principles provide a nuanced approach to acceptances with varying terms in three separate articles. These provisions (1) advance a softened version of the mirror-image rule for variations in correspondence other than standard forms;<sup>45</sup> (2) give effect to additional or different terms in a confirmation if they are immaterial and do not draw timely objection;<sup>46</sup> and (3) allow contract formation on the basis of consistent terms in the correspondence, absent objection by one of the parties, when variations are found only in standard terms.<sup>47</sup> In the view of this author, these UNIDROIT provisions clearly are better drafted and easier to apply than the currently effective UCC provision on “Additional Terms in Acceptance or Confirmation.”<sup>48</sup> Moreover, they are at least as effective as the relevant sections of the 2003 revisions to Article 2 of the

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as yet too uncertain and incomplete.”); Wolff, *supra* note 12, at 470 (reaching the same conclusion, for the same reason, regarding application of Hong Kong’s conflicts law, received from English common law rules); see also MORRISEY & GRAVES, *supra* note 33, at 7–28 (*lex mercatoria* “has no specific codification and very little clarity” so that “identifying what constitutes the *lex mercatoria* is extremely difficult”).

<sup>42</sup> INTERNATIONAL INSTITUTION FOR THE UNIFICATION OF PRIVATE LAWS, UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS preamble (2004) [hereinafter UNIDROIT PRINCIPLES] available at <http://www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf> (offering the Principles as the applicable law when the parties have chosen the *lex mercatoria* to apply to their international commercial contract or when the parties have not chosen any law).

<sup>43</sup> See, e.g., *id.* art. 3.1–3.20 (detailed treatment of challenges to the validity of a contract).

<sup>44</sup> See *id.* preamble (The Principles “may serve as a model for national and international legislators”); Michael Joachim Bonell, *The CISG, European Contract Law and the Development of a World Contract Law*, 56 AM. J. COMP. L. 1, 18–27 (2008) (optimistically discussing the possibility of using the UNIDROIT Principles as a model for a global law of commercial contracts).

<sup>45</sup> UNIDROIT PRINCIPLES, *supra* note 42, art. 2.1.11 (a purported acceptance with variations is a rejection and counter-offer unless the variations are immaterial and the offeror does not object without undue delay).

<sup>46</sup> *Id.* art. 2.1.12.

<sup>47</sup> *Id.* art. 2.1.22.

<sup>48</sup> U.C.C. § 2-207 (2002); see *supra* note 30 (including comments on the deficiencies of section 2-207).

UCC,<sup>49</sup> which do not make a distinction between variations in standard and non-standard terms, and which in any event were withdrawn by the American Law Institute in May 2011.<sup>50</sup>

The UNIDROIT Principles, however, do not have the status of primary law in any jurisdiction and have application mainly in international commercial arbitration.<sup>51</sup> Indeed, precisely because the UNIDROIT Principles are especially comprehensive, even addressing issues that implicate strong local policies such as overreaching in contract formation,<sup>52</sup> it would be difficult to achieve widespread adoption of an international convention for non-sales contracts based on the Principles. The Restatement<sup>53</sup> helps to minimize variations in the common law in the United States for non-sales transactions,<sup>54</sup> and the European community may someday succeed in unifying its general contract law;<sup>55</sup> however, global harmonization of substantive contract law—particularly on issues that most strongly implicate local policies—is not a realistic goal for the near future.<sup>56</sup>

<sup>49</sup> U.C.C. § 2-206(3) (2003) (“A definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer.”); U.C.C. § 2-207 (2003) (defining the terms of an agreement if conduct reflects an agreement, an agreement is established through offer and acceptance, or if a confirmation varies the terms of the contract it is confirming).

<sup>50</sup> AM. LAW INST., 88TH ANNUAL MEETING: UPDATES (May 17, 2011) (reporting the “withdrawal of the 2003 amendments to UCC Articles 2 and 2a”) available at <http://2011am.ali.org/updates.cfm>; see also CHARLES L. KNAPP, NATHAN M. CRYSTAL & HARRY G. PRINCE, RULES OF CONTRACT LAW 103 (2009) (reviewing contentious 15-year history of the revision project and noting that—as of May 2009—no state had adopted the revised Article 2 since its publication in 2003).

<sup>51</sup> See, e.g., John Y. Gotanda, *Using the UNIDROIT Principles to Fill Gaps in the CISG, in CONTRACT DAMAGES: DOMESTIC AND INTERNATIONAL PERSPECTIVES* 107 (Djakhongir Saidov & Ralph Cunnington eds., 2008) (the Principles are aspirational, are akin to the American Law Institute’s Restatements of Law, and thus should not be viewed as the primary authority reflecting the general principles on which the CISG is based for purposes of filling gaps in the CISG); Bonell, *supra* note 44, at 18 (referring to the Principles’ “non-binding” nature).

<sup>52</sup> UNIDROIT PRINCIPLES, *supra* note 42, art. 3.1–3.20 (grounds to challenge the validity of a contract).

<sup>53</sup> RESTATEMENT (SECOND) OF CONTRACTS (1981).

<sup>54</sup> See, e.g., *In re Cochise Coll. Park, Inc.*, 703 F.2d 1339, 1348 n.4 (9th Cir. 1983) (“[T]he principles of contract law do not differ greatly from one [U.S.] jurisdiction to another.”).

<sup>55</sup> See, e.g., ACQUIS GROUP, <http://www.acquis-group.org> (last visited Jun. 2, 2011); see also Bonell, *supra* note 44, at 9–15 (2008) (discussing the movement toward a common frame of reference in European contract law).

<sup>56</sup> But see generally *supra* note 44 (optimistic statements about the potential global reach of the Principles).

### C. THE NEED FOR HARMONIZATION OF CONFLICTS RULES

In sum, even after adoption of the CISG, international contract law plays a relatively small role in adding certainty and predictability to the law that will apply to disputes in international commercial transactions. As attorneys become more familiar with the CISG, one can hope that the practice of opting out of its provisions will become less automatic and more deliberate, and thus presumably less frequent. Even if so, however, contract rules applying to non-sales transactions will remain non-uniform. Moreover, as discussed earlier in this section, and as illustrated in depth in the next section, the general applicability of the CISG to an international sales transaction will not guarantee that the CISG provides a solution for the particular issue in dispute.

When international substantive law is not available to reduce risk and uncertainty, harmonization of the conflicts rules may reduce uncertainty, particularly if the uniform rules are highly predictable in their application.<sup>57</sup> Consider, for example, a commentator's characterization of the additional risks and costs resulting from uncertainty in the enforcement of contractual choice of law or forum in Brazil:

The resulting legal uncertainty makes it difficult for U.S. lawyers accustomed to working within a party autonomy framework to manage risk while negotiating commercial contracts with Brazilian counterparties. Brazil's conflicts rules have in fact forced U.S. lawyers to add a risk premium to their contracts with Brazilian parties—dubbed the “Brazil cost”—to capture the negative impact of increased transaction costs upon their client's bottom line.<sup>58</sup>

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<sup>57</sup> The Giuliano-Lagarde Report supported the unification of conflicts rules in the Convention on the Law Applicable to Contractual Obligations, on the ground that it would increase legal certainty, make it easier to predict the applicable contract law, and prevent forum-shopping. Mario Giuliano & Paul Lagarde, Rep. on the Convention on the Law Applicable to Contractual Obligations, 1980 O.J. (C 282) 1 (Oct. 31, 1980); Convention on the Law Applicable to Contractual Obligations, 1980 O.J. (L 266) 1 [hereinafter 1980 Rome Convention]; LAWRENCE COLLINS, *ESSAYS IN INTERNATIONAL LITIGATION AND THE CONFLICT OF LAWS* 409 (1994); see also Wolff, *supra* note 12, at 485–86 (discussing how, because of deep local attachment to domestic laws, it is easier to achieve harmonization in conflicts rules than in the underlying substantive law.).

<sup>58</sup> Dana Stringer, Note, *Choice of Law and Choice of Forum in Brazilian International Commercial Contracts: Party Autonomy, International Jurisdiction, and the Emerging Third Way*, 44 COLUM. J. TRANSNAT'L L. 959, 960 (2006); see also *id.* at 976 (“The continued use of the public policy exception to override the already limited choice of foreign law makes it extremely

The next Part examines and compares rules in Europe and the United States for choice of domestic contract law, beginning with rules governing enforcement of party choice, before addressing judicial choice of law in the absence of party choice.

## II. CHOICE BETWEEN DOMESTIC LAWS

In the absence of applicable international law in an international contracts dispute,<sup>59</sup> the forum must choose a domestic law to apply to the substantive issues in dispute; it can do so either by enforcing a contractual choice by the parties or by applying its choice-of-law rules in the absence of party choice.<sup>60</sup>

The starting point in such an analysis is asking why a court would not simply apply its domestic contract law in all cases, just as courts have always applied their own procedural rules in transnational commercial disputes.<sup>61</sup> Under such a forum-centered approach, a court might consult foreign law only for partial guidance in adapting domestic legal rules to suit international transactions.<sup>62</sup>

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difficult for a U.S. lawyer to manage risk and reduce ‘Brazil costs.’”); Wolff, *supra* note 12, at 482 (enhancing certainty and predictability in Hong Kong’s rules governing choice of contract law “must be one of the main goals of any reform”).

<sup>59</sup> See *supra* Parts II–III.A (discussing how the CISG does not apply to non-sales transactions nor to a sale of goods for household use, nor does it apply if the parties have opted out of the CISG; moreover, even when it generally applies, the CISG will not apply to all issues that might arise.).

<sup>60</sup> See NYGH, *supra* note 5, at 32–33 (explaining the forum’s conflicts rule certainly apply in the absence of contractual choice of law, and the enforceability of contractual choice of law is similarly governed by the forum’s conflicts rules, except under a particularly robust theory of party autonomy that has little support); SCOLES ET AL., *supra* note 13, at 120 n.2 (discussing how the forum applies its own conflicts rules except to the extent its rules are defined or displaced by a higher authority, such as if a treaty or other law of the United States displaced the conflicts rule developed under the statutory or common law of a state).

<sup>61</sup> E.g., RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 585 (1934) (“All matters of procedure are governed by the law of the forum.”); SCOLES ET AL., *supra* note 13, at 127–29; see also Lipstein, *supra* note 40, at 61 (referring to Prof. Ehrenzweig’s maxim that “the *lex fori* applies to questions of procedure”). Of course, jurisdictions may vary in their categorization of issues as substantive or procedural.

<sup>62</sup> See ERNST RABEL, THE CONFLICT OF LAWS: A COMPARATIVE STUDY 448 (1947) (discussing whether mid-nineteenth century Soviet codes, providing that courts should “consider” the foreign law where the contract had been formed, amounted to a choice-of-law rule or instead called for application of Soviet law in all cases, which presumably could be adapted or applied with sensitivity to the foreign rule); SCOLES ET AL., *supra* note 13, at 22–23 (describing Walter Wheeler Cook’s “local law theory,” which would grant a remedy under local law that is “adapted to the needs of justice that the existence of a foreign element creates”); cf. LIPSTEIN, *supra* note 40, at 17–18 (describing how prior to the eighteenth century, English common law courts applied only common law to suits over which they had jurisdiction, and other tribunals developed and applied international law, such as the *lex mercatoria*, to transnational disputes, so that the English courts had no need for a conflicts rule).

Few would argue that rules of customary international law compel a court to apply foreign law to a transnational dispute before it.<sup>63</sup> Instead, courts apply foreign law only to the extent dictated by rules of domestic law or of international conventions voluntarily adopted.<sup>64</sup>

Though not compelled by international law, however, conventions or other choice of law rules that open the door to foreign law are widely viewed as advancing the forum's domestic values regarding comity, transnational justice, and reciprocity.<sup>65</sup> Accordingly, states and nations have nearly universally adopted and applied choice-of-law rules that designate application of foreign contract law in appropriate circumstances.<sup>66</sup>

The approaches to choice of law, however, are hardly uniform. Instead, uncertainty about choice of applicable contract law is substantial, partly because the applicable choice-of-law rule itself depends on the forum in which a suit is brought<sup>67</sup> and whether the

<sup>63</sup> LIPSTEIN, *supra* note 40, at 125–26; *see also id.* at 94 (choice of law is a matter of domestic law, so that “the *lex fori* alone determines in what circumstances foreign law is to apply”); *cf. id.* at 64–65 (suggesting that a State’s broad discretion in the formulation of its conflicts rules is subject to international requirements of “minimum standards of justice and abstention from illegal discrimination”); SCOLES ET AL., *supra* note 13, at 2 (“conflicts law is essentially *national law*” that is “subject perhaps to mild restraints imposed by international law”). Indeed, in the United States, choice-of-law rules are largely a matter of state law. *Id.* at 2, 4, 170–71, 222–23.

<sup>64</sup> SCOLES ET AL., *supra* note 13, at 19 n.8 (quoting Joseph Story, COMMENTARIES ON THE CONFLICT OF LAWS, FOREIGN AND DOMESTIC 34 (1834)) (the application of foreign law within the forum is a matter of comity that “is derived altogether from the voluntary consent” of the forum); *id.* at 41 (“most commentators would agree that conflicts rules are local law, even those derived from national constitutional law or nationally adopted international treaties”); LIPSTEIN, *supra* note 40, at 19–20 (quoting Story’s maxims).

<sup>65</sup> In 1834, American scholar Joseph Story described this concept of comity as “mutual interest and utility” arising from “a spirit of moral necessity to do justice.” SCOLES ET AL., *supra* note 13, at 19 (quoting STORY, *supra* note 64, at 34).

<sup>66</sup> *See* LIPSTEIN, *supra* note 40, at 64 (“[M]ost countries possess a system of Private International Law and no country refuses categorically to recognize or to apply foreign law altogether.”). It wasn’t always so. Some early English cases simply dismissed cases that did not arise in England and contained foreign elements. SCOLES ET AL., *supra* note 13, at 6 & n.2. (citing to a case dated 1308). Moreover, as late as the early twentieth century, some writers interpreted the Soviet codes of civil procedure to make Soviet law “controlling in every single case,” even though they invited courts to “consider” the law of the country in which a contract was made. RABEL, *supra* note 62, at 448. The German scholar Wachter argued in favor of applying the law of the forum unless it left a gap that required supplementation. SCOLES ET AL., *supra* note 13, at 16. As late as the second half of the twentieth century, the leading U.S. theorist on choice of law, Brainerd Currie, espoused a governmental interest test that would nearly always result in selection of the substantive law of the forum. *Id.* at 33. Interestingly, the federal civil code of Mexico did not formally acknowledge the applicability of foreign law until 1988 amendments to the code. *See* Código Civil Federal [CC] [Federal Civil Code] art. 14 (Mex.).

<sup>67</sup> *See supra* note 60 and accompanying text (forum applies its choice-of-law rules); NYGH, *supra* note 5, at 3 (“national choice of law rules tend to differ”).

forum's choice-of-law rule chooses a single nation's law for the whole contract or potentially applies rules from different nations to different issues that arise in the contract dispute,<sup>68</sup> and partly because of the indeterminacy inherent in the tests advanced in some approaches to choice of law.<sup>69</sup>

### A. ENFORCEMENT OF PARTY CHOICE

Even if application of foreign contract law advances state or national policy in appropriate circumstances, it does not necessarily follow that a forum court should enforce the parties' agreement to choose a body of contract law other than the law that the forum's choice-of-law rules would designate. True, the parties can always copy the provisions of chosen law into the contract as statements of the parties' mutual promises,<sup>70</sup> or they could intentionally locate contract formation or performance to a legally desirable jurisdiction to ensure that the law of the desired jurisdiction will be chosen by the forum's conflicts rules.<sup>71</sup> Otherwise, the choice between domestic or foreign substantive contract law could be viewed as a matter of mandatory conflicts law that lies beyond the power of the parties to alter through agreement.<sup>72</sup>

<sup>68</sup> Cf. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 186 (1971) (referring to choice of the laws applicable to "issues in contract") with Rome I, *supra* note 3, art. 4–8 (in the absence of party choice, providing rules for determining the law applicable to "the contract" or to "a contract"). When the parties contractually choose the applicable law, Rome I permits them to select the law applicable to only a part of the contract, which may result in more than one law applying in the dispute.

<sup>69</sup> See, e.g., RESTATEMENT (SECOND) OF CONFLICT § 6 (1971). NYGH, *supra* note 5, at 3 (explaining that many choice-of-law tests "are open to judicial chauvinistic manipulation").

<sup>70</sup> See, e.g., *Louis Dreyfus v. Paterson S.S., Ltd.*, 43 F.2d 824, 827 (2d Cir. 1930) ("[P]arties cannot select the law which shall control, except as it becomes a term in the agreement, like the by-laws of a private association."); see also Rome I, *supra* note 3, Recital 13 (noting that in addition to the Regulation's enforcement of contractual choice of the laws adopted by a state, parties may incorporate "by reference into their contract a non-State body of law or an international convention"). But cf. RABEL, *supra* note 62, at 361–62 (opining that a contractual reference to the terms of foreign law should be treated as a choice of law rather than as the court would treat the incorporation by reference of other kinds of terms).

<sup>71</sup> See NYGH, *supra* note 5, at 2 (explaining that even if the forum denied parties the right to choose the applicable law in an international transaction, the parties can do so indirectly by tying the contract to the desired jurisdiction with appropriate connecting factors); Stringer, *supra* note 58, at 974–75 (discussing possibility that parties can indirectly choose at least elements of foreign contract law under Brazilian conflicts rules by locating contract formation in the foreign country); RABEL, *supra* note 62, at 366 (stating that parties can influence the application of a court's choice of law by "establishing locally connected obligations," although contractual agreement on choice of law ought to be viewed as something more than "mere 'localization'").

<sup>72</sup> EDWIN SCOTT FRUEHWALD, CHOICE OF LAW FOR AMERICAN COURTS: A MULTILATERALIST METHOD 123 (2001) (summarizing the views of Joseph Beale, reporter for the Restatement (First) of Conflict of Laws published in 1934.).



For several decades in the first half of the twentieth century, this argument against party autonomy in choice of law gained ground globally,<sup>73</sup> illustrated by the absence of a provision for contractual choice of law in the first Restatement of Conflict of Laws in 1934,<sup>74</sup> which in turn reflected the views of its reporter, Joseph Beale.<sup>75</sup> In the latter half of the twentieth century, however, the pendulum swung back nearly universally in favor of deference to contractual choice of law.<sup>76</sup>

The enforceability of forum selection clauses progressed in a similar manner in the twentieth century, as illustrated and explained by the U.S. Supreme Court's 1972 admiralty law decision in *M/S Bremen v. Zapata Off-Shore Co.*:<sup>77</sup>

Forum-selection clauses have historically not been favored by American courts. Many courts, federal and state, have declined to enforce such clauses on the ground that they were "contrary to public policy," or that their effect was to "oust the jurisdiction" of the court. Although this view apparently still

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<sup>73</sup> NYGH, *supra* note 5, at 8–10. Article 5 of the Additional Protocol of the Second S. Am. Congress on Private Int'l Law at Montevideo (1940) more affirmatively excluded party choice. *Id.* at 9 n.41; *see also* RABEL, *supra* note 62, at 514 (referring to nationalist experiment in conflicts law in Latin American countries). In 1930, Judge Learned Hand opined that "parties cannot select the law which shall control, except as it becomes a term in the agreement, like the by-laws of a private association." *Louis Dreyfus*, 43 F.2d at 827. During this period, contractual choice of law was less than fully effective in some European countries as well. NYGH, *supra* note 5, at 9 & nn.42 & 43. This trend represented a retreat from a movement toward deference to contractual choice of law in the nineteenth century. *Id.* at 8–9; *Pritchard v. Norton*, 106 U.S. 124, 128 (1882) (suggesting that contractual choice at least had substantial weight in the court's choice of law). English law appears to have continued its fidelity to party autonomy in choice of law throughout this period. *See* NYGH, *supra* note 5, at 10–11 (discussing *Vita Food Products Inc. v. Unus Shipping Co. Ltd.* [1939] AC 277, 290); COLLINS, *supra* note 57, at 416–18 (referring, among other things, to the views of Lord Wright in the *Vita Food* case).

<sup>74</sup> NYGH, *supra* note 5, at 9–10.

<sup>75</sup> Beale thought that "allowing the parties to select the law that controlled their contracts was a legislative act that interfered with state sovereignty" and "was theoretically indefensible in connection with vested rights." FRUEHWALD, *supra* note 72, at 123.

<sup>76</sup> *See id.* at 123–24 (referring to critics of Beale's views and to enforcement of choice of law clauses by "modern courts," subject to some limiting factors); NYGH, *supra* note 5, at 11–14; Stringer, *supra* note 58, at 972 (explaining that Brazilian scholars point to Italy as an example of a nation that replaced outmoded conflicts rules with a modern convention: the 1980 Rome Convention, *supra* note 57, which respects party autonomy in choice of law). *But see id.* at 968–79 (discussing how Brazilian law is uncertain in the enforcement of party choice of law and forum); CAL. BUS. & PROF. CODE § 20040.5 (West 2008) (discussing how in any claim arising out of a franchise agreement, relating to a franchise business operating in California, a clause in the contract choosing a dispute resolution venue outside California is void).

<sup>77</sup> *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972); *see* NYGH, *supra* note 5, at 21 (citing to a 1958 federal appellate case rejecting party choice of exclusive forum and crediting *Bremen* for reversing this restrictive approach).

has considerable acceptance, other courts are tending to adopt a more hospitable attitude toward forum-selection clauses. . . .

. . .

This [more hospitable] approach is substantially that followed in other common-law countries including England. It is the view advanced by noted scholars and that adopted by the [Second] Restatement of the Conflict of Laws. It accords with ancient concepts of freedom of contract and reflects an appreciation of the expanding horizons of American contractors who seek business in all parts of the world. Not surprisingly, foreign businessmen prefer, as do we, to have disputes resolved in their own courts, but if that choice is not available, then in a neutral forum with expertise in the subject matter. Plainly, the courts of England meet the standards of neutrality and long experience in admiralty litigation. The choice of that forum was made in an arm's-length negotiation by experienced and sophisticated businessmen, and absent some compelling and countervailing reason it should be honored by the parties and enforced by the courts.<sup>78</sup>

In *Bremen*, U.S. and German parties to an international towage contract had contractually selected London as the exclusive forum for disputes arising out of their contract.<sup>79</sup> The trial court sitting in Florida declined to defer to the London forum; it applied the doctrine of *forum non-conveniens* without regard to the parties' contractual choice, because it found that the parties' choice of forum violated public policy.<sup>80</sup> The Supreme Court reversed, holding that the trial court had given "far too little weight and effect"<sup>81</sup> to the parties' choice of forum in a freely negotiated contract without overreaching or other defects in formation.<sup>82</sup> It placed a "heavy burden"<sup>83</sup> on the party seeking to avoid that choice "to show that trial in the contractual forum will be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in court."<sup>84</sup>

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<sup>78</sup> *M/S Bremen*, 407 U.S. at 9–12 (footnotes omitted).

<sup>79</sup> *Id.* at 3.

<sup>80</sup> *Id.* at 6.

<sup>81</sup> *Id.* at 8.

<sup>82</sup> *Id.* at 12 & n.14, 15; *see also* *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 594 (1991) (*applying Bremen* to enforce to choice of forum clause in a domestic consumer contract).

<sup>83</sup> *M/S Bremen*, 407 U.S. at 19.

<sup>84</sup> *Id.* at 18.

*Bremen* helped signal a new era in the United States for party autonomy in choice of law,<sup>85</sup> as well as choice of forum, because the courts in *Bremen* assumed that the chosen forum would apply English law, which in turn would give effect to an exculpatory clause in the contract.<sup>86</sup> The policy considerations underlying the deference to party choice of forum applied equally to contractual choice of law:

For at least two decades we have witnessed an expansion of overseas commercial activities by business enterprises based in the United States. The barrier of distance that once tended to confine a business concern to a modest territory no longer does so. . . . The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts. . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.<sup>87</sup>

To be sure, international harmonization of rules respecting party autonomy is incomplete. Influenced by relatively recent memories of foreign domination, Latin American countries remained particularly wary of the operation of party-selected foreign laws well into the twentieth century.<sup>88</sup> Most notably, Brazilian law still excludes explicit

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<sup>85</sup> The Supreme Court's decision in *Bremen* followed closely on the heels of publication of the second Restatement, which advanced a rule respecting party choice of law, subject to public policy and relationships between the transaction and state interests. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

<sup>86</sup> *M/S Bremen*, 407 U.S. at 8, 13 n.15, 18 n.19. The decision is particularly notable because it required substantial deference to the parties' choice of an English forum, and the resulting application of English law, even though England had no substantial relationship to the transaction. *Id.* at 2–4, 13–14, 17–18 (describing a transaction with no relationship to England other than the forum selection clause and the filing of suit by one of the parties in England, and noting that the parties chose the English forum because of its neutrality and to gain certainty); NYGH, *supra* note 5, at 56 (discussing how the transaction in *Bremen* “had no connection, bar the choice of forum” with the chosen “English forum (and by implication . . . English law).”); *see also id.* at 16 (“English courts in particular will accept jurisdiction . . . and have never concerned themselves with the question of the connection of the parties or the substance of the dispute to England.”).

<sup>87</sup> *M/S Bremen*, 407 U.S. at 8–9.

<sup>88</sup> *See* NYGH, *supra* note 5, at 9 (referring to the 1940 Additional Protocol of the Second S. Am. Congress on Private Int'l Law at Montevideo, which excluded party autonomy); Stringer, *supra* note 58, at 970 (explaining that 1942 Brazilian laws limiting party autonomy may reflect a national desire to distance the country from former colonial powers as well as “nationalist

party choice of law, and some Brazilian courts have effectively restricted party choice of forum through expansive interpretations of public policy or mandatory Brazilian jurisdiction.<sup>89</sup>

Moreover, conflicts rules vary in the degree to which they permit contractual choice of the law of a state that has little or no relationship to the transaction. With some limitations, European conventions generally permit contractual choice of the law of a state that bears no relation to the international transaction in question.<sup>90</sup> In contrast, U.S. conflict rules frequently require a substantial or reasonable relationship between the transaction and the state whose law is contractually chosen.<sup>91</sup> Indeed, although revised Article 1 of the UCC proposed in 2001 to permit parties to choose the law of a state unrelated to the transaction—subject to special protections for consumers—every state that adopted revised Article 1 rejected the new rules regarding choice of law,<sup>92</sup> leading the American Law Institute to return to its previous position of requiring a “reasonable relation.”<sup>93</sup> A convention sponsored by the Organization for

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political impulses at a time in which Brazilian sovereignty was threatened by capital-exporting countries during World War II”).

<sup>89</sup> Stringer, *supra* note 58, at 968–79. Brazil has signed the Inter-American Convention on the Law Applicable to International Contracts (1994), which respects party choice of law in Article 7, but Brazil has not ratified it. *See id.* at 974–75.

<sup>90</sup> Hague Convention on the Law Applicable to International Sales of Goods art. 2, June 15, 1955 [hereinafter 1955 Hague Convention] available at <http://www.jus.uio.no/lm/hcpil.applicable.law.sog.convention.1955/> (applying the “domestic law of the country designated” by the parties, subject under art. 2 to overriding public policy, but without any explicit requirement of relationship between the transaction and the state whose law is chosen); 1980 Rome Convention, *supra* note 57, art. 3.1 (providing for application of the “law chosen by the parties,” subject only to overriding public policy of the forum under art. 16 or to certain mandatory rules of the forum or of another non-chosen country with a close connection, under art. 7); Rome I, *supra* note 3, art. 3.1 (discussing how a contract is “governed by the law chosen by the parties,” subject to special rules for contracts of carriage, consumer contracts, and insurance contracts, and individual employment contracts under arts. 5–8, and subject to overriding mandatory provisions, narrowly defined, under art. 9 and to public policy of the forum under art. 21).

<sup>91</sup> *See, e.g.*, U.C.C. § 1-301(b) (2008) (respecting party choice of law only if the chosen state has a “reasonable relation” to the transaction); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(a) (1971) (discussing when the issue is not one governed by default rules, so that the parties could resolve it by explicit provision in their agreement, and when “there is no other reasonable basis for the parties’ choice” of law, the chosen state must have a “substantial relationship to the parties or the transaction”). *But cf. M/S Bremen*, 407 U.S. at 10, 12 (applying admiralty law, the Court required substantial deference to the parties’ choice of an English forum, and thus of English law, even though England otherwise had no relationship to the transaction).

<sup>92</sup> *See* LANCE LIEBMAN, PROPOSAL TO AMEND OFFICIAL TEXT OF § 1-301 (TERRITORIAL APPLICABILITY; PARTIES’ POWER TO CHOOSE APPLICABLE LAW) OF REVISED ARTICLE 1 OF THE UCC, available at <http://www.ali.org/doc/uccamendment.pdf>.

<sup>93</sup> *See Meetings & Events: Actions Taken*, *supra* note 2.

American States would permit party choice of law without requiring a relationship between the transaction and the location of the chosen law,<sup>94</sup> but only Mexico and Venezuela have ratified this convention.<sup>95</sup>

In light of the limitations on enforcement of contractual choice of law in the Western Hemisphere, John Coyle argues that costs and risks in international commercial transactions can best be reduced within the sphere of conflicts law by expansively enforcing party choice and internationally harmonizing the rules for doing so.<sup>96</sup>

Coyle's views are eminently sensible. Sophisticated parties to international commercial contracts can reduce uncertainty about their legally enforceable rights and obligations by agreeing to a mutually acceptable forum and substantive law for dispute resolution.<sup>97</sup> Moreover, the difficulties of harmonizing rules governing enforcement of party choice of court and law may be surmountable in the near future, if only because we are relatively close to success on that front. Conventions and regulations have harmonized rules governing contractual choice of court<sup>98</sup> and law<sup>99</sup> in Europe. In the Western Hemisphere as well, robust enforcement of contractual choice of court and law is now the general

<sup>94</sup> Inter-American Convention on the Law Applicable to International Contracts art. 7, Mar. 17, 1994, 33 I.L.M. 733 (providing for application of the "law chosen by the parties," subject to the public order of the forum under art. 18 and to application of mandatory rules of the forum or possibly of another country with close ties to the contract under art. 11). In another way, however, this convention may restrict party autonomy by requiring application, without explicit qualification, of all "mandatory requirements" of the law of the forum, *see id.* art. 11, which may restrict party choice of law to those terms that are governed only by default terms of forum law and which could be varied by agreement of the parties in any event. *Cf.* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971) (permitting choice of law relating to issues others than default terms in some circumstances).

<sup>95</sup> *See B-56: Inter-American Convention on the Law Applicable to International Contracts*, DEPT. OF INT'L L., ORG. AM. STATES, <http://www.oas.org/juridico/english/signs/b-56.html> (last visited June 3, 2011).

<sup>96</sup> John F. Coyle, *Rethinking the Commercial Law Treaty*, 45 GA. L. REV. 343 (2011).

<sup>97</sup> *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13–14 (1972) (referring to the benefits of eliminating uncertainty regarding the forum through contractual choice of forum); NYGH, *supra* note 5, at 2–3 ("An international contract, like any other contract, requires certainty. Where several fora are available and several laws potentially applicable, the parties should be able to avert such uncertainties through an agreed choice of law and/or forum.").

<sup>98</sup> Council Regulation (EC) No. 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, art. 23, 2001 O.J. (L 12) 1 (commonly known as "Brussels I," permitting parties to agree that a court or courts of a Member State will have jurisdiction over a matter, either exclusive or concurrent, subject to some exceptions stated in other articles).

<sup>99</sup> *See Rome I*, *supra* note 3, art. 3; *see also* Council Regulation (EC) No. 864/2007 of 11 July 2007 on the Law Applicable to Non-Contractual Obligations (Rome II), 2007 O.J. (L 199) 40 (EC) (choice of law for non-contractual obligations in civil and commercial matters).

rule,<sup>100</sup> at least when the chosen country has a substantial relationship to the transaction,<sup>101</sup> to which the uncertainty of Brazilian law<sup>102</sup> is the exception.

Even the substantial relationship requirement does not prevent parties from reducing uncertainty in choice of court and law; it simply restricts the range of options for reducing the uncertainty. Because the parties' home countries will be the ones most likely to have a substantial relationship to an international transaction, the principal effect of this limitation on party choice may be to prevent the parties from choosing a forum and body of contract law that provides a neutral basis for dispute resolution, over which neither party has an advantage.

Even then, parties with the means to do so might be able to create the requisite relationship by forming the contract in the desired jurisdiction.<sup>103</sup> Moreover, a desire for neutrality simply underscores the parties' ability to contractually opt for international arbitration as a means of dispute resolution. The widely adopted 1958 New York Arbitration Convention<sup>104</sup> has largely realized harmonization in enforcement of party choice in the context of international arbitration. It provides a reliable basis for judicial enforcement of contractual choice of

<sup>100</sup> See *supra* notes 76–87 and accompanying text. Rules for enforcement of contractual choice of court may one day become more certain and uniform if the 2005 Hague Convention on Choice of Court Agreements enters into force, which requires ratification by at least two countries. Hague Convention on Choice of Court Agreements, art. 31(1), June 30, 2005, 44 I.L.M. 1294. As of November 2010, however, only Mexico had ratified this Convention, although the European Union and the United States have signed it. See Status Table: Convention of 30 June 2005 on Choice of Court Agreements, HAGUE CONF. PRIVATE INT'L L. (Nov. 19, 2010), [http://www.hcch.net/index\\_en.php?act=conventions.status&cid=98](http://www.hcch.net/index_en.php?act=conventions.status&cid=98).

<sup>101</sup> See *supra* notes 90–95 and accompanying text.

<sup>102</sup> See *supra* note 89 and accompanying text.

<sup>103</sup> See generally *supra* note 72 (discussing indirect choice of law in the absence of any enforcement of party choice).

<sup>104</sup> U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 [hereinafter N.Y. ARB. CONVENTION], available at <http://www.uncitral.org/pdf/1958NYConvention.pdf>; see also NYGH, *supra* note 5, at 24 (referring to this convention as “[f]irst and foremost” among conventions and model laws on arbitration that represent a “remarkable . . . international consensus . . . which crosses the traditional common law and civil law divisions”). Harmonization has been advanced further by the popularity of the UNCITRAL Model Law on International Commercial Arbitration as a blueprint for supplementary domestic legislation governing enforcement of arbitration agreements and awards. UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION (2006); see also Status: 1985—UNCITRAL Model Law on International Commercial Arbitration, with Amendments as Adopted in 2006, UNCITRAL, [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/1985Model\\_arbitration\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html) (last visited June 4, 2011) (showing dozens of countries that have based domestic legislation on the Model Law, either as originally published in 1985 or as modified in 2006).

the arbitration forum<sup>105</sup> and the resulting arbitration awards in international transactions.<sup>106</sup> Moreover, arbitrators will honor the parties' choice of applicable law,<sup>107</sup> likely more liberally than will a court that tries the dispute,<sup>108</sup> and arbitration awards are subject to limited judicial review for legitimacy.<sup>109</sup>

<sup>105</sup> N.Y. ARB. CONVENTION, *supra* note 104, art. II (providing for judicial deference to written agreements to arbitrate disputes).

<sup>106</sup> *Id.* arts. III–IV (providing for judicial enforcement of arbitral awards, subject to limited defenses).

<sup>107</sup> See, e.g., INT'L CHAMBER OF COMMERCE RULES OF ARBITRATION art. 17.1 (1998), available at [http://www.iccwbo.org/uploadedFiles/Court/Arbitration/other/rules\\_arb\\_english.pdf](http://www.iccwbo.org/uploadedFiles/Court/Arbitration/other/rules_arb_english.pdf) (“The parties shall be free to agree upon the rules of law to be applied the Arbitral Tribunal to the merits of the dispute. . . .”); AM. ARBITRATION ASS'N INT'L ARBITRATION RULES art. 28.1 (2009), available at <http://www.adr.org/sp.asp?id=33994#INTERNATIONAL%20ARBITRATION%20RULES> (“The tribunal shall apply the substantive law(s) or rules of law designated by the parties as applicable to the dispute. . . .”); UNCITRAL ARB. MODEL LAW, *supra* note 104, art. 28(1) (“The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute.”).

<sup>108</sup> A private arbitration panel is likely to respect party autonomy in a way that courts do not, by following the parties' directive to apply a set of rules that has not been adopted into any nation's law but has the status only of secondary authority, such as the UNIDROIT Principles of International Commercial Contracts (2004). See, e.g., AM. ARBITRATION ASS'N INT'L ARBITRATION RULES art. 28.1 (2009) (referring to “substantive law(s) or rules of law”) (emphasis added); INT'L CHAMBER OF COMMERCE RULES OF ARBITRATION art. 17.1 (1998) (referring to “rules of law”); UNCITRAL MODEL LAW ON INT'L COMMERCIAL ARBITRATION art. 28(3) (2006) (allowing arbitration tribunal to “decide *ex aequo et bono*,” but only if directed to do so by the parties). In contrast, judicial choice-of-law rules universally enforce only contractual choices of laws adopted by nations or states. See U.C.C. § 1-301(a) (2008) (parties can effectively choose the “law” of a “state”); 1955 Hague Convention, *supra* note 90, art. 2 (providing for application of the “domestic law of the country designated” by the parties); 1980 Rome Convention, *supra* note 57, art. 1 (the convention addresses “choice between the laws of different countries”); *id.* art. 3.1 (providing for application of the “law chosen by the parties”); Rome I, *supra* note 3, at art. 3.1 (a contract is “governed by the law chosen by the parties”); *id.* art. 3.3 (referring to the “country whose law has been chosen”). But cf. Wolff, *supra* note 12, at 470 (arguing that parties should be able to choose the UNIDROIT Principles, though not the less definable *lex mercatoria*, under Hong Kong conflicts rules received from pre-Rome I English common law conflicts rules). Regarding Rome I, the European Commission had proposed to authorize contractual choice of “rules of the substantive law of contract recogni[z]ed internationally or in the Community.” *Proposal for a Regulation of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I)*, art. 3(2), COM 2005 650 final (Dec. 15, 2005) [hereinafter *2005 Rome I Proposal*], available at [http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005\\_0650en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0650en01.pdf). The final version, however, omitted this provision. Francisco J. Garcimartin Alférez, *The Rome I Regulation: Much Ado About Nothing?*, EUR. LEGAL F., I-61, I-67 (2008); see also NYGH, *supra* note 5, at 60 (citing to several sources for the proposition that enforceable chosen law under Rome I “is the law of a State”). Instead, the recitals of Rome I refer to possible future authorization of party choice of rules of substantive contract law that might be adopted by the European Community, and to the ability of the parties to incorporate the equivalent of a legal rule into the body of their contract. Rome I, *supra* note 3, recitals 13, 14. The Inter-American Convention arguably permits a court to apply non-state rules, because it directs courts to supplement state law with “the guidelines, customs, and principles of international law as well as commercial usage and

Thus Coyle's priorities for harmonization are most realistic because they are nearest to satisfaction under current laws: judicial enforcement of party autonomy is nearly universal and on terms that are robust even if not uniformly so. For precisely this reason, however, when parties do not or cannot agree on the forum and the applicable contract law in an international transaction, the need is particularly great for further progress on harmonization of substantive contract law, as well as harmonization and improvement in choice-of-law rules.

In Part II, this article addressed harmonization of substantive law. It praised the CISG, expressed regret over the frequency with which parties opt out of the CISG in international sales transactions, and applauded the concededly ambitious goal of an international commercial contract law for non-sales transactions, perhaps patterned after the UNIDROIT Principles. The next part takes up the final argument for harmonization: reducing uncertainty in choice of law in the absence of applicable international law or party choice of domestic law, by harmonizing choice-of-law rules and adopting a test that is relatively certain and predictable in its selection of applicable contract law.

#### B. CHOICE OF LAW IN ABSENCE OF CONTRACTUAL CHOICE

The thesis of this section, and indeed the primary thesis of this article, is that harmonization of choice-of-law rules can reduce risk and uncertainty in a manner patterned after the European Community's

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practices . . . to discharge the requirements of justice and equity." Inter-American Convention on the Law Applicable to International Contracts, *supra* note 94, art. 10. It is likely, however, that this passage refers only to judicial resort to general principles as a means of interpreting or filling gaps in state law, and not as a directive to enforce contractual choice of a body of non-state rules as the exclusive or primary body of applicable law. *See* NYGH, *supra* note 5, at 151–52 nn.73–74 and accompanying text. In other respects, the convention focuses on the law of a state. Inter-American Convention on the Law Applicable to International Contracts, *supra* note 94, art. 2 (referring to the possibility that the Convention will call for application of the law of "a State that is not a party"); *id.* art. 9 (referring twice to "the law of the State with which it has the closest ties," although also directing courts to "take into account the general principles of international commercial law"). To the extent that the Inter-American Convention might be interpreted to permit contractual or judicial choice of non-state law, it would be controversial, perhaps explaining its failure to attract more than a few signatures and ratifications. *See B-56: Inter-American Convention on the Law Applicable to International Contracts*, *supra* note 95. Because courts themselves will not enforce party choice of non-State sets of rules or principles of contract law, parties who direct arbitrators to apply such rules presumably run some risk that a court will later balk at enforcing an arbitration award based on such rules.

<sup>109</sup> *See, e.g.,* N.Y. ARB. CONVENTION, *supra* note 104, art. V (listing grounds for refusal to enforce an arbitration award, such as contractual incapacity or invalidity, exceeding the scope of the arbitration agreement or submission, resolving non-arbitrable matters, violating public policy, or providing inadequate notice or opportunity to present a case in arbitration).



recently adopted Rome I Regulation, which provides a sensible balance between certainty and flexibility in choice of law rules.

The merits of Rome I can be better appreciated after briefly reviewing choice-of-law rules in the United States.

#### 1. INTRODUCTION: COMPETING CONCERNS AND APPROACHES

A number of approaches to choice of law have competed for attention and adoption over the centuries. Some writers have advanced a consequentialist concern for “material” or “substantive” justice by favoring a choice of law that would bring about the best outcome in the transnational dispute.<sup>110</sup> Hints of such an approach can be seen in European Conventions that provide special conflicts rules for consumers and employees, usually choosing the law of the consumer’s residence or the employee’s place of work, which laws are familiar to them and consistent with their expectations, and barring contractual choice of law that would evade protections provided by the law that would otherwise be chosen.<sup>111</sup>

Most conflicts theories, however, have left material justice largely to the substantive law and have instead sought “conflicts justice” through choice-of-law rules that are sensitive to the relationship between the transaction and the competing substantive laws.<sup>112</sup> In the nineteenth

<sup>110</sup> See SCOLES ET AL., *supra* note 13, at 48–52 (referring to commentators who advanced “material justice” approaches); FRUEHWALD, *supra* note 72, at 2–3, 27–29 (discussing consequentialist approaches such as the “better rule” approach); LIPSTEIN, *supra* note 40, at 39–41 (discussing the “result selecting,” “better law” approach of Prof. Cavers as set forth in David Cavers, *A Critique of the Choice-of-Law Problem*, 47 HARV. L. REV. 173 (1933)). An early approach to material or substantive justice, during the Roman empire, authorized an official—the *praetor peregrinus*—to engage in the creative development of a cosmopolitan law, the *ius gentium*, for disputes involving non-citizens, partly through the blending of laws of different origins. See FRIEDRICH K. JUENGER, *CHOICE OF LAW AND MULTISTATE JURISDICTION* 8–10 (1993). Although modern courts generally do not engage in such common law creation of transnational law, a few commentators have urged them to do so. See Paul Schiff Berman, *Towards a Cosmopolitan Vision of Conflict of Laws: Redefining Governmental Interests in a Global Era*, 153 U. PA. L. REV. 1819, 1852–56 (2005) [hereinafter Berman, *Towards a Cosmopolitan Vision*] (referring to the transnational substantive approaches of Juenger and Luther McDougal, and examining Graeme Dinwoodie’s advocacy of the formulation of blended or hybrid rules in international copyright disputes); *id.* at 1862 (the author’s “cosmopolitan” approach would permit construction of a hybrid rule, contrary to most traditional choice-of-law rules).

<sup>111</sup> See, e.g., *infra* notes 169–72, 188–90 and accompanying text (discussing special provisions for employees and consumers in the 1980 Rome Convention and its successor, the Rome I Convention).

<sup>112</sup> See SCOLES ET AL., *supra* note 13, at 48; see also FRUEHWALD, *supra* note 72, at 49–51 (arguing that “choice of law should be substantively neutral” and that “[s]ubstantive justice should be accomplished at the substantive level . . . , not at the choice of law level”); Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1844–45, 1855 (advocating a conflicts approach that

century, the German scholar Friedrich Carl von Savigny advanced modern conflicts analysis by focusing on territorial connecting factors between a legal relationship and legal systems, leading to selection of the legal system associated with the “seat” of the legal relationship, without special weight given to the forum’s interests.<sup>113</sup>

## 2. CHOICE OF LAW IN THE UNITED STATES SINCE THE TWENTIETH CENTURY

### (a) NON-SALES TRANSACTIONS

In the first half of the twentieth century, choice-of-law rules in the United States remained narrowly territorial in the manner in which they connected a dispute to substantive contract law, reflecting the “vested rights” theory of Joseph Beale, the reporter for the first Restatement of Conflict of Laws.<sup>114</sup> The first Restatement, for example, called for application of the law of the place of contract formation to issues of contract formation and validity,<sup>115</sup> even though that place might have been a transitory place of meeting between the parties<sup>116</sup> or the fortuitous place from which the offeree happened to dispatch his acceptance while traveling on business.<sup>117</sup> This approach fostered

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examines communities and affiliations shared by the parties, as well as other factors, in an inquiry that is distinct from assessment of the competing substantive laws).

<sup>113</sup> SCOLES ET AL., *supra* note 13, at 16–17; LIPSTEIN, *supra* note 40, at 22. Savigny’s view that choice of law was a matter of universal application, rather than a matter of choice for each forum, did not take hold. *Id.*; see *supra* notes 63–64. Credit should be given to Ulrich Huber and the Dutch School in the seventeenth century for espousing a test based on connecting factors, as well as recognizing that the choice-of-law rule was a matter of local law and comity. LIPSTEIN, *supra* note 40, at 13–16, 18. Huber’s views, however, did not gain favor in Europe prior to Savigny, although they influenced thought in England and the United States, which in turn were revised by Savigny and revived in the Continent. See *id.* at 16–18; RABEL, *supra* note 62, at 442 (Savigny’s test for connecting factors prevailed in Europe as a test of “characteristic” connection or performance).

<sup>114</sup> Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1840–45 (summarizing and critiquing Beale’s “territorialism” and vested rights theory); FRUEHWALD, *supra* note 72, at 11–14 (summarizing Beale’s theory and discussing early twentieth century case law tending to support this theory in domestic conflicts through application of Due Process and Full Faith and Credit).

<sup>115</sup> RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 332 (1934).

<sup>116</sup> See *id.* § 325.

<sup>117</sup> See *id.* §§ 314, 326(b); see also RABEL, *supra* note 62, at 454–57 (discussing the difficulties of defining the place of contracting when jurisdictions differ on their recognition of the mailbox rule).

apparent certainty and predictability,<sup>118</sup> but at the price of potential arbitrariness, as when contract formation took place in a state having no other relationship to the parties or the transaction.<sup>119</sup>

The second half of the twentieth century witnessed a conflicts “revolution” in the United States, causing the pendulum to swing fully to the opposite end of its arc. The Restatement (Second) of Conflict of Laws represents the prevailing approach.<sup>120</sup> In hybrid fashion, it seems to draw both from Savigny’s focus on connecting factors<sup>121</sup> and American scholar Brainerd Currie’s focus on governmental interests.<sup>122</sup> The second Restatement’s approach appears to avoid arbitrariness, purchased at the price of maximum flexibility and indeterminacy.<sup>123</sup>

<sup>118</sup> Some have argued, however, that escape hatches and judicial manipulation made this apparent certainty illusory. See, e.g., Brainerd Currie, *Notes on Methods and Objectives in the Conflict of Laws* 1959 DUKE L.J. 171, 175 (1959) [hereinafter Currie, *Notes on Methods*] (explaining that escape hatches and manipulation of the connecting factors can “introduce a very serious element of uncertainty and unpredictability, even if there is fairly general agreement on the rules themselves”); SCOLES ET AL., *supra* note 13, at 23 (summarizing the arguments of Walter Cook).

<sup>119</sup> See SCOLES ET AL., *supra* note 13, at 126; cf. Currie, *Notes on Methods*, *supra* note 118, at 174 (“The territorialist conception has been responsible for indefensible results.”).

<sup>120</sup> The second Restatement has been adopted by roughly half the states, and several others apply approaches that borrow elements of it. LIPSTEIN, *supra* note 40, at 37; SCOLES ET AL., *supra* note 13, at 68. The courts of some states have adopted verbatim its provisions on choice of contract law. See, e.g., *Swanson v. The Image Bank, Inc.*, 206 Ariz. 264, 266–67, 77 P.3d 439, 441–42 (2003) (quoting, adopting, and applying section 187 of the second Restatement, addressing contractual choice of contract law, which required reference as well to section 188, presenting default rules for choice of contract law); *Landi v. Arkules*, 172 Ariz. 126, 130, 835 P.2d 458, 462 (Ct. App. 1992) (applying § 187). A few states have retained a traditional territorialist approach for non-sales transactions. E.g., *Key Motorsports, Inc. v. Speedvision Network, L.L.C.*, 40 F. Supp. 2d 344, 347 (M.D.N.C. 1997) (quoting *Fast v. Gulley*, 155 S.E.2d 507, 510 (N.C. 1967)) (referring to North Carolina conflicts law, which applies the law of the place of the last act of contract formation).

<sup>121</sup> See RABEL, *supra* note 62, at 442–43 (writing in 1947, prior to publication of the second Restatement, stating that “Savigny’s main principle . . . has gained supremacy” in Europe and “is the direction in which all efforts ought to be concentrated”).

<sup>122</sup> See BRAINERD CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* (1963); Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1845–52 (critically examining Currie’s “parochial” approach). In contrast to the weighing of interests and factors in the second Restatement, Currie’s interest analysis ironically did not call for a balancing of interests in the case of true conflict, and it nearly always chose the law of the forum. See SCOLES ET AL., *supra* note 13, at 26–33. Though much discussed among scholars, Currie’s approach did not have great influence on courts or legislatures. *Id.* at 34. Although some states combine Currie’s interest analysis with other approaches, and though the second Restatement relies partly on interest analysis, “the strict judicial following of [Currie’s] theory appears close to extinction.” *Id.* at 103.

<sup>123</sup> One European critic referred to the approaches in the second Restatement as “legal impressionism.” SCOLES ET AL., *supra* note 13, at 64; see *id.* at 65 (responding that the second Restatement sets forth an *approach* rather than rules, but opining that it amounts to more than impressionistic “non-rules”).

In the absence of a statutory directive, for example, section 6 of the second Restatement sets forth seven principles underlying its common law approach to choice of law:

**Section 6. CHOICE-OF-LAW PRINCIPLES:**

- (1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.
- (2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include:
  - (a) the needs of the interstate and international systems,
  - (b) the relevant policies of the forum,
  - (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
  - (d) the protection of justified expectations,
  - (e) the basic policies underlying the particular field of law,
  - (f) certainty, predictability and uniformity of result, and
  - (g) ease in the determination and application of the law to be applied.<sup>124</sup>

Section 188 then calls for analysis of the seven principles of section 6 in connection with at least five listed points of contact, in an effort to identify the State with “the most significant relationship to the transaction”:

**Section 188. LAW GOVERNING IN ABSENCE OF EFFECTIVE CHOICE BY THE PARTIES:**

- (1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.
- (2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying

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<sup>124</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971). Section 6 was not included in the initial draft of the second Restatement but was added later in response to criticisms that the initial draft failed to consider government interest analysis. FRUEHWALD, *supra* note 72, at 95.

the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.<sup>125</sup>

True, section 188(3) provides that the law of a state will “usually be applied” when that state is the place both of contract negotiation and performance.<sup>126</sup> In other cases, however, section 188 does not specify the relative weights to accord to the seven principles of section 6 and the five connecting factors of section 188.<sup>127</sup> Within a jurisdiction, precedent might establish some general parameters, such as giving priority to the principles in section 6 over the connecting factors in section 188, or according special weight to a particular connecting factor in particular contexts. On the other hand, it is possible that the open-ended approach of the second Restatement is popular with courts precisely because it offers them maximum flexibility and provides cover for a variety of methods.<sup>128</sup>

Consequently, when various principles and points of contact point in different directions, this approach is spectacularly flexible and uncertain in its choice of applicable law, despite the listing of “certainty, predictability and uniformity of result” as one of the seven principles in

<sup>125</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 188(1), (2) (1971).

<sup>126</sup> *Id.* § 188(3).

<sup>127</sup> See FRUEHWALD, *supra* note 72, at 95–96 (the second Restatement’s test provides no guidance about the interaction of policies within section 6, or about the interrelationship between the policies of section 6 and the most significant relationship test of section 188, leading one commentator to characterize this hybrid approach as schizophrenic).

<sup>128</sup> *Id.* at 96–97 (discussing practices of courts, characterizing the second Restatement’s test as “unsuitable as a choice of law method,” and quoting commentators for their views that the test works “badly” in practice and “allows judges to hide their use of judicial intuition”); Paul Schiff Berman, *The Globalization of Jurisdiction*, 151 U. PA. L. REV. 311, 421–22 & n.461 (2002) [hereinafter cited as Berman, *Globalization*] (citing commentators who “have often criticized the second Restatement’s ‘most significant relationship’ test because it tends to devolve into an unguided list of governmental interests with a conclusory decision appended”); *cf.* FRUEHWALD, *supra* note 72, at 61 (“The most significant relationship test is more predictable than governmental interest analysis or the better rule approach because it is substantively and forum neutral. Any predictability problems in this test will occur because judges may apply its criteria differently.”).

section 6.<sup>129</sup> Moreover, the second Restatement advances the concept of *dépeçage* by inviting courts to apply its test separately to each issue in a contracts dispute, and raising the possibility of applying the laws of different states to different issues,<sup>130</sup> thus multiplying the opportunities for uncertainty and litigation.

Thus, the second Restatement's approach most often would fail to provide to the parties at the time of contracting dependable notice of the applicable law in the event of a dispute. Moreover, its indeterminacy invites expensive litigation whenever the choice of law affects the outcome on the merits.

One might argue that parties to an interstate or international transaction can best avoid these uncertainties and consequent costs by contractually clarifying the applicable contract law, and one might place tongue in cheek to argue further that extreme indeterminacy in the default choice-of-law rules will encourage the parties to reduce risks and uncertainty by contractually choosing the contract law. But ill-advised default rules can hardly be justified by the fortuitous consequence that they could frighten some parties into negotiating choice of law when the parties otherwise might have been content to submit to a simpler and more certain default rule.

Some might defend the multi-faceted approach of the second Restatement, complete with *dépeçage*, by arguing that it maximizes a court's ability to identify—for each issue—the one state with the closest ties to the transaction, thus (1) reflecting the probable, if unexpressed, assumptions or expectations of the parties regarding the legal backdrop to their contractual activities, or (2) identifying the State with the greatest interest in the transaction. More cynically, one might argue (3) that the second Restatement's flexible approach provides a smokescreen to permit the covert achievement of other goals that are thought to be laudable but inconvenient to specify, such as selecting the law of the

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<sup>129</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2)(f) (1971). By the terms of the Restatement, this policy factor is not intended to encourage certainty and predictability to the Restatement's *approach*; instead, it suggests that certainty and predictability in the underlying contract law of a State is a factor in whether to choose that State's contract law. *Id.* ("the factors relevant to the choice of the applicable rule of law include . . . (f) certainty, predictability and uniformity of result").

<sup>130</sup> *Id.* § 188(1) ("with respect to an issue in contract"); *id.* § 188(3) ("with respect to the particular issue"). Compare RABEL, *supra* note 62, at 483–84, 536–37 (critiquing and rejecting *dépeçage*) with Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1843 (in complex multistate transactions, a cosmopolitan approach to choice of law "can recognize the possibility that norms of multiple states might apply to different parts of the dispute").

forum in all but the clearest cases for applying foreign law, or selecting the law that achieves the best results on the merits of the dispute.

(i) PARTY ASSUMPTIONS OR EXPECTATIONS ABOUT THE LEGAL  
BACKDROP TO THE TRANSACTION

The first argument, although reflected in one of the seven policy factors of the second Restatement's approach,<sup>131</sup> strikes this author as one based largely on a fiction when applied to international contracts. If the parties have not bothered to specify their choice of law in their contract, it seems unlikely that they have consciously adopted assumptions about which State's law has the closest connection to various facets of their contractual activities in a close case. More likely, the parties have simply neglected to confront the issue of governing law or failed to reach agreement on it.

A supposition that parties were consciously content to rely on a default choice-of-law system would be more plausible if the system employed extremely simple, clear, and certain rules that would apply uniformly within the population of states whose law might potentially govern the dispute, so that the parties could dependably predict the applicable law—in the absence of contractual choice—when negotiating their contract. Alternatively, if the absence of a choice-of-law clause reflects a failure to agree on choice of law or to address it at all, great certainty in the applicable choice of law rule will at least minimize costs of researching, analyzing, and litigating the issue. One can make this claim for Rome I, as will be argued in Part II.B.4 later, but one can hardly make this claim for the second Restatement.

(ii) IDENTIFYING THE STATE WITH THE GREATEST INTEREST IN  
THE TRANSACTION

In the wake of Currie's influential espousal of interest analysis during the American conflicts revolution,<sup>132</sup> it is no surprise that the second Restatement fosters an approach that chooses applicable contract law in relation to a State's ties to,<sup>133</sup> and interests in,<sup>134</sup> the transaction.

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<sup>131</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2)(d) (1971) (referring to the "protection of justified expectations").

<sup>132</sup> See *supra* notes 122, 124 and accompanying text.

<sup>133</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971) (referring to places of contracting, negotiation, performance, subject matter, and the parties' natural and legal locations).

<sup>134</sup> *Id.* §§ 6(2)(b), (c) (identifying as policy factors the policies of the forum and other interested States).

Currie himself, however, argued that courts are not competent to weigh State interests.<sup>135</sup> In an international contracts dispute, moreover, one can question the desirability of identifying the State with the greatest interest in the transaction if that inquiry rests on indeterminate tests with unpredictable results.

Identifying a State with close ties to the transaction helps to avoid the perception of arbitrariness stemming from applying the law of a place that has only transitory connection to the transaction,<sup>136</sup> and it ensures that the resolution of the dispute vindicates fundamental policies of a jurisdiction with significant ties to the transaction. On these criteria, the multi-faceted approach of the second Restatement is superior to some facets of the territorial approach of the first Restatement, such as the latter's choice of the law of the place of contract formation—even if only transitory—to govern issues of formation and validity.<sup>137</sup>

As argued in Part II.B.4 later, however, these criteria can be satisfied without the indeterminacy of the second Restatement's approach, which arguably represented an excessively robust swing of the pendulum away from the first Restatement. Non-arbitrariness and protection of fundamental policies of interested States need not be viewed as inconsistent with simplicity and predictability. Somewhere between the arbitrariness of the first Restatement's territorialist rules and the second Restatement's indeterminate approach is the potential for a choice of law regime that simply and predictably chooses the contract law of a state connected to the transaction in a non-arbitrary way, while protecting the interests of consumers and employees, and providing a basis for recognizing overriding public policies of an interested state, but only if they amount to fundamental policies in an international sense.

### (iii) INDETERMINACY AS A SMOKESCREEN FOR ACHIEVING UNSTATED GOALS

The flexible approach of the second Restatement may appeal to those who favor maximal application of the law of the forum<sup>138</sup> or who

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<sup>135</sup> Currie, *Notes on Methods*, *supra* note 118, at 176 ("where several states have different policies, and also legitimate interests in the application of their policies, a court is in no position to 'weigh' the competing interests, or evaluate their relative merits, and choose between them accordingly"); *see id.* at 176–77 (arguing that such weighing is properly a legislative rather than a judicial function).

<sup>136</sup> *Cf.* CURRIE, *supra* note 122, at 1–6 (critically discussing case in which local tort law was displaced by the law of the accident site, Saudi Arabia).

<sup>137</sup> *See supra* notes 115–17, and accompanying text.

<sup>138</sup> *See supra* notes 66 & 122 (discussing the homeward bound theories of Wachter and Currie).



favor choice of the substantive law that works the “best result” in the view of the court,<sup>139</sup> particularly if they find it inconvenient to make those goals explicit. The indeterminacy, flexibility, and multi-faceted nature of the second Restatement could provide judges with “cover” for achievement of goals other than the Restatement’s stated goal of identifying the State with the most significant relationship to the transaction.<sup>140</sup>

Promoting a smokescreen to permit achievement of covert goals, however, amounts to an admission that the goals are not sufficiently meritorious to withstand scrutiny. If one favors the material justice of choosing the best results in particular cases rather than conflicts justice, for example, that result-oriented goal is best pursued in the light of day, where it can be held up to critical examination. This article argues that international commercial contracts will derive greater benefits from a predictable choice of law—which provides notice for the need to contractually negotiate the choice of another law if the law predictably chosen by the default rule is unattractive to a party—than from an indeterminate approach that leaves the chosen law uncertain until the material justice instincts of a judge<sup>141</sup> are brought to bear. In consumer and employment contracts, moreover, the material justice of protecting parties with lesser bargaining power is not inconsistent with conflicts justice; a conflicts rule can achieve both by consistently choosing laws

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<sup>139</sup> See *supra* note 110 and accompanying text.

<sup>140</sup> See FRUEHWALD, *supra* note 72, at 96 (referring to Prof. Borchers’s view that the second Restatement’s “open-ended provisions . . . allow judges to hide their use of judicial intuition”).

<sup>141</sup> See generally FRUEHWALD, *supra* note 72, at 52 (advancing normative position that “choice of law should be as predictable as possible”); Wolff, *supra* note 12, at 482 (flexibility in choice of law rules “can only be possible as long as it does not compromise legal certainty”). If commercial parties have consented to arbitration, without contractually choosing the contract law or the choice-of-law rule, the arbitration tribunal would have even greater flexibility in its approach to choice of law and its ultimate choice of rules of contract law. See, e.g., AM. ARBITRATION ASS’N INT’L ARBITRATION RULES art. 28.1 (2009) (in the absence of contractual choice of law, “the tribunal shall apply such law(s) or rules of law as it determines to be appropriate”); INT’L CHAMBER OF COMMERCE RULES OF ARBITRATION art. 17.1 (1998) (referring to “rules of law” which the tribunal “determines to be appropriate”). Thus, an arbitration tribunal’s choice of law may be even less predictable than that of a judge, but the popularity of international arbitration suggests that certainty in choice of law is not an important consideration for many litigants. See Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1866. Perhaps parties that have taken the significant step of opting out of a judicial forum and choosing arbitration are highly likely to choose the governing law as well. Alternatively, some parties who opt for arbitration might be less concerned about certainty in the arbitrators’ choice of law if they anticipate that arbitrators would take special efforts to choose a law, or at least adopt a choice-of-law approach, that is viewed by both parties as relatively fair and neutral.

that match the expectations of parties such as consumers and employees, as explained later in Part II.B.3.

Similarly, a strongly homeward-bound approach is best employed overtly, as in some interpretations of the UCC (discussed in the next subsection) so that it can be held up to scrutiny and debate. A rule that largely chooses the law of the forum offers some benefits: It eases the forum court's burden by permitting the court to apply familiar law, and—depending on how surely it points to forum law—it can be simple, certain, and predictable. For obvious reasons, however, widespread use of homeward-bound approaches would encourage equally widespread forum shopping, because it enables the plaintiff to unilaterally choose the substantive law by choosing where to file suit,<sup>142</sup> and thus leaves the choice of law uncertain until the plaintiff chooses the forum. More fundamentally, a strongly homeward-bound approach belies the fundamental principles of comity that underlie the universal acceptance and application of foreign law in appropriate circumstances.<sup>143</sup> Jurisdictions may differ on defining such appropriate circumstances, but a homeward-bound approach that challenges conventional views of comity should do so transparently.

#### (b) SALES TRANSACTIONS: CHOICE OF LAW UNDER THE UCC

In a transaction for the sale of goods, and in the absence of contractual choice of law, the UCC instructs courts to apply the UCC of the forum state if that state has an “appropriate relation” to the transaction.<sup>144</sup> The phrase “appropriate relation” lends itself to a range of

<sup>142</sup> See, e.g., RABEL, *supra* note 62, at 383–84 (stating that conflicts law has traditionally discouraged forum shopping, to protect the defendant from unfairness); FRUEHWALD, *supra* note 72, at 51 (arguing the choice of law should be forum-neutral, partly to avoid promoting forum shopping); see also Guiliano & Lagarde, *supra* note 57 (supporting the 1980 Rome Convention partly because it would avoid forum shopping).

<sup>143</sup> See SCOLES ET AL., *supra* note 13, 33–35 (explaining that critics characterized Brainerd Currie's homeward bound approach as parochial and likely to lead to forum shopping and retaliation); Berman, *Towards a Cosmopolitan Vision*, *supra* note 110, at 1850–51 (as with similar critiques in the field of international relations, Currie's approach is subject to the criticism that “[i]f a state is too parochial in pursuit of its short-term interests, it may damage its longer-term goals by creating lack of trust in other states”). *But cf.* Berman, *Globalization*, *supra* note 128, at 525 (arguing that the evils of forum shopping should be supported by empirical data and weighed against the benefits of an otherwise cosmopolitan approach to choice of law).

<sup>144</sup> U.C.C. § 1-301(b) (2008). This provision is still numbered § 1-105(1) in states that have not yet adopted revised Article 1 of the U.C.C. Section 1-301 of revised Article 1 initially proposed a more contemporary and nuanced set of choice-of-law rules, but the American Law Institute reverted to the test of section 1-105 of the original Article 1, after states universally rejected the new proposed rules. See *supra* notes 92–93 and accompanying text.

interpretations, as recognized by the Official Comment to the original provision, which invites clarification by “judicial decision.”<sup>145</sup>

The comments also take a position on the question, however, encouraging choice of the forum’s UCC even in circumstances in which the forum in the past had declined to apply a law of the forum that is more “purely local” in nature.<sup>146</sup> True, even under this view the relation of the UCC-adopting forum to the transaction will normally not be “appropriate” if both contracting and performance take place in a non-UCC state.<sup>147</sup> Nonetheless, the undemanding statutory term “appropriate” and the Official Comment invited UCC-adopting forums to liberally apply the forum’s Code, as against the law of a non-UCC state, to maximize application of the Code.<sup>148</sup>

As discussed in the immediately preceding subsection, a strongly homeward-bound standard is likely to foster forum shopping<sup>149</sup> and is inconsistent with the principles of comity underlying prevailing views about international conflicts rules.<sup>150</sup> It is therefore not surprising that—as the UCC became the uniform commercial law in the United States—many states interpreted the “appropriate relation” test so that it equated with a search for the “most significant relationship,” similar to the test advanced by the Restatement.<sup>151</sup> As discussed in Part II.B.2(a), that test—when not used as a smokescreen to achieve other goals covertly—is non-

<sup>145</sup> U.C.C. § 1-105 cmt. 3 (1999).

<sup>146</sup> *Id.* Comment 3 states in part:

[A] conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries.

<sup>147</sup> U.C.C. § 1-105 cmt. 2 (1999).

<sup>148</sup> *See, e.g., Boudreau v. Baughman*, 322 N.C. 331, 337, 368 S.E.2d 849, 855 (1988) (citing to journal articles and referring to this interpretation as “very literal-minded”). In doing so, the UCC was advocating a break from traditional territorialist choice-of-law rules, which would not necessarily have promoted application of the UCC. *See id.* (“enactment of the section was intended to change this state’s rigid choice of law rules with respect to” sales transactions); *cf. Key Motorsports, Inc. v. Speedvision Network, L.L.C.*, 40 F. Supp. 2d 344, 347 (M.D.N.C. 1997) (quoting *Fast v. Gulley*, 155 S.E.2d 507, 510 (N.C. 1967) when explaining that North Carolina still applies the law of the place of contracting in non-sales transactions).

<sup>149</sup> *See supra* notes 142, 143 and accompanying text.

<sup>150</sup> *See supra* note 143 and accompanying text; *see generally Boudreau*, 368 S.E.2d at 855 (referring to this “very literal-minded” interpretation of the UCC as “at best outmoded”).

<sup>151</sup> *See, e.g., Boudreau*, 368 S.E.2d at 855 (citing nine jurisdictions and adopting this approach for North Carolina); *see also LIEBMAN, supra* note 92, at 11 (in applying the “appropriate relation” test, many courts simply apply the forum’s general choice-of-law principles).

arbitrary but fails to provide a predictable result and thus fails to provide a reliable basis for planning and assessment of risks.

### 3. CHOICE OF LAW IN EUROPE—THE MODERN ROAD TO ROME I

Before the end of the nineteenth century, Europe had the benefit of centuries of experimentation with a variety of choice-of-law approaches.<sup>152</sup> In the latter half of the twentieth century, as the United States was experiencing its conflicts revolution, the European experimentation continued but began to settle on an approach that could avoid both the arbitrariness of the first Restatement and the uncertainty of the second Restatement. Examined below are the 1955 Hague Convention,<sup>153</sup> the 1980 Rome Convention,<sup>154</sup> and the Rome I Regulation.<sup>155</sup>

#### (a) THE 1955 HAGUE CONVENTION FOR INTERNATIONAL SALES

The 1955 Hague Convention on the Law Applicable to International Sales of Goods took the first step by calling for application of the law of the country in which the seller habitually resides,<sup>156</sup> except that the law of the buyer's residence would apply if the seller took the order in that country.<sup>157</sup> A court may exclude an element of the chosen law, however, "on a ground of public policy."<sup>158</sup>

The text of the 1955 Convention does not exclude consumer transactions but contains no special provision for consumers. Consequently, consumers' expectations would be protected under the 1955 Convention only to the extent that consumer interests might be vindicated through excluding harsh provisions in chosen law on grounds of public policy, or if a buyer took the order in the buyer's residence, triggering application of that State's laws. To address this gap in consumer protection, in 1980 the Fourteenth Hague Conference issued a declaration interpreting the 1955 Convention to permit signatory States

<sup>152</sup> See SCOLES ET AL., *supra* note 13, at 7 (Europe had experimented with all possible approaches by 1850); *id.* at 10–18 (tracing European developments in conflicts law, from the fourteenth century Italian *Statutists* and the sixteenth century Dutch School to Savigny's 19th century focus on connecting factors).

<sup>153</sup> 1955 Hague Convention, *supra* note 90.

<sup>154</sup> 1980 Rome Convention, *supra* note 57.

<sup>155</sup> Rome I, *supra* note 3.

<sup>156</sup> 1955 Hague Convention, *supra* note 90, art. 3. If the seller receives the buyer's order at an establishment of the seller in another country, the law of that other country will apply. *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* art. 6. The Convention does not apply to issues of capacity, form of contract, or transfer of ownership. *Id.* art. 5.

to adopt and apply special rules regarding consumer transactions without violating the provisions of the convention.<sup>159</sup> This interpretation would allow a signatory of the 1955 Convention, in a consumer sales dispute, to apply the conflicts rules of the 1980 Rome Convention, or—after 2009—those of Rome I, neither of which would otherwise supersede the 1955 Hague Convention in international sales disputes.<sup>160</sup>

Seven European nations and one African nation, Niger, have adopted the 1955 Hague Convention.<sup>161</sup> Rome I does not supersede the 1955 Convention, in contrast to its replacement of the 1980 Rome Convention.<sup>162</sup> Thus, the 1955 Convention can still apply to an international sales contract entered into by a party from a member of the European Union, subject to the supplementation described in the preceding paragraph.<sup>163</sup>

The 1955 Hague Convention appears to be territorialist in nature, tying choice of law to the country in which a party—usually the seller—is located, based on where the order is taken.<sup>164</sup> This approach, however, offers a high degree of certainty and predictability, while ensuring that the parties' dispute will be governed by the law of the location of one the parties to the transaction, which is relatively mechanical but nonetheless less arbitrary than, for example, the law of the place where the contract might have been concluded in a transitory meeting or in the dispatch of an acceptance.<sup>165</sup> It could not be a complete blueprint for the modern era, however, because of its limitation to sales contracts and its failure to address parties requiring special protections.

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<sup>159</sup> See Gert Reinhart, *Development of a Law for International Sale of Goods*, 14 CUMB. L. REV. 89, 90 (1983–84); CAROLINA SAF, A STUDY OF THE INTERPLAY BETWEEN THE CONVENTIONS GOVERNING INTERNATIONAL CONTRACTS OF SALE § 2.4.4 (1999), available at <http://www.cisg.law.pace.edu/cisg/biblio/saf.html>.

<sup>160</sup> See SAF, *supra* note 159, § 2.4.4 (noting that Article 21 of the 1980 Rome Convention would give the 1955 Hague Convention general priority over the 1980 Convention, but discussing several means by which signatory states could supplement the 1955 Convention with measures to protect consumers); FRANCO FERRARI & STEFAN LEIBLE, *ROME I REGULATION: THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS IN EUROPE* 162–63 (2009) (noting that Article 25 of Rome I would give the 1955 Convention general priority over Rome I, but explaining that Rome I's consumer protection provisions could supplement the 1955 Convention).

<sup>161</sup> See *Status Table: Convention of 15 June 1955 on the Law Applicable to International Sale of Goods*, HAGUE CONF. PRIVATE INT'L L., [http://www.hcch.net/index\\_en.php?act=conventions.status&cid=31](http://www.hcch.net/index_en.php?act=conventions.status&cid=31) (last visited June 5, 2011).

<sup>162</sup> Rome I, *supra* note 3, art. 24.

<sup>163</sup> See *infra* notes 211–23 and accompanying text (discussing Rome I, *supra* note 3, arts. 24, 25).

<sup>164</sup> 1955 Hague Convention, *supra* note 90, art. 3.

<sup>165</sup> See *supra* notes 115–19, and accompanying text.

## (b) THE 1980 ROME CONVENTION

A more sophisticated choice-of-law convention followed with the Convention on the Law Applicable to Contractual Obligations (EEC) (1980), commonly known as the 1980 Rome Convention. In the absence of contractual choice of law, the 1980 Rome Convention appeared to take a cue from the second Restatement by choosing the “law of the country with which [the contract] is most closely connected.”<sup>166</sup> The Rome Convention added a measure of certainty by creating a presumption that the most closely connected country is the home country of the “party who is to effect the performance which is characteristic of the contract.”<sup>167</sup> Because the payment of money for goods or services does not distinguish one contract from another, the characteristic performance of a service contract is the provision of services, and of a sales contract is the provision of the goods.<sup>168</sup>

The 1980 Rome Convention improves upon the 1955 Hague Convention by specifically protecting the interests of consumers and employees. In certain kinds of consumer contracts, for example, a contractual choice of law cannot “have the result of depriving the consumer of the protection afforded to him by the mandatory rules of the law of the country in which he has his habitual residence.”<sup>169</sup> Similarly, in an employment contract, a contractual choice of law cannot “have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law which would be applicable under [the Convention] in the absence of choice.”<sup>170</sup>

In the absence of contractual choice, the 1980 Rome Convention provides that certain consumer contracts generally will be governed by the law of the consumer’s habitual residence,<sup>171</sup> and that an employment contract will be governed by the law of the country in which the employee “habitually carries out his work in performance of the

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<sup>166</sup> 1980 Rome Convention, *supra* note 57, art. 4(1).

<sup>167</sup> *Id.* art. 4(2). I use the phrase “home country” as shorthand for a variety of terms employed by the Rome Convention, depending on the circumstances: “habitual residence,” place of “central administration,” “principal place of business,” or other “place of business” where “performance is to be effected.” *Id.*

<sup>168</sup> The concept of the characteristic performance developed in Switzerland. *See* COLLINS, *supra* note 57, at 423. The 1980 Rome Convention provides special rules for contracts relating to immovable property. *Id.* art. 4(3) (“the country where the immovable property is situated”). It also provides special rules for contracts of carriage. *Id.* art. 4(4).

<sup>169</sup> 1980 Rome Convention, *supra* note 57, art. 5(2).

<sup>170</sup> *Id.* art. 6(1).

<sup>171</sup> *Id.* art. 5(3).

contract,” if the employee does habitually perform work within one country.<sup>172</sup>

Two “escape hatches,” prevent the 1980 Rome Convention from operating in an overly mechanical or inflexible manner. One defers to overriding public policy but appropriately limits its application to a degree consistent with the expected departures from homogenous values in transactions that cross national and cultural borders, and consistent with a desire to avoid introducing excessive uncertainty into choice of law. The second escape hatch recognizes exceptions to the characteristic performance presumption, but is sufficiently unqualified that it threatens to render the presumption illusory.

The first escape hatch permits departures from the law chosen under the Convention to vindicate important public policies. For example, the forum may apply mandatory rules of the forum<sup>173</sup> or of any country closely connected to “the situation,”<sup>174</sup> if the rules are mandatory in the international sense,<sup>175</sup> in the sense that they are intended to apply regardless of which law would otherwise apply.<sup>176</sup> Similarly, a violation

<sup>172</sup> *Id.* art. 6(2).

<sup>173</sup> *Id.* art. 7(2).

<sup>174</sup> *Id.* art. 7(1).

<sup>175</sup> See Wolff, *supra* note 12, at 474–75 (distinguishing between ordinary mandatory rules that apply in domestic disputes and “overriding mandatory rules” of the forum that should be observed even when foreign law otherwise applies); NYGH, *supra* note 5, at 60 (discussing public policies that are sufficiently fundamental that they qualify as policy in the “international sense”); *id.* at 67–69 (public policy exception should be limited to important policies and not employed to guard against evasion of all policies); RABEL, *supra* note 62, at 550 (“resort to the public policy of the forum is a delicate and very rarely justifiable measure”); *id.* at 555–56, 581–84 (discussing consensus that public policy exception should be restricted); see also *Loucks v. Standard Oil Co.*, 224 N.Y. 99, 112, 120 N.E. 198, 202 (1918) (in interstate dispute, refusing to exclude law of other state because it did not “shock our sense of justice in the possibility of a punitive recovery” even though it differed from local law). Because *Loucks* dealt with application of the law of another state within the United States, it could be read as an application of the special comity owed to other states within a federal system, as reflected in the Full Faith and Credit Clause of the U.S. Constitution. See, e.g., FRUEHWALD, *supra* note 72, at 76–77 (distinguishing the deference owed to the laws of other States, based on international comity, from the domestic obligations imposed by the Full Faith and Credit Clause). In *Loucks*, however, Justice Cardozo did not discuss the Full Faith and Credit Clause but asked whether the Massachusetts statute was “penal in the international sense.” *Loucks*, 224 N.Y. at 102, 120 N.E. at 201. It cited precedent in both domestic and international disputes. *Id.* at 108–11, 120 N.E. at 207–10.

<sup>176</sup> 1980 Rome Convention, *supra* note 57, art. 7(1), (2). Subsection 1 refers to application of the law of a country with a “close connection” to “the situation,” if under the law of that country “those rules must be applied whatever the law applicable to the contract.” *Id.* art. 7(1). Subsection 2 provides that “[n]othing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract.” *Id.* art. 7(2). When giving effect to the mandatory rules of a country

of public policy of the forum can block the application of the chosen law, but again only if the chosen law violates public policy in the international sense, if it is “*manifestly* incompatible with the public policy (“*ordre public*”) of the forum.”<sup>177</sup> These provisions appropriately permit vindication of important public policies while adhering to default rules in the face of routine and inevitable policy differences between legal regimes and cultures.

The second escape hatch arguably brings the convention full circle from the closest-connection standard, through the characteristic-performance presumption, and back to the closest-connection standard. The characteristic-performance presumption will not apply if “the characteristic performance cannot be determined” or if “it appears from the circumstances as a whole that the contract is more closely connected with another country.”<sup>178</sup> Thus, a presumption that the State with the closest connection in a sales contract is that of the seller’s residence arguably would be effective only if a full analysis of connecting factors independently pointed to that State. Under that interpretation, this provision is not so much an escape hatch from the characteristic-performance presumption as it is a shutting of the door leading to the presumption.

#### (c) ASSESSMENT OF THE 1955 AND 1980 CONVENTIONS

The 1955 Hague Convention seems simpler and more certain than the 1980 Rome Convention. It applies only to international sales of goods, however, and its apparent simplicity and certainty stems partly from the absence of explicit protections for consumers or other parties in similarly weak bargaining positions.

On the other hand, the 1955 Convention’s public policy exception is unrestricted, so its apparent certainty may be illusory. To some extent every law reflects policy concerns and judgments within the State adopting the law. At that level, a policy difference can be identified in any conflict between the chosen law on the one hand, and the law of the forum or that of another interested country on the other. To avoid entirely swallowing up the default choice of law, therefore, a public policy exception should be invoked to protect only the most fundamental

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other than the forum, the Convention provides that “regard shall be had to their nature and purpose and to the consequences of their application or non-application.” *Id.* art. 7(1).

<sup>177</sup> *Id.* art. 16 (emphasis added).

<sup>178</sup> *Id.* art. 4(5).



interests of a State.<sup>179</sup> Otherwise, the exception would require a court to weigh competing policies in an effort to select the “best” contract law among alternatives.

The 1980 Rome Convention more ably addresses the public policy issue, providing specific protections for consumers and employees, but otherwise allowing mandatory rules or *ordre public* to override the chosen law only in limited circumstances. This limited recognition of public policy in the international sense is appropriate when parties engage in international commerce and thus are voluntarily dealing across borders and outside the comfort zone of a relatively homogenous domestic culture, legal system, and corresponding policies and principles.

The 1980 Rome Convention’s closest-connection test, however, recalls the indeterminacy of the second Restatement’s approach. The presumptions relating to characteristic performances appear at first glance to provide greater certainty and predictability, but the Convention does not specifically define the characteristic performances. The combination of approaches, coupled with broad escape hatches from the presumptions, suggest a convention in search of a consistent theme, creating fertile ground for inconsistent interpretations.

#### 4. ENTER ROME I

Rome I, applicable to contracts formed after December 17, 2009,<sup>180</sup> is a regulation within the European Union and thus amounts to mandatory law in member States.<sup>181</sup> Designed to replace the 1980 Rome Convention,<sup>182</sup> it retains many of the good features of the 1980 Rome Convention and remedies the earlier convention’s shortcomings. Rome I combines certainty and predictability with non-arbitrary choices, special provisions for consumers and employees, and limited escape hatches that provide an appropriate measure of flexibility while refraining from undermining the fundamental certainty of its default rules.

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<sup>179</sup> See *supra* note 175 and accompanying text (authorities discussing public policy in the international sense).

<sup>180</sup> Rome I, *supra* note 3, art. 28.

<sup>181</sup> See Treaty on European Union art. 288, July 29, 1992, 1992 O.J. (C 191) 1 (in contrast to recommendations and directives, regulations are fully binding and directly applicable in all member States).

<sup>182</sup> Rome I, *supra* note 3, art. 24.

## (a) ROME I'S BASIC DEFAULT RULES FOR CHOICE OF LAW

In contrast to the uncertainty of the 1980 Rome Convention's reliance on closest connections, coupled with characteristic performance presumptions and escape hatches from those presumptions, Rome I for the most part provides for simple default rules that permit the parties to easily identify the applicable law when they negotiate the contract. For example, in the absence of contractual choice of law, Article 4(1) of Rome I provides the following simple default rules for sales or service contracts:

- (a) a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence;
- (b) a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence; . . . .<sup>183</sup>

The choice of the habitual residence of the seller or service provider in a non-consumer transaction is not arbitrary, because it coincides with the European concept of the provider of the characteristic performance.<sup>184</sup> This default choice of law permits the provider of commercial goods or services to enjoy the economic benefits of contracting under a single system of law to which it has easy access, thus controlling its costs and, ideally, its prices as well.

Although the vendor's habitual residence may not relate to the transaction in other ways, such as providing the place of contract formation or performance, the simplicity and certainty of this default rule outweighs the benefits of using a multi-faceted test to identify the State with precisely the greatest interests and contacts with a transaction. In an international commercial contract, the predictability of the chosen law permits a party to assess its risks and to plan accordingly, or to commit resources to an attempt to override the default rule with a negotiated choice-of-law clause, which Rome I will enforce with few limitations.<sup>185</sup>

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<sup>183</sup> *Id.* art. 4(1)(a), (b).

<sup>184</sup> See *supra* notes 167–68 and accompanying text (discussing characteristic performance under the 1980 Rome Convention).

<sup>185</sup> Rome I, *supra* note 3, art. 3. The parties cannot by agreement evade the mandatory provisions of the law of a State where “all other elements relevant to the situation at the time of choice are located.” *Id.* art. 3(3). Nor can they evade mandatory provisions of European Community law where “all other elements relevant to the situation at the time of the choice are located in one or more Member States.” *Id.* art. 3(4).

Article 4 supplies similarly certain choices of law for contracts dealing with franchises, distribution of goods, sales by auction, and multiple third-party buying and selling interests in financial instruments.<sup>186</sup> Under separate articles, Rome I more thoroughly addresses four other kinds of contracts: carriage contracts, consumer contracts, insurance contracts, and individual employment contracts.<sup>187</sup>

(b) RULES FOR CONSUMERS, EMPLOYEES, PASSENGERS, AND  
INSURED PARTIES

In a transaction with a consumer, if a professional directs activities to the State in which the consumer has his or her habitual residence, Article 6(1) of Rome I generally chooses the law of that consumer's residence,<sup>188</sup> rather than the usual choice under article 4, the habitual residence of the seller or service provider. Similarly, in the absence of contractual choice, an individual employment contract normally is governed by the law of the place where the employee "habitually carries out his work in performance of the contract," or "failing that, from which he habitually carries out his work."<sup>189</sup> The parties can override either of these default rules with contractual choice of law, but only within parameters that protect the interests of the consumer or the employee: the contractual choice may not have the result of depriving the consumer or employee of the protection afforded to him by mandatory provisions of the law that would apply in the absence of contractual choice.<sup>190</sup> Accordingly, as default rules, Rome I normally selects laws that would be consistent with the expectations of a consumer or employee about protections available under the law of the consumer's residence or the employee's place of work.

Similarly, in contracts for carriage of passengers, Rome I chooses the law of the State of residence of the passenger, so long as "either the place of departure or the place of destination is situated in that

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<sup>186</sup> *Id.* art. 4(c)–(h).

<sup>187</sup> *Id.* arts. 5–8.

<sup>188</sup> *Id.* art. 6(1). This automatic selection of the consumer's habitual residence does not apply in a number of consumer contracts, some of which are governed by other articles: contracts for services rendered to the consumer exclusively in a State other than the consumer's habitual residence, most contracts of carriage, contracts for certain rights in immovable property, and contracts for certain kinds of rights and obligations relating to financial instruments and specified investments or multilateral systems for buying and selling. *Id.* art. 6(4) (referring in art. 6(4)(e) to multilateral systems addressed by art. 4(1)(h)).

<sup>189</sup> *Id.* art. 8(2).

<sup>190</sup> *Id.* art. 6(2), (8)(1).

country,” and it restricts contractual choice of law.<sup>191</sup> Rome I also places some restrictions on the parties’ choice of law in contracts for insurance that do not cover a “large risk” as defined by an EEC Directive.<sup>192</sup>

(c) A SENSIBLE BALANCE BETWEEN CERTAINTY  
AND FLEXIBILITY

With respect to contracts not specifically addressed in Article 4, or contracts with features of two or more of the types of contracts specifically addressed in Article 4, Rome I reverts to a characteristic-performance test, choosing the law of the habitual residence of the party effecting the characteristic performance.<sup>193</sup> At least in cases where one party primarily pays money for some sort of product or service from the other party, the second party should be readily identified under this test, providing a relatively certain and predictable choice of law in most cases.

Viewed in isolation, the provisions of Rome I discussed so far present a framework that, in this author’s view, is superior to both the territorialist and sometimes arbitrary approach of the first Restatement<sup>194</sup> and the maximally flexible and indeterminate approach of the second Restatement,<sup>195</sup> to which the UCC may equate<sup>196</sup> when it is not interpreted literally to point homeward in nearly all cases.<sup>197</sup> Rome I sets forth simple,<sup>198</sup> certain, predictable default rules that give the parties notice of the applicable law at the time of negotiation of the contract, while protecting the interests of consumers and employees. If Rome I’s escape hatches are measured, the benefits of certainty and predictability can be retained.

(d) ROME I’S ESCAPE HATCHES: CLOSEST CONNECTION AND  
PUBLIC POLICY

Rome I provides a measure of flexibility with two kinds of escape hatches, one based on closest connection and the other on public

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<sup>191</sup> *Id.* art 5(2).

<sup>192</sup> *Id.* art. 7(2).

<sup>193</sup> *Id.* art. 4(2).

<sup>194</sup> *See supra* notes 114–19 and accompanying text.

<sup>195</sup> *See supra* notes 120–30 and accompanying text.

<sup>196</sup> *See supra* note 151 and accompanying text.

<sup>197</sup> *See supra* notes 144–50 and accompanying text.

<sup>198</sup> Simplicity is furthered by Rome I’s rejecting *dépeçage* in the absence of party choice, providing for a single State’s law to apply to “the contract,” while allowing the parties to agree to choose the law that will apply to all or part of the contract. *See Rome I, supra* note 3, art. 4(1), 3(1); *cf. supra* note 130 and accompanying text (referring to *dépeçage* in the second Restatement).

policy. In both cases, Rome I improves on the 1955 Hague Convention and the 1980 Rome Convention by addressing important concerns without threatening to swallow up the default rules or undermine their certainty and predictability.

(i) CLOSEST-CONNECTION ESCAPE HATCH

The closest-connection escape hatch applies to contracts that would be governed by article 4, rather than the passenger, consumer, individual employment, or insurance contracts governed by articles 5–8. It provides in part that the law of the country most closely connected with the contract will apply if the applicable law cannot be determined through the specific choices in article 4, or through its fallback characteristic performance test.<sup>199</sup> Such cases should be exceedingly rare.

Second, the closest-connection test will apply “[w]here it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than” the law that would otherwise be applied by article 4.<sup>200</sup> The addition of the qualifier “manifestly” should significantly limit the application of this escape hatch, so that it does not unduly undermine certainty and predictability, while still allowing for vindication of the interests of a State whose closest connection is so obvious that it cannot reasonably be doubted or debated.

(ii) PUBLIC POLICY ESCAPE HATCH

The public policy escape hatch in Rome I is even more clearly international in nature<sup>201</sup> than the public policy provisions in the 1980 Rome Convention, which were themselves great improvements on the very general and unqualified public policy exception in the 1955 Hague Convention. Article 9 of Rome I defines “overriding mandatory provisions” narrowly as

provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organization, to such an extent that they are applicable to any situation falling within their

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<sup>199</sup> Rome I, *supra* note 3, art. 4(4).

<sup>200</sup> *Id.* art. 4(3).

<sup>201</sup> *See supra* note 175 and accompanying text.

scope, irrespective of the law otherwise applicable to the contract under this Regulation.<sup>202</sup>

The forum may apply such overriding mandatory provisions without more,<sup>203</sup> but the requirement that the provisions be “crucial” to “safeguarding . . . public interests” is a demanding standard, much more demanding than the standard for giving effect to mandatory provisions protecting consumers and employees.<sup>204</sup> Moreover, the overriding mandatory provisions of another State may be given effect only if that State is the place of performance and if the mandatory provisions render the performance unlawful there.<sup>205</sup> Even then, the forum should give effect to such mandatory provisions of the place of performance only after considering “their nature and purpose and . . . the consequences of their application or non-application.”<sup>206</sup>

Consistent with this careful, international approach to the application of mandatory provisions, the chosen law will not be *excluded* except for substantial conflict with the forum’s public policy: “The application of a provision of the law of any country specified by this Regulation may be refused only if such application is *manifestly* incompatible with the public policy (ordre public) of the forum.”<sup>207</sup> As with a similar provision in the 1980 Rome Convention, the qualifier “manifestly” should limit application of this escape hatch to cases in which conflict with the forum’s public policy is substantial and fundamental.<sup>208</sup>

##### 5. RELATIONSHIP BETWEEN ROME I AND THE 1955 AND 1980 CONVENTIONS

Rome I replaces the 1980 Rome Convention,<sup>209</sup> which applied to contractual obligations generally.<sup>210</sup> Moreover, like the 1980 Convention,

<sup>202</sup> Rome I, *supra* note 3, art. 9(1).

<sup>203</sup> *Id.* art. 9(2).

<sup>204</sup> Parties cannot contractually choose the contract law in a way that deprives the consumer or employee of the protection of rules that are mandatory in the ordinary sense that they “cannot be derogated from by agreement by virtue of the law which, in the absence of choice” would have been applicable under the default provisions of Rome I. *Id.* art. 6(2), 8(1), 9(1).

<sup>205</sup> *Id.* art. 9(3).

<sup>206</sup> *Id.*

<sup>207</sup> *Id.* art. 21 (emphasis added).

<sup>208</sup> See *supra* note 177 and accompanying text.

<sup>209</sup> Rome I, *supra* note 3, art. 24. Section 1 of art. 24 sets forth this point as well as an exception: Relationship with the Rome Convention: This Regulation shall replace the Rome Convention in the Member States, except as regards the territories of the Member

Rome I's provision in Article 2 for "Universal Application" mandates that "[a]ny law specified by this Regulation shall be applied whether or not it is the law of a Member State."<sup>211</sup> Accordingly, because Rome I is a mandatory regulation of the European Union, one could conclude that its provisions generally apply in any forum within the European Union, regardless of the State of residence of the parties over which the court has jurisdiction.<sup>212</sup>

Like the 1980 Rome Convention,<sup>213</sup> however, Rome I defers in Article 25 to other conventions:

**Relationship with existing international conventions**

1. This Regulation shall not prejudice the application of international conventions to which one or more Member States are parties at the time when this Regulation is adopted and which lay down conflict-of-law rules relating to contractual obligations.

2. However, this Regulation shall, as between Member States, take precedence over conventions concluded exclusively between two or more of them in so far as such conventions concern matters governed by this Regulation.<sup>214</sup>

Rome I obviously does not defer to the 1980 Rome Convention, because it explicitly replaces it under Article 24.<sup>215</sup> It does, however, give way, to some extent, to the 1955 Hague Convention in contracts for the international sale of goods.

An early draft for Rome I included a proposal to supersede the 1955 Hague Convention if "material aspects of the situation" at the time

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States which fall within the territorial scope of that Convention and to which this Regulation does not apply pursuant to Article 299 of the Treaty.

*Id.* art. 24(1).

<sup>210</sup> 1980 Rome Convention, *supra* note 57, art. 1 (identifying the convention's applicability to "contractual obligations" in subsection 1, while listing several relatively narrow exclusions from coverage in subsection 2).

<sup>211</sup> Rome I, *supra* note 3, art. 2; *cf.* 1980 Rome Convention, *supra* note 57, art. 2 ("Any law specified by this Convention shall be applied whether or not it is the law of a Member State.").

<sup>212</sup> Garcimartín, *supra* note 108, at I-62 (interpreting Article 2 to make Rome I applicable even to litigation in a member State between parties from two non-member States).

<sup>213</sup> Article 21 of the 1980 Rome Convention provides: "**Article 21 Relationship with other conventions.** This Convention shall not prejudice the application of international conventions to which a Contracting State is, or becomes, a party." 1980 Rome Convention, *supra* note 57, art. 21.

<sup>214</sup> Rome I, *supra* note 3, art. 25.

<sup>215</sup> *See supra* note 209 and accompanying text.

of contracting “are located in one or more Member States.”<sup>216</sup> This provision, however, was abandoned in the final version of Rome I and replaced with article 25, quoted earlier.

The 1955 Hague Convention would not be excluded under article 25(2) of Rome I, because it has a non-member signatory, Niger, and thus is not “concluded exclusively between two or more [Member States].” Thus, if the forum is a member of the European Union and also a signatory to the 1955 Hague Convention, the 1955 Convention would provide the choice-of-law rule in an international sale of goods, under article 25(1) of Rome I. Because Rome I fills a notable gap in the 1955 Convention by providing special protections for consumers in sales transactions,<sup>217</sup> this result would be viewed by some as “utterly paradoxical” if not mitigated in some way.<sup>218</sup>

In most cases, however, the 1955 Hague Convention—perhaps working in tandem with Rome I—will ultimately provide the same analysis as would exclusive application of Rome I. First, the 1955 Convention normally chooses the law of the seller’s habitual residence,<sup>219</sup> as does Rome I.<sup>220</sup> Moreover, if the seller takes the order in the buyer’s State of residence, the 1955 Hague Convention chooses the law of the buyer’s residence,<sup>221</sup> consistent with the choice of law under Rome I if the buyer is a consumer and if the seller is a professional who directed commercial or professional activities in the buyer’s State of residence.<sup>222</sup> Indeed, if the buyer is a consumer, article 6 of Rome I may apply directly, even if the forum is a signatory to the 1955 Convention, because the Declaration and Recommendation of the Fourteenth Hague Conference in 1980 permits signatories to the 1955 Convention to supplement the Convention with consumer protective choice-of-law legislation, such as that in Rome I.<sup>223</sup>

For purposes of the normative theme of this article, however, the current reach of Rome I is only a matter of passing interest. This article argues for universal adoption of Rome I or its equivalent in place of the 1955 and 1980 Conventions, in place of the more indeterminate and less

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<sup>216</sup> 2005 *Rome I Proposal*, *supra* note 108, art. 23(2) (proposed Article 23 was entitled “Relationship with existing international conventions”).

<sup>217</sup> Rome I, *supra* note 3, art. 6.

<sup>218</sup> FERRARI & LEIBLE, *supra* note 160, at 162.

<sup>219</sup> 1955 Hague Convention, *supra* note 90, art. 3.

<sup>220</sup> Rome I, *supra* note 3, art. 4(1)(a).

<sup>221</sup> 1955 Hague Convention, *supra* note 90, art. 3.

<sup>222</sup> Rome I, *supra* note 3, art. 6(1).

<sup>223</sup> See *supra* notes 159–60 and accompanying text.



explicitly and specifically consumer-protective approaches in the United States and, more generally, in place of other national conflicts rules.

To illustrate how such a global regime might operate, the next Part examines the limited public policy escape hatches of Rome I in the context of a conflict between French and U.S. treatment of penalty clauses.

### **III. ILLUSTRATION OF PUBLIC POLICY UNDER ROME I— ENFORCEMENT OF PENALTY CLAUSES**

An example of a true conflict in the domestic laws connected with an international transaction will serve to focus this article's previous discussion of choice of law. A good vehicle for discussion is the treatment of contractual penalty clauses in the United States and France.

Below, Subsection III.A first explains why the CISG would not supply a solution as a matter of international sales law, if the penalty clause appeared in a commercial sales contract. Subsections III.B and C then describe the conflicting laws and policies in France and the United States regarding enforcement of penalty clauses. Finally, Subsection III.D illustrates how the restrained public policy provisions of Rome I, if adopted as the international choice-of-law approach in the United States, could permit enforcement of freely negotiated penalty clauses in a U.S. forum, and appropriately so.

#### **A. THE ABSENCE OF A UNIFYING INTERNATIONAL LAW ON PENALTY CLAUSES**

The CISG would supply a body of contract law in a commercial sale of goods between a party with its place of business in the United States and a party with its place of business in France, both of which are signatories to this convention.<sup>224</sup> This body of international law, however, almost certainly does not address the enforceability of a penalty clause, thus leaving that question to domestic law.

The CISG's general provision on damages limits monetary remedies to compensation for foreseeable losses:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not

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<sup>224</sup> See *supra* notes 16–17 and accompanying text.

exceed the loss which the party in breach foresaw or ought to  
have foreseen . . . .<sup>225</sup>

Thus, the CISG does not provide for an award of punitive damages in the absence of a contractual damages clause.

The CISG contains no provisions about the enforcement of damages clauses, but it specifically permits parties to “derogate from or vary the effect of any of its provisions.”<sup>226</sup> Accordingly, the CISG appears to permit parties to contractually depart from the default provisions on damages by agreeing to fix damages of any amount in their contract.

The CISG specifically excludes from its coverage, however, any issue regarding “the validity of the contract or of any of its provisions.”<sup>227</sup> Accordingly, the domestic law selected under the forum’s choice of law rules, and not the CISG, would govern a challenge to the “validity” of a penalty clause.<sup>228</sup> Because a penalty clause in a contract for the sale of goods is unenforceable as a violation of public policy under the U.S. UCC,<sup>229</sup> a challenge to the clause under the law in nearly all U.S. states presumably would raise an issue of “validity” under the CISG.

A number of questions about CISG applicability to a penalty clause remain. For example, if French law would enforce the penalty clause but U.S. law would not,<sup>230</sup> must the court first determine that U.S. domestic law will apply in the absence of CISG coverage before confirming that the “validity” of the clause is in issue? Must the court

<sup>225</sup> CISG, *supra* note 6, art. 74. Other articles provide specific formulae for calculating compensation. *Id.* art. 50 (proportional price reduction based on reduced value); *id.* art. 75 (damages based on substitute purchase or sale); *id.* art. 76 (market price remedy); *id.* art. 77 (mitigation of damages); *id.* art. 78 (interest on payment past due).

<sup>226</sup> *Id.* art. 6.

<sup>227</sup> *Id.* art. 4(a).

<sup>228</sup> *Id.* art. 7(2) (providing that issues not settled by CISG provisions or in conformity with its underlying principles will be governed by “the law applicable by virtue of the rules of private international law”).

<sup>229</sup> U.C.C. § 2-718(1) (2000) (“A term fixing unreasonably large liquidated damages is void as a penalty.”). The UCC specifically prohibits enforcement of penalty clauses even though it expresses a policy of “liberally” administering remedies to provide full compensation and protect expectation interests. U.C.C. § 1-106 (1977); U.C.C. § 1-305 (2001). The Restatement states the same conclusion about penalty clauses “on grounds of public policy.” RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981); *see also* E. Allan Farnsworth, *Damages and Specific Relief*, 27 AM. J. COMP. L. 247, 248 (1979) (rule against penalty clauses is rooted in public policy).

<sup>230</sup> *See infra* Part IV.B–C. For a fuller comparison of French and U.S. law on enforcement of penalty clauses, *see* Charles R. Calleros, *Punitive Damages, Liquidated Damages, and Clauses Pénales in Contract Actions: A Comparative Analysis of the American Common Law and the French Civil Code*, 32 BROOK. J. INT’L L. 67 (2006).

find further that the damages clause is at least arguably extra-compensatory so that it would violate U.S. public policy?<sup>231</sup> Or is the CISG excluded if a party raises a good-faith argument that the clause is unenforceable under a domestic law that could possibly be chosen as the applicable domestic law? More fundamentally, should the CISG's validity exception encompass any challenge based on violation of any applicable domestic mandatory contract rules or public policies, or should it be limited to claims that a clause violates international norms, or a domestic policy of such gravity that it would apply mandatorily in the face of a contrary contractual choice of domestic law?<sup>232</sup>

In the absence of definitive answers to these questions, it is safe to say that public policy against penalty clauses is sufficiently deeply rooted in U.S. law that exclusion of the CISG under section 4(a) almost certainly would be triggered by an assertion of invalidity,<sup>233</sup> at least if U.S. law might plausibly apply under choice-of-law rules. Moreover, of course, domestic law, and not the CISG, will govern the enforceability of penalty clauses in non-sales international contracts. The absence or exclusion of international law governing penalty clauses opens the door for an outcome determinative choice between French and U.S. law on the subject.

#### **B. THE FRENCH APPROACH: EMPHASIS ON INDIVIDUAL AUTONOMY**

In the absence of a stipulated damages clause, French law—like the law in nearly all states in the United States—limits monetary relief to compensatory damages for actual losses caused by breach of contract.<sup>234</sup>

<sup>231</sup> See, e.g., U.C.C. § 2-718(1) (1977) (enforcing liquidated damages clauses in sales contracts only if they are “reasonable in light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy”); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981) (stating generalization that such clauses are enforced only if they are “reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss”).

<sup>232</sup> See Helen Elizabeth Hartnell, *Rousing the Sleeping Dog: The Validity Exception to the Convention on Contracts for the International Sale of Goods*, 18 YALE J. INT'L L. 1 (1993) (espousing a moderate scope for Article 4(a), so that it would not be triggered by every mandatory rule of domestic law).

<sup>233</sup> See *id.* at 79–80 (citing Farnsworth, *supra* note 229). The historical basis for the non-enforcement of penalty clauses is discussed in Part III.C of this article. Specific enforcement, of course, would compel performance even more surely than the threat of punitive damages. Interestingly, the CISG has also backed away from an international standard for specific relief: “[A] court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.” CISG, *supra* note 6, art. 28.

<sup>234</sup> “Les dommages et intérêts dus au créancier sont, en général, de la perte qu’il a faite et du gain dont il a été privé, sauf les exceptions et modifications ci-après.” C. CIV. art. 1149. Professor

Indeed, the French antipathy toward punitive damages in civil cases exceeds that of the United States, because the limitation of damages to compensation extends to tort claims as well as those for breach of contract.<sup>235</sup> Article 1152 of the French *Code Civil*, however, affirmatively requires enforcement of penalty clauses,<sup>236</sup> subject to discretionary judicial reduction of the amount of the extra-compensatory penalty if it is manifestly excessive.<sup>237</sup>

The impetus for French enforcement of penalty clauses, in the face of exclusion of judicially formulated punitive damages, lies in the French respect for party autonomy juxtaposed against the backdrop of a national distrust of robust judicial power. In reaction to perceived abuses of power by pre-Revolution courts in France, the *Napoleonic Code Civil* prohibited the post-Revolution high civil court, the *Cour de Cassation*, from issuing general regulations or pronouncements of law.<sup>238</sup> To comply with this limitation, that court affirms or reverses lower court decisions on narrow grounds, expressed in single sentence syllogisms that identify the applicable civil code provisions in each case and state whether the appellate court correctly applied them to the material facts.<sup>239</sup> Similarly, the *Code Civil*'s exclusion of judicially formulated punitive damages in all civil cases reflects a sentiment that courts generally should have the power to mete out punishment only within the protective procedures of a criminal prosecution.<sup>240</sup>

Although enforcement of a penalty clause might be viewed at first glance as running against the grain of these limitations on judicial

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Crabb translates Article 1149 to read: "Damages due to a creditor are, in general, from the loss which he incurred and from the gain of which he was deprived, apart from the hereinafter exceptions and modifications." THE FRENCH CIVIL CODE, *supra* note 8, at 223.

<sup>235</sup> "Tout fait quelconque de l'homme, qui cause à autrui un dommage, oblige celui par la faute duquel il est arrivé, à le réparer." C. CIV. art. 1382. Professor Crabb translates Article 1382 to read: "Any act whatever of man which causes damage to another obliges him by whose fault it occurred to make reparation." THE FRENCH CIVIL CODE, *supra* note 8, at 252.

<sup>236</sup> See *supra* note 9 and accompanying text.

<sup>237</sup> See *supra* note 15 and accompanying text.

<sup>238</sup> "Il est défendu aux juges de prononcer par voie de disposition générale et réglementaire sur les causes qui leur sont soumises." C. CIV. art. 5. Prof. Crabb translates Article 5 to read: "Judges are forbidden to pronounce decisions by way of general and regulative disposition on causes which are submitted to them." THE FRENCH CIVIL CODE, *supra* note 8, at 2; see EVA STEINER, FRENCH LEGAL METHOD 78 (2002) (explaining scope of Article 5); see also JOHN P. DAWSON, THE ORACLES OF THE LAW 375-76, 379 (1968) (prohibition against judicial issuance of "regulations" originated in Constituent Assembly of 1790 and was carried over to the *Code Civil* of 1804).

<sup>239</sup> See, e.g., Mitchel de S.-O.-l'E. Lasser, *Judicial (Self-)Portraits: Judicial Discourse in the French Legal System*, 104 YALE L.J. 1325, 1342 (1995).

<sup>240</sup> JOHN YUKIO GOTANDA, SUPPLEMENTAL DAMAGES IN PRIVATE INTERNATIONAL LAW 193 (1998).

remedies, in fact it furthers the policy of restraining the power of the courts. When the *Code Civil* commands the court to enforce a penalty clause, it directs the court to respect the autonomy of the parties and their freedom to contract.<sup>241</sup> Their agreement on damages becomes the law,<sup>242</sup> which—according to the original version of Article 1152—the courts were bound to enforce without modification.<sup>243</sup> Even after amendments to Article 1152 granted limited discretionary authority to reduce the amount of a manifestly excessive penalty,<sup>244</sup> the amended article is best interpreted as contemplating retention of at least part of the extra-compensatory penalty agreed to by the parties, because the amendments authorize the court only to “moderate . . . the penalty” when the penalty is manifestly excessive.<sup>245</sup> Of course, when the penalty is not manifestly excessive, the second sentence of Article 1152 does not apply, and the first sentence instructs the court to enforce the penalty without adjustment.<sup>246</sup>

Accordingly, this article adopts the generalization that French law will enforce a penalty clause voluntarily agreed to by contracting parties, even if the court exercises discretion to reduce the amount of the penalty to avoid manifestly excessive extra-compensatory damages.

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<sup>241</sup> See MAZEAUD, *supra* note 15, at 295–96 (Article 1152 helped to give voice to principles of individual liberty and autonomy advanced in the French Revolution).

<sup>242</sup> See *supra* note 8 and accompanying text.

<sup>243</sup> See *supra* note 9 and accompanying text.

<sup>244</sup> See *supra* note 15 and accompanying text.

<sup>245</sup> See *supra* note 15 and accompanying text; Cour de cassation [Cass.] [supreme court for judicial matters] com., Jan. 29, 1991, Bull. civ. IV, No. 43 (Fr.) (approving modified award with punitive element beyond compensation). In the interests of protecting individual liberty and autonomy, the drafters of the *Code Civil* of 1804 rejected a provision that would permit courts to reduce damages whenever they appeared to exceed actual damages. See MAZEAUD, *supra* note 15 and accompanying text. Such an approach could have authorized courts to prohibit penalties altogether by leaving only compensatory damages intact. In contrast, the amended version of article 1152 leaves intact the original language mandating enforcement of penalty clauses without adjustment, and supplements that language with a grant of discretionary authority to moderate—not eliminate—the penalty. This analysis is consistent with responses provided to me in 2005 by two small groups of French magistrates, who stated that—even when moderating a manifestly excessive penalty clause—they normally would retain some degree of extra-compensatory penalty, to vindicate the parties’ intentions to discourage breach.

<sup>246</sup> See *supra* note 9 and accompanying text.

### C. THE COMMON LAW REJECTION OF PENALTIES FOR BREACH OF CONTRACT

Although courts within the United States famously award damages for egregious torts,<sup>247</sup> they will not award punitive damages on a claim based solely on breach of contract, even if the breach was deliberate,<sup>248</sup> with limited exceptions.<sup>249</sup>

<sup>247</sup> See *Atl. Sounding Co. v. Townsend*, 129 S. Ct. 2561, 2566–67 (2009) (briefly tracing the history of punitive damages in the colonies and the states); William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 689 nn.325–27 (1999) (collecting cases, stating the general standard of reckless or intentional torts, and noting that gross negligence will suffice in a few states); Patrick S. Ryan, *Revisiting the United States Application of Punitive Damages: Separating Myth From Reality*, 10 ILSA J. INT'L & COMP. L. 69, 70 (2003) (showing that punitive damage awards in the United States have earned global notoriety). Unfortunately, our fame—or infamy—for huge or unjustified punitive damage awards is exaggerated by widely circulated urban legends and other inaccuracies. See *id.* at 71–73 (lamenting the inaccuracies about U.S. tort law and punitive damage awards that are circulated even by academics in Europe); see also Theodore Eisenberg et al., *The Predictability of Punitive Damages*, 26 J. LEGAL STUD. 623, 633–34 (1997) (noting that punitive damages were awarded in only about 3% of tort cases in a study, with a modest median punitive damage award of \$50,000, contrary to the popular perception, which is influenced by a few very large awards); *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 498 nn.13–15 (2008) (citing to studies that undercut much of the criticisms aimed at punitive damage awards in the United States). In recent years, the Supreme Court has imposed due process limitations on the substance of punitive damages awards, and on the procedures used to impose and review them. *Philip Morris USA v. Williams*, 549 U.S. 346, 349–56 (2007) (reviewing various limitations established by previous Supreme Court cases and holding that juries may not directly punish a defendant for the specific harms suffered by non-parties to the litigation); see also *Exxon Shipping Co.*, 554 U.S. at 494–96 (in case governed by federal maritime law, reviewing substantial limitations on punitive damages imposed by a few states). Nonetheless, the Supreme Court has noted that “punitive damages overall are higher and more frequent in the United States than anywhere else.” *Id.* at 496.

<sup>248</sup> See, e.g., *Thyssen Inc. v. S.S. Fortune Star*, 777 F.2d 57, 62–63 (2d Cir. 1985) (identifying this standard as a general rule in the United States); *White v. Benkowski*, 155 N.W.2d 74, 77 (Wis. 1974) (absent independent basis for punitive damages in tort, holding that punitive damages were not available for breach of a water supply contract, even though the jury found that the breaching parties had maliciously cut off the flow of water to the other parties for the purpose of harassing them); RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981) (“Punitive damages are not recoverable for breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.”); JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS 488 (6th ed. 2009) (punitive damages “are usually not awarded in contract actions, no matter how egregious the breach”).

<sup>249</sup> Traditional exceptions have included punitive damages for breach of promise to marry, a breach of contract amounting to a breach of fiduciary duty, and a public service company’s breach of contract that also constitutes breach of a duty otherwise owed by law to the public. HENRY MATHER, CONTRACT LAW AND MORALITY 117–18 (1999); Dodge, *supra* note 247, at 636 (1999); see, e.g., *Atl. Sounding Co. v. Townsend*, 129 S. Ct. 2561, 2566 (2009) (as part of historical review, citing to *Coryell v. Colbaugh*, 1 N.J.L. 77 (1791), which authorized punitive damages for breach of promise to marry because of its “most atrocious and dishonourable nature”); *Brown v. Coates*, 253 F.2d 36, 39 (D.C. Cir. 1958) (approving punitive damages for an agent’s flagrant and intentional contract breach constituting a breach of fiduciary duty to his principal, perhaps because it “merges with, and assumes the character of, a willful tort”); see also

Similarly, when the parties have included a damages clause in their contract, U.S. jurisdictions generally will not enforce the clause if it exceeds compensatory “liquidated damages” and instead constitutes a penalty.<sup>250</sup> As a general matter, a damages clause is punitive if it exceeds

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Rawlins v. Apodaca, 726 P.2d 565 (Ariz. 1986) (referring to contractual relationships implicating the public interest, giving rise to fiduciary responsibilities, or raising problems of adhesion). States have also permitted punitive damages for bad-faith breach of insurance contracts, although many of them have avoided a clash with traditional contract law by characterizing such a breach as tortious. *See* Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198 (Cal. 1958) (seminal decision holding that an insurer’s breach of an implied covenant of good faith and fair dealing sounds in tort as well as contract, thus opening up the possibility of tort recovery, including punitive damages); W. DAVID SLAWSON, BINDING PROMISES: THE LATE 20<sup>TH</sup> CENTURY REFORMATION OF CONTRACT LAW 74–80, 104–16, 131–32 (1996) (discussing “relational torts,” “bad faith breach,” and justifications for punitive damages); Dodge, *supra* note 247, at 637–44 (discussing expansion of this doctrine in the 1970s and 1980s, followed by partial retraction beginning in 1988). Some states also legislatively permit multiples of compensatory damages, such as treble damages, for bad faith withholding of salaries or wages earned under an employment contract. *See, e.g.,* ARIZ. REV. STAT. ANN. § 23-355 (West 2005). A few states more broadly permit punitive damages for certain egregious breaches of contract with tortious elements, even in the absence of proof of an independent tort. *E.g.,* Vernon Fire & Cas. Ins. Co. v. Sharp, 349 N.E.2d 173, 180 (Ind. 1976) (allowing punitive damages whenever “elements of fraud, malice, gross negligence or oppression mingle” with the contract breach, regardless whether an independent tort is established) (quoting Taber v. Hutson, 5 Ind. 332, 334 (1854)); Wright v. Pub. Sav. Life Ins. Co., 204 S.E.2d 57, 59 (S.C. 1974) (allowing punitive damages for “the breach of a contract, committed with fraudulent intent, and accompanied by a fraudulent act”); Bank of New Mexico v. Rice, 429 P.2d 368 (N.M. 1967) (permitting punitive damages for a malicious breach of contract, or one that reflects a wanton disregard of the other party’s rights); PERILLO, *supra* note 248, at 488 n.5 (citing to cases).

<sup>250</sup> *E.g.,* Wasserman’s, Inc. v. Twp. of Middletown, 645 A.2d 100, 105 (N.J. 1994) (distinguishing “an enforceable liquidated damages provision” from “an unenforceable penalty clause”); Westmount Country Club v. Kameny, 197 A.2d 379 (N.J. Ct. App. 1964) (defining and contrasting these two kinds of stipulated damages clauses); U.C.C. § 2-718(1) (1998) (in transactions in goods, “[a] term fixing unreasonably large liquidated damages is void as a penalty”); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981) (under the common law, “[a] term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty”); PERILLO, *supra* note 248, at 531 (distinguishing “a valid liquidated damages clause” from “an invalid penalty clause”); *see also* Lake River v. Carborundum Co., 769 F.2d 1284, 1290 (7th Cir. 1985) (referring to steadfast insistence under Illinois law “on the distinction between penalties and liquidated damages”).

reasonable estimate of damages for breach,<sup>251</sup> as viewed in light of the anticipated difficulty of quantifying the loss.<sup>252</sup>

One may be tempted to assume that these rules originated with the prohibition of judicially awarded punitive damages in contract actions, and that the policies underlying this prohibition were extended to prohibit enforcement of penalty clauses voluntarily agreed to by the parties. However, the common law restrictions on penalty clauses have their origin in English equity practices that predate the common law's awarding of punitive damages in the absence of an agreement to do so.

The eighteenth century case of *Wilkes v. Wood*,<sup>253</sup> awarding damages for a warrantless search, is widely acknowledged as the first reported award of punitive damages under common law.<sup>254</sup> Centuries

<sup>251</sup> E.g., *Wasserman's*, 645 A.2d at 106, 109 (requiring a "reasonable forecast" of damages that would be caused by breach) (quoting *Kameny*, 197 A.2d 379); *Carborundum*, 769 F.2d at 1290 (under Illinois law, stipulated damages clause was a penalty rather than a reasonable forecast of damages, because the stipulated damages did not correspond to the extent of the breach, and it called for damages that would greatly exceed likely actual losses); U.C.C. § 2-718(1) (1977) (invalidating "unreasonably large liquidated damages" and requiring liquidated damages to be "reasonable" in light of a number of factors); RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981); PERILLO, *supra* note 248, at 532 ("A provision containing an unreasonably high liquidated damages clause is void as a penalty.")

<sup>252</sup> The most traditional or formalistic statement of the rule for enforceable liquidated damages required a separate showing that the parties anticipated at the time of contracting that damages would be difficult to fix once a breach occurred. See, e.g., *Carborundum*, 769 F.2d at 1289-90 (summarizing Illinois law); PERILLO, *supra* note 248, at 531, 532 (referring to a requirement "ritualistically" listed by courts and "traditionally . . . stated . . . as a prerequisite"); William H. Loyd, *Penalties and Forfeitures*, 29 HARV. L. REV. 117, 129 (1915) ("where . . . the injury that may result from a breach is not ascertainable with exactness, depending upon extrinsic circumstances, a stipulation for damages, not on the face of the contract out of proportion to the probable loss, may be upheld"). Under the modern approach, however, anticipated difficulty in fixing damages is viewed as one factor in the analysis of reasonableness. See, e.g., *Wasserman's*, 645 A.2d at 107 ("[t]he greater the difficulty of estimating or proving damages, the more likely the stipulated damages will appear reasonable") (quoting *Wassenaar v. Panos*, 331 N.W.2d 357, 363 (1983)); U.C.C. § 2-718(1) (1977) (liquidated damages must be "reasonable in light of . . . the difficulties of proof of loss" and other factors); RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981); PERILLO, *supra* note 248, at 532 ("[A] liquidated damages clause is most useful to the parties and most likely to be upheld in cases where actual damages are most difficult to prove."). Traditionally, courts have also stated a requirement of compensatory contractual intent, rather than a punitive one; however, the UCC and the common law in most states have abandoned a separate requirement of non-punitive intent. See *id.* at 532 nn.11 & 16 (citing to U.C.C. § 2-718(1) (1977), RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981), and case law); E. ALLAN FARNSWORTH, *CONTRACTS* 817 (4th ed. 2004) (references in case law to the parties' intentions regarding stipulated damages are "fast disappearing").

<sup>253</sup> *John Wilkes, Esq. v. Wood*, (1763) 98 Eng. Rep. 489 (C.B.).

<sup>254</sup> See GOTANDA, *supra* note 240, at 196 (discussing *Wilkes v. Woods*). Gotanda speculates that awards of punitive damages in appropriate cases grew out of a judicial practice of deferring to jury awards that granted extra-compensatory damages, disguised as compensatory damages for non-pecuniary injuries. See *id.* at 200-01.



earlier, however, the common law courts of England had been enforcing a form of penalty clause in a sealed instrument, the penal bond.<sup>255</sup> Such a bond imposed an obligation on the debtor to pay a certain sum, subject to discharge if the debtor completed a specified performance, such as constructing a bridge or repaying a loan, which was the real object of the transaction.<sup>256</sup> The sum subject to discharge was typically twice the value of the performance sought by the obligee.<sup>257</sup>

Throughout the fourteenth and fifteenth centuries, the common law courts enforced the specified penalty in such a conditional bond when the debtor failed to discharge the bond by completing the performance.<sup>258</sup> In the sixteenth century, however, the Chancery began granting equitable relief from the penalty in some circumstances, limiting relief to actual damages suffered.<sup>259</sup> This equity practice was well established near the end of the seventeenth century,<sup>260</sup> was extended by statute in 1697 to actions at law on penal bonds,<sup>261</sup> and eventually translated to a rejection of all contractual penalties.<sup>262</sup>

Thus, after 1763, when English courts permitted jurors to award punitive damages for egregious torts,<sup>263</sup> it is unsurprising that the common law denied such awards for claims based solely on breach of contract.<sup>264</sup> By that time, English law had long rejected penalties that the parties had voluntarily adopted.<sup>265</sup> The English approach carried over to common law and legislation in the United States.<sup>266</sup>

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<sup>255</sup> FARNSWORTH, *supra* note 252, at 812.

<sup>256</sup> *Id.*; D.J. IBBETSON, A HISTORICAL INTRODUCTION TO THE LAW OF OBLIGATIONS 29 (1999).

<sup>257</sup> IBBETSON, *supra* note 256, at 30; Wasserman's, 645 A.2d at 105 (citing Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 554 (1977)).

<sup>258</sup> IBBETSON, *supra* note 256, at 28–29, 29 n.23.

<sup>259</sup> *Id.* at 29 n.23, 213–14.

<sup>260</sup> FARNSWORTH, *supra* note 252, at 812.

<sup>261</sup> IBBETSON, *supra* note 256, at 214; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 356(2) (1981) (a conditional bond is unenforceable on grounds of public policy in the United States to the extent that it imposes a penalty for failure of the condition of the bond).

<sup>262</sup> FARNSWORTH, *supra* note 252, at 812 (citing Loyd, *supra* note 252).

<sup>263</sup> *See supra* notes 253–54 and accompanying text (referring to *Wilkes v. Woods*).

<sup>264</sup> *See* GOTANDA, *supra* note 240, at 195.

<sup>265</sup> *See supra* notes 259–62 and accompanying text.

<sup>266</sup> *See supra* notes 247–52 and accompanying text (with limited exceptions, punitive damages not available for breach of contract, nor are penalty clauses enforceable); *Atl. Sounding Co. v. Townsend*, 129 S. Ct. 2651, 2566–67 (2009) (in maritime case, stating that punitive damages have been available under U.S. common law “in appropriate cases since at least 1784,” such as for torts and for the exceptional breach of a contract to marry).

The U.S. approach may result in an award of extra-compensatory damages, viewed retrospectively, because prospective reasonableness at the time of forming the contract can validate a liquidated damages clause, even if actual damages unexpectedly turn out to be smaller.<sup>267</sup> Indeed, if the stipulated damages are reasonable at the time of contracting, many states follow the traditional view of awarding those damages even if the victim of the breach unexpectedly suffers no damages at all.<sup>268</sup> Moreover, in less exceptional circumstances than a complete absence of actual damages, the trend appears to favor more liberal enforcement of stipulated damages.<sup>269</sup>

Nonetheless, non-enforcement of penalty clauses under U.S. law continues to contrast starkly with the civil law approach, typified by the

<sup>267</sup> See FARNSWORTH, *supra* note 252, at 813 (an enforceable liquidated damages clause displaces the damages that otherwise would have been awarded, regardless whether those would have been greater or lesser than the stipulated damages). The second Restatement and the UCC have both added a retrospective test or factor, referring to damages actually sustained, but they added it to the traditional prospective test with the conjunctive “or,” as an additional basis for demonstrating the reasonableness of stipulated damages, and not as a basis for invalidating a clause that is prospectively reasonable. U.C.C. § 2-718(1) (1977); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981); see FARNSWORTH, *supra* note 252, at 814–15 (the traditional test is prospective, and the modern trend to add a retrospective test only adds an additional basis for enforcing a damages clause and not to undermine enforcement of a clause that is reasonable when viewed prospectively); PERILLO, *supra* note 248, at 532–33 (adding a retrospective test to the traditional prospective test simply increases the possibility of enforcement). *But see* *Lind Bldg. Corp. v. Pac. Bellevue Devs.*, 776 P.2d 977, 981 (Wash App. 1989) (in dictum, questioning whether stipulated damages should be validated under a prospective test if—in light of actual damages as viewed retrospectively—forfeiture of a deposit would result in “a large windfall to the vendor”).

<sup>268</sup> See FARNSWORTH, *supra* note 252, at 814 (characterizing this approach as the “traditional view,” which some courts have rejected); PERILLO, *supra* note 248, at 533, 533 n.18 (citing to representative cases); James A. Weisfield, Note, *Keep the Change: A Critique of the No Actual Injury Defense to Liquidated Damages*, 65 WASH. L. REV. 977 (1990) (critiquing view that reasonable liquidated damages clause is not enforceable if the victim of breach in fact suffers no injury, and characterizing this approach as the minority view). *But cf.* *Lind Bldg. Corp.*, 776 P.2d at 982 (explaining the reasoning of the “better-reasoned cases” constituting “the weight of authority” and holding that stipulated damages cannot be enforced in the absence of any actual loss); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981) (substantial liquidated damages should be viewed as unreasonable if no loss is sustained).

<sup>269</sup> *Wasserman’s, Inc. v. Twp. of Middletown*, 645 A.2d 100, 108 (N.J. 1994) (referring to the “trend toward enforcing stipulated damages clauses”); FARNSWORTH, *supra* note 252, at 812–13 (citing *Walter Motor Truck Co. v. State*, 292 N.W.2d 321 (S.D. 1980) (recognizing such a “modern tendency”)); see *supra* note 267 and accompanying text (citing to authorities referring to a trend to add a retrospective test as a second possible basis for upholding a damages clause); see also *Murray v. Leisureplay Plc.*, [2005] EWCA (Civ.) 963 (as an illustration of the modern, pragmatic English approach, enforcing stipulated damages for employer’s breach of senior executive’s contract, even though the stipulated damages greatly exceeded what likely could have been awarded for breach absent the clause and after mitigation of damages, because the clause represented legitimate severance pay).

French *Code Civil*.<sup>270</sup> Indeed, several domestic commentators and at least one judge have criticized the U.S. approach for its failure to honor party autonomy and freedom of contract.<sup>271</sup>

The early equitable practice granting relief from the strict terms of penal bonds, from which sprang the modern rule against enforcement of penalty clauses, reflected a policy of disfavoring unconscionable or oppressive terms, which were often the product of overreaching.<sup>272</sup> In the latter half of the twentieth century, however, economic efficiency emerged as the most popular justification for the U.S. rule against punitive damages and penalty clauses.<sup>273</sup> This theory posits that resources are allocated in an optimal manner when a party breaches a contract to shift its performance to a third party who values the performance more highly than the original obligee: by paying expectation damages to the victim of the breach, the breaching party theoretically leaves the victim of breach no worse off than if the contract had been performed.<sup>274</sup> Moreover, the breaching party can still earn greater profits in a new contract with the third party, who has a more valuable or more urgent use for the performance and is willing to pay more for it.<sup>275</sup> The threat of punitive damages, or the prospect of enforcement of a penalty clause, on

<sup>270</sup> See *supra* notes 236–46 and accompanying text (French law enforces penalty clauses, while permitting judges to reduce the amount of a manifestly excessive penalty).

<sup>271</sup> E.g., *Lake River v. Carborundum Co.*, 769 F.2d 1284, 1290 (7th Cir. 1985) (referring to Illinois law as “paternalistic” in the face of “academic skepticism” toward the U.S. approach, and citing to Goetz & Scott, *supra* note 257); PERILLO, *supra* note 248, at 530–31 (in light of “deeply rooted principle of freedom of contract” and the general judicial reluctance to inquire into “the wisdom of a bargain,” the U.S. “rule is anomalous”).

<sup>272</sup> *Wasserman’s*, 645 A.2d at 105 (N.J. 1994) (referring to “an unusual danger of oppression and extortion” in penalty bonds, quoting Goetz & Scott, *supra* note 257, at 555); PERILLO, *supra* note 248, at 530 (the equitable rule “was designed to prevent over-reaching and to give relief from unconscionable bargains”); see also Loyd, *supra* note 252, at 123 (referring to the role of the equitable rule in bringing the “harshness” and “excessive literalism of the law” into “harmony with more humane standards of conduct”).

<sup>273</sup> See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 142 (5th ed. 1998); Dodge, *supra* note 247, at 631–34 nn.6–15 (citing to sources that promote the efficient breach argument).

<sup>274</sup> See, e.g., ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 226 (3d ed. 2000) (victim of breach should be indifferent between performance and receiving expectation damages).

<sup>275</sup> See, e.g., *Carborundum*, 769 F.2d at 1289 (authored by Judge Posner, who provides an example of efficient breach); Calleros, *supra* note 230, at 85–86 (also providing an example); Dodge, *supra* note 247, at 652–53 (explaining the difference between Pareto efficiency, in which breach causes some to be better off and no one to be worse off, and Kaldor-Hicks efficiency, in which breach increases total wealth but the victim of the breach may be worse off for the breach). *But cf.* PERILLO, *supra* note 248, at 537–38 (critiquing a premise of one of Judge Posner’s examples).

the other hand, could have the effect of deterring breach and thus impeding an efficient allocation of resources.<sup>276</sup>

Neither the rule of equity applied to the early penal bonds nor the argument in favor of economic efficiency, however, provides a convincing justification for the categorical prohibition of punitive damages and penalty clauses. For one thing, the threat of punitive damages or enforcement of a contractual penalty need not prevent efficient allocation of resources; instead, it could simply provide the prospective victim of breach with sufficient bargaining power to negotiate a settlement in which that party would agree to rescind the less efficient contract (along with our hypothetically enforceable penalty clause) in exchange for a share of the additional income to be made in the more profitable enterprise.<sup>277</sup>

Second, not all breaches are efficient. If a breaching party withholds performance out of spite or malice rather than to reallocate his resources to a more efficient use, remedies that deter breach will not decrease economic well-being—at least if no value is assigned to vindicating the feelings of spite or malice.<sup>278</sup>

Finally, a contractual penalty clause may not be abusive or oppressive. Instead, it may advance the interests of the parties by allowing an insecure recipient of goods or services—one who places great value on actual performance, perhaps for sentimental reasons—to pay a premium fee in exchange for the other party's agreement to pay a penalty in the event of its breach. Through its agreement to the penalty clause, the provider of goods or services signals its exceptional commitment to actual performance by forgoing its usual ability to choose between performance and paying expectation damages.<sup>279</sup>

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<sup>276</sup> *Carborundum*, 769 F.2d at 1289 (explaining that a penalty clause would discourage efficient breach, “and a transaction that would have increased value will be forgone.”); see also FARNSWORTH, *supra* note 252, at 811 (a penalty sufficiently substantial to deter breach and compel performance departs from “the fundamental principle” of the law’s compensatory goals).

<sup>277</sup> See Dodge, *supra* note 247, at 632–34, 665–78 (negotiating a release is less costly than litigation, supporting the author’s view that punitive damages should be allowed for certain breaches of contract).

<sup>278</sup> Cf. *White v. Benkowski*, 155 N.W.2d 74, 75, 78 (Wis. 1974) (applying general rule against punitive damages despite the jury’s finding that suppliers cut off the flow of water to a neighbor maliciously rather than to allocate the water to a more profitable use).

<sup>279</sup> See *Carborundum*, 769 F.2d at 1289 (referring to an “earnest of performance” that may “be essential to inducing some value-maximizing contracts”); Calleros, *supra* note 230, at 88 n.3 (citing to illustrations from three other sources); see also *id.* at 88–91 (presenting the hypothetical example of a wedding couple willing to pay a premium fee for a penalty clause that would deter their favorite band from breaching its obligation to play at the wedding reception, to which the band is willing to agree, both to earn the premium and to signal its reliability).

Thus, if the common law could break from the traditions growing out of equity's reactions to oppressive penal bonds, it could selectively address real abuses—while honoring freedom of contract—by permitting parties to knowingly and voluntarily agree to admitted penalties, subject to review for unconscionability<sup>280</sup> or true violations of public policy.<sup>281</sup> Just as a court can withhold specific performance when compelled performance would result in an inefficient allocation of resources,<sup>282</sup> it can apply the doctrines of unconscionability or public policy to strike down a penalty clause that is clearly oppressive or that harms the community by preventing the efficient allocation of resources to a substantial degree without a countervailing justification.

Despite this critique, however, and despite the trend to liberalize the definition of liquidated damages,<sup>283</sup> there is no indication that the common law will evolve in the near future to permit enforcement of stipulated damages clauses that indisputably amount to penalties, designed to deter breach. Thus, a choice between state law within the United States and French law will normally determine the outcome of a challenge to such a clause.<sup>284</sup>

#### **D. HYPOTHETICAL APPLICATION OF ROME I TO A PENALTY CLAUSE IN A U.S. FORUM**

To illustrate the limited public policy exception in Rome I in a vivid and provocative way, this section will assume that the United States has adopted the equivalent of Rome I as federal law applying to international contracts, and that a court within the United States is the forum for litigation of an international service contract between an architect located exclusively in France and a developer located exclusively in the United States. This hypothetical contract calls for the French architect to draw plans for a spectacular, ultra-modern and energy-efficient office building in the United States, and it includes a

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<sup>280</sup> See *supra* note 272 and accompanying text (citing explanations that common law equity intervention was designed to prevent oppression and unconscionability).

<sup>281</sup> Compare *supra* notes 273–76 and accompanying text (illustrations and explanations of efficient breach) with notes 277–79 and accompanying text (referring to the option of efficiently negotiating a release in many cases, to an example of malicious, inefficient breach, and to examples of efficient use of penalties).

<sup>282</sup> See Calleros, *supra* note 230, at 86 n.82 (citing authorities and presenting a variety of views).

<sup>283</sup> See *supra* notes 267–69 and accompanying text.

<sup>284</sup> Any flaws or over-inclusiveness in the justifications for the common law rule against enforcement of penalty clauses, however, should weaken the policy argument for mandatory application of the common law rule in place of a foreign rule that would otherwise be chosen by conflicts rules. See *infra* notes 297–302 and accompanying text.

clause imposing a penalty for late or otherwise deficient performance. The parties negotiated and concluded the contract in the United States, and the contract required the French architect to visit the site in the United States; however, the architect would perform its obligations mainly in its offices in France. The architect partially performed but breached in a way that triggers the penalty clause. The developer has brought suit against the French contractor in a court in the United States, in a state that fully adheres to the general common law rule against penalty clauses.

Applying the hypothetical version of Rome I adopted in the United States, the court chooses French contract law, either because the parties contractually chose French law<sup>285</sup> or because Rome I points to the law of the habitual residence of the service provider in the absence of contractual choice.<sup>286</sup> When the American firm seeks to enforce the penalty clause, the French contractor argues that the penalty is manifestly incompatible with the public policy of the forum.

As explored in Part III.B earlier, the French *Code Civil* honors the autonomy of the parties to the contract by requiring enforcement of freely negotiated penalties, subject to moderation of manifestly excessive penalties.<sup>287</sup> In contrast, the common law views contractual penalties as unenforceable violations of public policy.<sup>288</sup> Applying the hypothetical U.S. equivalent to Rome I, should the American forum find that French Civil Code's enforcement of penalties would be "manifestly incompatible" with the public policy of the forum?<sup>289</sup> Alternatively, to the extent that the state law of the forum includes an affirmative provision outlawing penalty clauses, would it amount to an "overriding mandatory provision" of the forum,<sup>290</sup> because it is "regarded as crucial . . . for safeguarding . . . public interests"?<sup>291</sup>

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<sup>285</sup> See Rome I, *supra* note 3, art. 3(1).

<sup>286</sup> *Id.* art. 4(1)(b).

<sup>287</sup> See *supra* notes 236–46 and accompanying text.

<sup>288</sup> See *supra* notes 250–76 and accompanying text.

<sup>289</sup> See Rome I, *supra* note 3, art. 21. We can assume that this hypothetical version of Rome I permits consideration of either the public policies of the particular state in which the court sits, or public policies more generally shared by states within the United States. Under either view, the penalty clause would be viewed as incompatible with public policy, at least in the broad, domestic sense.

<sup>290</sup> *Id.* art. 9(2).

<sup>291</sup> *Id.* art. 9(1).

Conflict law has long recognized special public policy barriers to the forum's enforcing the penal laws of another country.<sup>292</sup> This special hesitation, however, is best viewed as operating against penal claims based on foreign public law, such as another State's criminal law, as distinguished from a private claim with an extra-compensatory element.<sup>293</sup> It should have no application in a claim based on a contractual penalty clause freely negotiated by the parties, designed to assure performance. Thus, as a matter of comity, a foreign statute that provides for extra-compensatory damages for a civil wrong should be excluded in a transnational dispute only if it offends the forum's fundamental public policy in an international sense,<sup>294</sup> as nicely captured by the public policy escape hatches in Rome I.<sup>295</sup>

French law illustrates the significance of the penalty's arising out of private agreement: The French *Code Civil* does not authorize a court to award punitive damages on its own for breach of contract, or even for tort; yet, it requires a court to enforce a contractual penalty clause, subject only to moderation of a manifestly excessive penalty.<sup>296</sup>

As discussed in Part III.C, this author believes that the common law rule against freely negotiated penalty clauses between parties of equal bargaining power is not grounded on sound public policy. The economic justification based on efficient breach should not outweigh support for party autonomy when the parties would each gain utility if the recipient of goods or services places special value on full performance by a particular vendor, and if the vendor desires to signal its reliability through acceptance of a penalty clause, perhaps for a premium

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<sup>292</sup> See, e.g., *Huntington v. Attrill*, 146 U.S. 657, 666 (1892); Story, *supra* note 64, at 516–19; see also *Loucks v. Standard Oil Co.*, 120 N.E. 198, 198–99 (1918) (interstate conflict).

<sup>293</sup> See, e.g., *Huntington*, 146 U.S. at 674 (distinguishing between “an offense against the public justice of the State” and a “private remedy to a person injured by the wrongful act”); *Loucks*, 120 N.E. at 199 (Massachusetts statute that provided for extra-compensatory damages was not “penal” in this sense because its purpose was “not designed as atonement for a crime; it is solace to an individual who has suffered a private wrong”); RABEL, *supra* note 62, at 562–81 (distinguishing between policies based on public law and private law). The Full Faith and Credit Clause was strongly implicated in *Huntington*, because the plaintiff sought to enforce a judgment from a sister state. *Huntington*, 146 U.S. at 660–61, 666, 684. However, for purposes of determining whether a claim under state law was penal, the court referred several times to the question whether it was penal in the international sense, under international law. *E.g., id.* at 666, 673, 680–83; see also *supra* note 175 and accompanying text (explaining that *Loucks* addressed whether a claim was penal in the international sense, without invoking the Full Faith and Credit Clause).

<sup>294</sup> See *supra* note 175 and accompanying text.

<sup>295</sup> See *supra* notes 201–08.

<sup>296</sup> See *supra* notes 234–46 and accompanying text.

fee.<sup>297</sup> In other cases, enforceable penalty clauses should not stand as an absolute barrier to efficient reallocation of resources, because the vendor is always free to negotiate a voluntary release from the contract and its penalty. An enforceable penalty clause simply increases the bargaining power of the recipient of the goods or services, in the negotiation over sharing the additional profit offered to the vendor in the intervening opportunity.<sup>298</sup>

The historical basis for the common law rule against penalty clauses is a concern about the operation of oppressive terms, much like the considerations underlying modern unconscionability doctrine.<sup>299</sup> These concerns, however, can be addressed both by the French *Code Civil*'s provision for judicial moderation of the penalty,<sup>300</sup> and by the possibility of entirely striking out a penalty clause in a consumer transaction, if it is found to be unfair under the French Consumer Code.<sup>301</sup>

Consequently, assuming application in a U.S. forum of a national conflicts law equivalent to Rome I, and in light of the shaky foundations of the policies underlying the common law rule against penalty clauses, the absence of international consensus on those policies, and the ability of a court to curb abuses in penalty clauses under French law, a strong argument can be made that the common law policy against freely negotiated penalty clauses does not qualify for a public policy exception in the international sense and should not be invoked by a U.S. forum to override choice of French law.<sup>302</sup>

<sup>297</sup> See *supra* note 279 and accompanying text.

<sup>298</sup> See *supra* note 277 and accompanying text.

<sup>299</sup> See *supra* note 272 and accompanying text (historical basis); cf. U.C.C. § 2-302 (2001) (modern unconscionability doctrine).

<sup>300</sup> See *supra* note 15 and accompanying text.

<sup>301</sup> CODE DE LA CONSOMMATION art. L 132-1 (Fr.), available at <http://195.83.177.9/code/liste.phtml?lang=uk&c=61&r=2140>. As translated by LEGIFRANCE, this law refers to an annex that sets forth an "illustrative and non-exhaustive list of clauses that may be regarded as unfair" to consumers, and thus are "null and void" under L. 132-1 because they create a "significant imbalance" against the consumer "in rights and obligations." *Id.* As translated by LEGIFRANCE, subsection 1(e) of the annex provides that a clause with the following effect may be viewed as unfair to consumers: "obliging the consumer who has failed to perform his/her obligations to pay compensation in a disproportionately high amount." *Id.* at Annex 1(e). This law permits a court to "void" a penalty clause, rather than just moderate the penalty. Moreover, one can imagine that the annex's phrase "disproportionately high amount," as applied to a consumer contract, can trigger judicial intervention more easily than the reference to a "manifestly excessive" penalty in French Civil Code art. 1152, which can apply to commercial as well as consumer contracts.

<sup>302</sup> See generally RABEL, *supra* note 62, at 544 (penalty clauses should not automatically be viewed as violating the public policy of American states).



If the equivalent of Rome I would apply in a U.S. forum as well as a French forum, then both parties would be on clear notice of the applicability of French law at the time of contracting. The French architect, in particular, would be culturally attuned to French law and its enforcement of penalty clauses, so that invoking contrary public policy of the forum would not be necessary to protect its interests. But even if the penalty were lodged against the American developer, the U.S. forum should hesitate to override the choice of French law to protect the interests of a developer who knowingly conducted business with a contractor from a different legal system, a system that was certainly and predictably chosen by the Rome I regime hypothetically in place in both countries.

Precisely because Rome I provides such clear notice of the applicable law on the basis of criteria known at the time of contracting, its public policy exceptions should be applied sparingly, as their language suggests, because the parties have ample notice and opportunity to negotiate a different choice of law or to agree to liquidated damages rather than a penalty. By the same token, if the public policy exceptions are narrowly construed in this manner, the certainty and predictability of Rome I's default choices are further enhanced.

#### **CONCLUSION AND RECOMMENDATION: ROME I AS GLOBAL CONVENTION**

In the absence of contractual choice of law, Rome I offers an approach to choice of law that is ideally suited to international contract disputes. Its approach is rational and non-arbitrary, protects the interests of consumers and employees, and achieves a high degree of certainty and predictability while retaining an appropriate measure of flexibility with limited escape hatches. Because parties in most cases will be able to predict, at the time of contract negotiation, the law that would be chosen by Rome I, they have a dependable basis for assessing risks and adjusting their contract terms accordingly, either on substantive matters or by replacing the default choice of law with their contrary agreement on applicable law.

The benefits offered by Rome I will be maximized, and forum-shopping will be minimized, if the approach of Rome I is exported to forums beyond those in the European Union. Ideally, the equivalent of Rome I should be proposed as a global convention that garners wide support. Such a proposal is hardly realistic in the near future, and might even attract charges of naiveté. This author prefers to view this

recommendation instead as simply decades ahead of its time, and he looks forward to the time when the chaotic field of conflict of laws can be harmonized, at least in the limited context of international contract disputes.

In the meantime, the United States should take a substantial step toward this long-term goal by adopting the equivalent of Rome I for all judicial forums in the United States. Such federal legislation could be limited in scope to international contracts disputes, thus leaving intact the patchwork of choice-of-law rules in force in the states for domestic contracts litigation, thus satisfying the appetites of those who crave diversity and maximum vindication of local sensibilities.

U.S. adoption of the equivalent of Rome I may seem unlikely, due to general allegiance to American law and its common law methods. Flexible common law standards, such as those represented in the second Restatement, are consistent with the traditional role of judges in our common law system; in contrast, the precise and comprehensive statutory rules set forth in Rome I are more consistent with the legal traditions of civil code countries. As unlikely as such a change may seem, however, the United States need only follow the example of its common law parent, England. In 1990, after initial hesitation, England largely abandoned its common law choice-of-law rules in international contracts disputes, which had referred to the “closest and most real connection” between the contract and system of law,<sup>303</sup> and replaced them with the 1980 Rome Convention.<sup>304</sup> As a member of the European Union, England’s common law choice-of-law regime is now superseded by Rome I.<sup>305</sup> The United States and other countries outside the European Union could do much for certainty and coherence in international conflicts law by following suit with similar legislation.

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<sup>303</sup> COLLINS, *supra* note 57, at 399 (referring to rule of choosing the governing law in the absence of express party choice or circumstances from which party choice can be inferred); *see also* Wolff, *supra* note 12, at 472–74 (discussing this English common law rule as received into the conflicts law of Hong Kong).

<sup>304</sup> Wolff, *supra* note 12, at 465, 467, 487–88 (referring to the Contracts (Applicable Law) Act, 1990 ch. 36 (Eng.), which largely replaced English common law conflicts rules with the 1980 Rome Convention).

<sup>305</sup> European Communities Act, 1972, § 2(1) (U.K.) (providing for automatic implementation of rights and obligations provided under European Union treaties).