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# From Politics to Efficiency in Choice of Law

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*This Article proposes a comprehensive system for choice of law that is designed to enhance social wealth by focusing on individual rather than governmental interests. To the extent practicable, parties should be able to choose their governing law, subject to possible procedural protections designed to ensure that the choice is real. In the absence of an explicit agreement, courts should apply rules that facilitate party choice or that select the law the parties likely would have contracted for—that is, the law of the state with the comparative regulatory advantage. The system relies on clear rules that enable the parties to determine, at low cost and ex ante, what law applies to given conduct, and therefore to choose the applicable law by altering their conduct. State regulatory concerns are accounted for through explicit state legislation on choice of law rather than ad hoc judicial determination of the states' interests. The Article shows how this system might be implemented through jurisdictional competition.*

Despite a burgeoning law and economics literature over the last three decades, economic analysis has made surprisingly little inroad into one of the most perplexing legal areas—the rules for determining which law applies to an interstate dispute.<sup>1</sup> To be sure, conflict of laws has not been completely bereft of explicit economic analysis.<sup>2</sup> Moreover, some choice-of-law theories can easily be placed into an efficiency framework even if their economic underpinnings have not been made explicit.<sup>3</sup> Nevertheless, no one has proposed a comprehensive system

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<sup>1</sup> See Richard A. Posner, *Introduction to Baxter Symposium*, 51 *Stan L Rev* 1007, 1007 (1999) (commenting that Professor Baxter's thirty-five-year-old article applying economic analysis to law remains a leading authority on this topic). Some evidence for this proposition can be gleaned from the bibliographies on choice of law in 1 *The New Palgrave Dictionary of Economics and the Law* 241, 395 (Stockton 1998); Erin Ann O'Hara and Larry E. Ribstein, *Conflict of Laws and Choice of Law*, in Boudewijn Bouckaert and Gerrit De Geest, eds, 5 *Encyclopedia of Law and Economics: The Economics of Crime and Litigation* 631, 653–60 (Edward Elgar 2000).

<sup>2</sup> See Richard A. Posner, *Economic Analysis of Law* 645–46 (Aspen 5th ed 1998) (arguing that choice of law should be determined according to each state's comparative regulatory advantage); Bruce Hay, *Conflicts of Law and State Competition in the Product Liability System*, 80 *Georgetown L J* 617 (1992) (applying public choice to interest analysis); Larry Kramer, *Re-thinking Choice of Law*, 90 *Colum L Rev* 277, 339–44 (1990) (positing that a clear and frank identification of state interests will allow jurisdictions to develop a stable and cooperative solution to the prisoner's dilemma common in conflicts law); Michael E. Solimine, *An Economic and Empirical Analysis of Choice of Law*, 24 *Ga L Rev* 49, 74–89 (1989) (testing empirically and analyzing differences between Restatement (First) of Conflict of Laws and modern approaches).

<sup>3</sup> See William F. Baxter, *Choice of Law and the Federal System*, 16 *Stan L Rev* 1, 4–22

for dealing with conflict of laws that rests solidly on the foundations of economic theory.

The theories that have so far held center stage owe virtually nothing to economic theory.<sup>4</sup> The Restatement (First) of Conflict of Laws reflected the approach to choice of law prevalent in United States courts until recently.<sup>5</sup> The “vested rights” rationale offered by its reporter, Joseph Beale, led to a set of rules delineating the territorial boundaries of states’ lawmaking authority. Under this territorial approach, an individual’s rights vested at one point and place in time, and only that jurisdiction could determine the extent of the rights created.<sup>6</sup> The vested rights theory accordingly emphasizes the states’ *political power* to control the outcome of a dispute. Most courts eventually replaced their territorial rules with some form of “interest analysis,” which focuses on legislative intent—that is, on the states’ *political objectives*.

Instead of a choice-of-law system that allocates political power among the states, this Article proposes a system based on principles of wealth-maximization and individual choice. Emphasizing states’ interests and powers is misguided from this perspective because political leaders cannot be expected to maximize social welfare. Rather, political decisionmaking is infected by the agency costs that inevitably follow delegation of power. Conflict-of-laws rules can help to alleviate political agency costs by letting the governed avoid inefficient mandatory rules by individual action.

An efficient choice-of-law system should start with a presumption in favor of enforcement of choice-of-law clauses in contracts. Where the parties cannot contract explicitly, the rules should be designed to enable the parties to determine, at low cost and *ex ante*, that given conduct will trigger the application of a particular state’s law. Armed with this knowledge, the parties may be able to structure their behavior to avoid laws ill-suited to their affairs. Moreover, an efficient choice-of-law system will also minimize the costs of contracting for efficient laws or avoiding inefficient ones. In the absence of an explicit contract, courts should apply the state law that the parties most likely would have selected had they contracted explicitly before their legal

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(1963) (arguing that choice of law should maximize the effectuation of the states’ interests). See also Part II.B.2.

<sup>4</sup> These approaches are extensively discussed in Part II.

<sup>5</sup> See Part II.A.

<sup>6</sup> See *id.*

<sup>7</sup> This argument has been made in the securities context. See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 *Yale L J* 2359, 2395–99, 2415–18 (1998) (arguing that more favorable securities laws can result under choice-of-law clause approach if state regulatory competition replaces federal securities regulation).

dispute arose.<sup>8</sup> Assuming that the parties typically would prefer to be governed by the law that maximizes their joint welfare,<sup>9</sup> they could be expected to choose the law of the state with the comparative regulatory advantage. But in order to preserve ex ante predictability, comparative regulatory advantage should be employed not as a general standard but rather as a criterion for developing specific and predictable rules.

A system that facilitates individual choice has the potential to dilute the effect of *efficient*, as well as *inefficient*, law. The choice-of-law system therefore must preserve a role for beneficial government regulation by prohibiting some party choice of law or by making it contingent upon the satisfaction of procedural protections. However, to maximize predictability and individual choice, the final determination should be made by state legislatures<sup>10</sup> rather than by courts. Thus, the choice-maximizing rules proposed in this Article operate as default rules that legislatures can overrule by explicit statutes where necessary to preserve their power to legislate effectively.

An efficiency approach attempts to minimize the sum of the costs that choice-of-law decisions can entail. These include the extra litigation costs associated with legal uncertainty,<sup>11</sup> the parties' costs of predicting the applicable law at the time of the relevant conduct, the social costs of inefficient laws, and the lost benefits resulting from evasion of laws through party choice of law. A choice-of-law system might decrease some of these costs while increasing others. For example, if courts always applied forum law, their decisions would be simple and predictable ex post, after suit has been filed, and so might minimize litigation costs. However, this approach would create uncertainty about the applicable law ex ante, prior to the relevant conduct. This, in turn, would reduce beneficial interstate competition and channeling of productive activities. Although no choice-of-law solution can eliminate all of these costs, we show that there are strong arguments supporting a clear set of rules that enhances ex ante predictability.

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<sup>8</sup> See Part III.B.

<sup>9</sup> See Posner, *Economic Analysis of Law* at 646 (cited in note 2).

<sup>10</sup> Part III.E specifies which states' statutes should be consulted to determine whether party choice is prohibited or restricted.

<sup>11</sup> These costs are not a focus of this Article but are discussed widely in the general legal and economic literature on litigation. See, for example, Louis Kaplow, *A Model of the Optimal Complexity of Legal Rules*, 11 J L, Econ, & Org 150 (1995) (modeling the effects of increased legal complexity on individual decisionmaking); Richard A. Posner, *Economic Analysis of Law* 554-60 (Little, Brown 4th ed 1992) (discussing how uncertainty affects decision to settle or to go to trial); Isaac Ehrlich and Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J Legal Stud 257, 265 (1974) (positing that a clear legal rule will facilitate more settlements, thus diminishing the need for litigation, which is generally a more costly method of settling disputes). For discussions of such costs of choice-of-law rules, see text accompanying note 179.

The Article proceeds as follows. Part I outlines an efficiency approach to choice of law. It explains how choice-of-law rules can mitigate the perverse effects of inefficient substantive laws by allowing parties to avoid these laws. However, these rules also should be designed to minimize interference with efficient state regulation. Part II shows how the efficiency criterion, which emphasizes individual choice over government interests, may produce results that differ from those under the conflict-of-laws approaches that have dominated judicial and academic thinking.

Part III articulates the general principles that guide our approach. These include the enforcement of private contracts; rules designed to permit parties to choose their governing law *ex ante* rather than later through plaintiffs' choice of forum; default rules selecting the state with the comparative regulatory advantage where party choice is impracticable; and statutory rather than judicial deviations from these general principles. Part IV develops the framework in more detail by deriving from these general principles choice-of-law rules for particular types of legal disputes. The proposed rules reach results somewhat similar to those under the Restatement (First) territorial rules except that they focus on enhancing private ordering rather than on states' ability to regulate within their borders.

Part V discusses possible ways to implement an efficiency approach to choice of law. It is initially skeptical of relying on state law, as enforced either in state or federal courts. On the other hand, federal adoption of our proposal is not a viable alternative. Instead, the forces of long-run state competition might ultimately encourage the states to provide efficient choice-of-law rules.

## I. AN EFFICIENCY APPROACH TO CHOICE OF LAW

Previous conflicts scholars have treated substantive laws as fixed and exogenous to the choice-of-law decision. As this Part explains, the perverse effects of inefficient substantive laws can be mitigated to the extent that parties can avoid these laws.<sup>12</sup> On the other hand, the parties' ability to evade laws reduces the benefits generated by efficient laws.

The problem is best described using simple algebra. Assume that, if parties lack the ability to avoid the application of a law, the law generates aggregate benefits  $B$  while imposing social costs  $C$ . If those

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<sup>12</sup> See Bruce H. Kobayashi and Larry E. Ribstein, *Contract and Jurisdictional Competition*, in F.H. Buckley, ed., *The Fall and Rise of Freedom of Contract* 325, 325–26 (Duke 1999) (arguing that validating choice-of-law clauses will lead parties to opt out of inefficient laws, promoting jurisdictional competition between states to pass efficient laws). The parties also can, in a sense, “avoid” the law by altering their conduct. However, since this is part of the law’s intended effect, it should be viewed as an aspect of applying rather than of avoiding the law.

burdened by the law have some ability to opt out of its application, then the costs are reduced by the amount  $C_e$ . On the other hand, the law's benefits might be reduced by an amount  $B_e$  through parties' ability to avoid application of the law.

Choice-of-law rules ideally should strengthen efficient laws while mitigating the inefficient ones. Such rules also should help ensure application of laws where they produce efficiencies but not where they produce inefficiencies. In other words, a law that is selected by a choice-of-law rule is efficient if  $B - B_e > C - C_e$ . Increasing the availability of exit increases both  $B_e$  and  $C_e$ . A choice-of-law rule is efficient if  $C_e > B_e$ —that is, if exit reduces the law's overall costs by more than it reduces the law's benefits.<sup>13</sup> Because the rule's effects on those who benefit from the law and those who incur costs from the law will vary from one person or transaction to another, there is no reason to believe that a choice-of-law rule will affect  $B_e$  and  $C_e$  equally. Because reducing exit costs may increase both  $B_e$  and  $C_e$ , higher exit costs can increase social welfare for laws with high  $B$  and low  $C$ , and decrease social welfare for laws with low  $B$  and high  $C$ . This tension between  $B_e$  and  $C_e$  can be difficult to resolve without data on the law's efficiency.

The efficiency of choice-of-law rules depends upon the extent to which the rules increase social wealth by enabling exit from inefficient laws or, conversely, reduce social wealth by enabling exit from efficient laws. Part I.A sets forth the basic problem of inefficient laws, while Part I.B discusses exit as a potential solution. Part I.C discusses the potential for choice of law to facilitate exit from efficient laws, and indicates how choice-of-law rules might be used to enhance  $C_e$  while simultaneously preserving  $B$ .

It is, of course, necessary to define "efficient." While this Article generally characterizes an inefficient law as one that primarily redistributes wealth while imposing deadweight transfer costs, society may judge the redistribution itself as an aspect of  $B$  rather than of  $C$ . Indeed, one might define efficiency according to the extent to which courts enhance democratically enacted laws.<sup>14</sup> If so, parties should not be able to escape even laws whose primary effect is to transfer wealth.

Rather than attempting to define efficiency or to determine a priori the relevant costs and benefits of particular state laws, this Arti-

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<sup>13</sup> The overall efficiency of choice-of-law rules must be analyzed in light of the public choice implications of these rules. By reducing the effect of laws, exit can decrease both the support of interest group proponents and the opposition of those who would be burdened by proposed laws. Exit therefore may not only mitigate the effect of an enacted law, but also deter or encourage the enactment of a law. See Erin A. O'Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 Vand L Rev (forthcoming 2000). For a further discussion of this point, see Part V.D.

<sup>14</sup> We thank Larry Kramer for raising this issue.

cle proposes a process-oriented approach. For two reasons, we would leave ultimate decisions on whether to permit party avoidance of legislative wealth transfers to legislatures rather than to courts. First, the legislature is best situated to make the factual and policy findings that are necessary to determine the value and propriety of the wealth transfer. Second, as explained later,<sup>15</sup> forcing the legislature explicitly to exclude party choice minimizes public choice difficulties inherent in legislative decisionmaking.<sup>16</sup>

#### A. The Problem of Inefficient Laws

A law's efficiency depends on the extent to which it suits individual parties or transactions that are subject to the law.<sup>17</sup> In other words, if a law is ill-suited for some parties or transactions, *C* rises with the number of these parties and transactions and with the magnitude of the costs imposed on these parties or transactions. We focus here on potential inefficiencies in statutory law, including judicial and administrative application and interpretation of statutes. A statute's costs and benefits depend on the baseline of common law or other legal rules that existed prior to its passage. We do not assume either that the common law is efficient<sup>18</sup> or that all statutory law is inefficient. Moreo-

<sup>15</sup> See Part IV.A.2.

<sup>16</sup> Our proposed approach is *jurisdiction-selecting* rather than *law-selecting*. Some commentators advocate law selection in order to emphasize the relevant policies the law seeks to accomplish rather than what Cavers regarded as "the dogma of the automatic and inflexible rule" under the Restatement (First) of Conflict of Laws. David F. Cavers, *A Critique of the Choice-of-Law Problem*, 47 Harv L Rev 173, 177 (1933). But Cavers himself objected only to choice-of-law rules that lacked a policy foundation. See, for example, *id.* at 190 (arguing that "social policies" should serve as a basis for deciding "representative" cases). Because our system attempts to promote efficient results, it does rest on a policy foundation. Moreover, it avoids the potential inflexibility of rule-based approaches by leaving the choice mostly to the affected parties rather than the courts. Legislatures can trump party choice, but only by giving notice to the parties who, in turn, can fashion their conduct accordingly.

<sup>17</sup> This refers to default as well as to mandatory rules because of the potential costs of drafting around default rules. See R.H. Coase, *The Problem of Social Cost*, 3 J L & Econ 1, 15-19 (1960) (discussing the significance of transaction costs for legal rules). Choice of law arguably makes an entire body of state law a "default" rule and may be a less costly alternative than drafting around each rule individually.

<sup>18</sup> For arguments that the common law is efficient, see George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J Legal Stud 65, 65-66 (1977) (arguing that efficient outcomes of common law are largely immune to individual biases of judges); Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J Legal Stud 51, 51-52 (1977) (arguing that efficient legal rules result from an evolutionary mechanism in which inefficient rules are more likely to be challenged through litigation). For arguments to the contrary, see Paul H. Rubin, Christopher Curran, and John Curran, *Litigation versus Legislation: Forum Shopping by Rent-Seekers* (unpublished manuscript) (on file with authors) (discussing litigating for new precedent as an alternative to rent-seeking through lobbying); Martin J. Bailey and Paul H. Rubin, *A Positive Theory of Legal Change*, 14 Int'l Rev L & Econ 467, 468-69 (1994) (positing model of legal change in which legal rules reflect temporary balances in rent-seeking pressures); Paul H. Rubin, *Common Law and Statute Law*, 11 J Legal Stud 205, 206-11 (1982) (arguing that recent common law is ineffi-

ver, since our analysis of exit costs is not likely to differ much when applied to the common law contexts, we expect the same conclusions to apply there too.

### 1. Legislators.

Agency costs exist whenever power is delegated to agents, including political representatives. Close monitoring of a legislator's efforts is difficult. Moreover, legislators can increase their campaign contributions and other perks by brokering wealth transfers that end up favoring the members of some interest groups at the expense of others.<sup>19</sup> The winning interest groups are typically those who can organize most cheaply and effectively to raise and spend money, or to mobilize votes and other political resources.<sup>20</sup> Successful interest groups tend to be those that are best able to prevent some members from free riding off expenditures and additional political efforts by others. Because relatively small, homogeneous groups often can more effectively contain free riding, resulting legislation may fail to serve the interests of even a majority of voters.<sup>21</sup> More importantly from the perspective of social welfare, the proponent interest group's gains from the law may not outweigh losses to the rest of society.

Even legislators motivated to enhance social welfare are not perfect agents. First, legislators lack perfect knowledge and foresight about the effects of their laws. Second, even legislators with perfect knowledge and foresight may be unable to craft efficient regulation because a law may impose net costs on some people even if it has net benefits as applied to others. For example, spendthrift laws may make sense in rural areas where most contracting is between parties who know one another, and therefore know whether the other party is a spendthrift. On the other hand, these laws may be less suited to more

cient); Robert Cooter and Lewis Kornhauser, *Can Litigation Improve the Law Without the Help of Judges?*, 9 J Legal Stud 139, 140–41 (1980) (arguing that unguided evolution of law does not by itself maximize economic efficiency); William M. Landes and Richard A. Posner, *Adjudication as a Private Good*, 8 J Legal Stud 235, 280–84 (1979). Part III considers the specific question of the efficiency of common law choice-of-law rules.

<sup>19</sup> For a general discussion, see Robert D. Tollison, *Public Choice and Legislation*, 74 Va L Rev 339, 361–62 (1988) (describing legislators as rent creators for interest groups); Robert E. McCormick and Robert D. Tollison, *Politicians, Legislation, and the Economy* (Martinus Nijhoff 1981) (applying interest group theory to legislatures). See also Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J Legal Stud 101, 102–05 (1987) (arguing that legislators can extract rents from interest groups in return for forbearing from regulating).

<sup>20</sup> For a general discussion, see Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* 53–57 (Harvard 1971) (arguing that these features have made small groups historically effective).

<sup>21</sup> For discussion of the importance of free riding in interest group theory, see the sources cited in note 19.

densely populated communities because anonymity allows spendthrifts to take advantage of sellers who have no advance notice that they are dealing with a spendthrift.<sup>22</sup>

Our analysis depends on two plausible assumptions. First, some legislative outcomes are likely to be inefficient given legislator and interest group incentives. Second, it is often impossible to determine with certainty whether any *particular* law is Kaldor-Hicks efficient because the incidence of burdens and benefits depends on elasticities of supply and demand in particular markets.<sup>23</sup> As Jerry Mashaw has noted:

[A] close look at virtually any individual piece of legislation will generate both a plausible private-interest and a plausible public-interest explanation. Is occupational licensing a means of protecting consumers from fraud and incompetence, or a device for restricting competition and raising the earnings of licensees? Does Food and Drug Administration regulation of prescription pharmaceuticals protect the public from dangerous drugs? Or is it a hardy means for ensuring that only large producers will have the capacity to do drug development, thus limiting the supply and raising the prices of useful medications? Does Environmental Protection Agency regulation of sulfur dioxide in coal-fired electrical generating plants protect the public health? Or is it designed instead to curry favor with western real estate interests and protect the market for eastern high-sulfur coal?<sup>24</sup>

The difficulty of determining whether any particular law is efficient suggests preserving a role for individuals and firms to decide for themselves the laws that apply to them.

## 2. Courts.

Courts could combine statutory interpretation and choice of law to at least mitigate inefficiencies created by legislation. But since judicial lawmaking also involves agency costs, it is not clear that courts can

<sup>22</sup> This example is suggested by *Lilienthal v Kaufman*, 239 Or 1, 395 P2d 543 (1964), in which the court applied a law enacted in the relatively rural state of Oregon to a debtor who contracted in more urbanized California.

<sup>23</sup> See Erin O'Hara and Larry E. Ribstein, *Interest Groups, Contracts and Interest Analysis*, 48 Mercer L Rev 765, 766-67 & n 7 (1997) (commenting that inefficiency depends on unknown elasticities of supply and demand); Jonathan R. Macey, *Promoting Public-Regarding Legislation through Statutory Interpretation: An Interest Group Model*, 86 Colum L Rev 223, 228 n 28 (1986) (observing that the impossibility of making interpersonal comparisons of utility makes determining whether a legislatively imposed transfer of wealth is Kaldor-Hicks efficient difficult).

<sup>24</sup> Jerry L. Mashaw, *Greed, Chaos, and Governance: Using Public Choice to Improve Public Law* 37 (Yale 1997).

consistently check interest group deals.<sup>25</sup> State court judges have some incentive to respond to legislators' interests to the extent that the latter control judges' salary and tenure.<sup>26</sup> If so, judges might actually increase the durability and value of legislators' interest group deals by enforcing them within the state.<sup>27</sup>

Even when judges are unconstrained by legislative pressures they may not act in the public interest. State judges may be particularly responsive to lawyers' interests because they are usually nominated and recommended by bar associations, may seek work in the legal profession when they leave the bench, and are naturally attuned to lawyers' interests by training and association. Trial lawyers are politically active, and they seek to attract litigation to their states<sup>28</sup> whether or not the litigation produces efficient incentives. And, of course, in-state liti-

<sup>25</sup> See Erin A. O'Hara and William R. Dougau, *Redistribution Through Discriminatory Taxes: A Contractarian Explanation of the Role of the Courts*, 6 Geo Mason U L Rev 869, 914-16 (1998) (arguing that courts are institutions endogenous to our rent-seeking structure and therefore cannot be expected to play a major role in checking legislative bargains); Richard S. Murphy and Erin A. O'Hara, *Mistake of Federal Criminal Law: A Study of Coalitions and Costly Information*, 5 S Ct Econ Rev 217, 274-76 (1997) (discussing example of how court rulings on mistake of law can strengthen an interest group bargain made with the legislature, but conversely how these rulings may also ripen conditions for grass-roots change in the law).

<sup>26</sup> Few state judges have life tenure. See Edward Hartnett, *Why Is the Supreme Court of the United States Protecting State Judges from Popular Democracy?*, 75 Tex L Rev 907, 975 (1997) (Only three states grant de facto life tenure.); Erwin Chemerinsky, *Parity Reconsidered: Defining a Role for the Federal Judiciary*, 36 UCLA L Rev 233, 275-76 (1988) (judges in forty-six states subject to "some form of electoral review").

<sup>27</sup> See Gary M. Anderson, William F. Shughart II, and Robert D. Tollison, *On the Incentives of Judges to Enforce Legislative Wealth Transfers*, 32 J L & Econ 215, 217, 220-26 (1989) (arguing that legislative control of judicial salaries is used as a reward for upholding and preserving legislative output and offering empirical evidence to support this theory); W. Mark Crain and Robert D. Tollison, *The Executive Branch in the Interest-Group Theory of Government*, 8 J Legal Stud 555 (1979); W. Mark Crain and Robert D. Tollison, *Constitutional Change in an Interest Group Perspective*, 8 J Legal Stud 165 (1979); William M. Landes and Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J L & Econ 875, 877-88 (1975) (describing the "independent judiciary" as a guarantor of the stability of interest group deals).

<sup>28</sup> See, for example, Larry E. Ribstein and Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J Legal Stud 131, 144 (1996) (arguing that lawyers participating in drafting uniform laws may serve their institutional interests by creating complex and vague provisions); Ian Ayres, *Supply-Side Inefficiencies in Corporate Charter Competition: Lessons from Patents, Yachting and Bluebooks*, 43 U Kan L Rev 541, 558-59 (1995) (arguing that the Delaware bar has an incentive to lobby for seemingly innocuous statutory changes in order to extract rents from the initial wave of clarifying litigation); Jonathan R. Macey, *Judicial Preferences, Public Choice, and the Rules of Procedure*, 23 J Legal Stud 627, 628 (1994) (stating that the organized bar is unlikely to support procedural changes that serve to minimize the cost of litigation); Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 Geo Wash L Rev 984, 1023 (1993) (observing that support among lawyers for changes to the corporate governance code is affected by the nature of the lawyers' work due to the differential impact of increased litigation costs); Michelle J. White, *Legal Complexity and Lawyers' Benefit From Litigation*, 12 Intl Rev L & Econ 381, 381-82 (1992); Jonathan R. Macey and Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex L Rev 469, 505 (1987) (commenting that the Delaware bar "has some interest in reducing the clarity of Delaware law to enhance the amount of litigation").

gation opportunities can often be expanded with forum-biased choice of law.

Judges also may have personal biases that skew their decisions.<sup>29</sup> Although appellate courts and reputational considerations may discipline trial court judges,<sup>30</sup> this constraint is imperfect.<sup>31</sup> Because choice-of-law decisions often create very narrow precedents, lower-level judges are tempted to do justice in the individual case without sufficient attention to the effect on future cases.<sup>32</sup> And some decisions are effectively insulated from reversal on appeal.<sup>33</sup>

## B. Exit as a Potential Solution to Inefficient Laws

Bad laws can be eliminated in two ways. First, the political process can facilitate public participation and monitoring of their representatives. Unfortunately, this *voice* option has limited effect. Individuals must use scarce resources, including time, energy, and money, to gain information and be heard. Voters may have inadequate incentives to expend private resources in order to generate laws that have public benefits.

<sup>29</sup> For example, some judges may want to expand their power and prestige. See Richard A. Epstein, *The Independence of Judges: The Uses and Limitations of Public Choice Theory*, 1990 BYU L Rev 827, 831–38 (describing the importance of prestige, academic beliefs, and world view in the absence of robust institutional checks).

<sup>30</sup> See Erin O'Hara, *Social Constraint or Implicit Collusion?: Toward a Game Theoretic Analysis of Stare Decisis*, 24 Seton Hall L Rev 736, 746, 767–68 (1993) (discussing constraining effect of appellate court review on lower court judges).

<sup>31</sup> An important exception may be conflict-of-laws cases. This complicates the problem of implementing a move toward more efficient choice-of-law rules. See text accompanying notes 127–29.

<sup>32</sup> See Stewart E. Sterk, *The Marginal Relevance of Choice of Law Theory*, 142 U Pa L Rev 949, 993–96 (1994). Sterk notes that Charles D. Breitel, former Chief Judge of the New York Court of Appeals, commented “that judges first approached cases by asking themselves which party deserved to win. Only after ascertaining where justice lies in the individual case do judges move on the next question: What harm to the jurisprudence will result if I do justice in the individual case?” Id at 995.

<sup>33</sup> See, for example, Jonathan T. Molot, *How Changes in the Legal Profession Reflect Changes in Civil Procedure*, 84 Va L Rev 955, 1004 (1998) (observing that “a judge’s managerial decisions typically are insulated from appellate review, because they are interlocutory in nature, often are made off the record, and, in any event, typically are subject to a lenient ‘abuse of discretion’ standard of review”); Kevin Jon Heller, *Whatever Happened to Proof Beyond a Reasonable Doubt? Of Drug Conspiracies, Overt Acts, and United States v. Shabani*, 49 Stan L Rev 111, 135 (1996) (concluding that eliminating the overt act requirement in criminal conspiracy “effectively insulates unjust convictions from meaningful appellate review”); J. Clark Kelso, *A Report on the California Appellate System*, 45 Hastings L J 433, 471–73 (1994) (arguing that the “substantial evidence” standard of review insulates trial court findings); Rochelle Cooper Dreyfuss, *The Federal Circuit: A Case Study in Specialized Courts*, 64 NYU L Rev 1, 48–49 (1989) (concluding that indeterminacy of fact/law distinctions allows district courts to insulate their findings from appellate review in the context of patent law).

*Exit* can both complement and substitute for voice in the political process.<sup>34</sup> Since no political entity has infinite jurisdiction, people often can escape from laws they do not like by gravitating toward more appealing legal systems. As Charles Tiebout recognized, people can decide on their preferred levels of taxes and expenditures if they can effectively vote with their feet.<sup>35</sup> People become willing to take the exit route when their costs of exit are less than the costs they would incur by remaining in the jurisdiction.

Exit not only sorts people by preferences, but also in the long run can force lawmakers to consider the public interest in order to avoid losing clientele. Politicians may even actively compete for clientele if actors are mobile<sup>36</sup> and politicians are motivated to compete.<sup>37</sup> An important potential advantage of exit over voice as a disciplinary mechanism is that those who choose to move, and thereby indirectly exert discipline on lawmakers, capture the direct benefits of the move.

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<sup>34</sup> For a general discussion, see Albert O. Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard 1970).

<sup>35</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J Pol Econ 416, 418–21, 423–24 (1956) (arguing that consumer-voters can choose their preferred level of public goods by moving). See also the following essays in Lüder Gerken, ed, *Competition among Institutions* (MacMillan 1995): Bruno S. Frey and Reiner Eichenberger, *Competition among Jurisdictions: The Idea of FOCJ 209* (advocating a theoretical framework that would encourage competition among all levels of government in the European Union, thus enhancing social welfare); Lüder Gerken, *Institutional Competition: An Orientative Framework* 1 (proposing a system in which legislatures of different states compete with one another, leading to a more efficient supply of public goods and more limited government intervention); Wolfgang Kerber and Viktor Vanberg, *Competition among Institutions: Evolution within Constraints* 35, 42–48 (analogizing to market competition and observing that jurisdictions that “introduce new superior institutions or abolish old ones, which outlived their usefulness,” can obtain a competitive advantage that attracts capital and labor).

<sup>36</sup> For articles discussing the importance of mobility to jurisdictional competition, see Daniel R. Fischel, *From MITE to CTS: State Anti-Takeover Statutes, the Williams Act, the Commerce Clause, and Insider Trading*, 1987 S Ct Rev 47, 75; Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J L & Econ 23, 34–35 (1983); Tiebout, 64 J Pol Econ at 418–19 (cited in note 35).

<sup>37</sup> Some commentators are skeptical about politicians’ motivation to compete. See, for example, Douglas J. Cumming and Jeffrey G. MacIntosh, *The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law: A Second Look*, 20 Intl Rev L & Econ 141 (2000). Politicians may face little pressure from taxpayers, who cannot capture enough benefits from legislative action to justify expending resources on legislation. Legislators also may not be able to capture benefits from engaging in the competition because other jurisdictions easily can free ride on their efforts by copying successful legislation. See Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?*, 9 J Legal Stud 593, 594, 605–06 (1980). At the same time, legislators incur costs in competing to provide state law. On the other hand, state competition to supply law may be driven by lawyers rather than legislatures. See Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs*, 73 Wash U L Q 369, 392–94 (1995) (discussing lawyers’ competing interests in their push for limited liability company statutory provisions); Larry E. Ribstein, *Delaware, Lawyers, and Contractual Choice of Law*, 19 Del J Corp L 999, 1007–12 (1994) (arguing that “Delaware lawyers, in essence, are the Delaware legislature, at least insofar as corporate law is concerned” and also commenting on their influence on choice of law).

Exit thereby eliminates some of the free rider problem inherent in the voice option.

Exit's disciplinary power depends on its cost. Choice-of-law rules that emphasize domicile impose potentially higher exit costs because they require people and firms to physically move and to avoid dealing with people who live in protective jurisdictions. The cost of exit would be low, and the ability to avoid inefficient laws commensurately high, if people and firms could continue to reside in one state while electing to be governed by the laws of another. As the cost of exit falls to zero, the problem of inefficient law disappears.<sup>38</sup>

Jurisdictional competition was first observed with regard to corporations. In the United States, the law of a corporation's state of incorporation almost always governs its management and control arrangements.<sup>39</sup> Because the corporation can incorporate in any state regardless of whether the state bears any relationship to the corporation's assets or business, this internal affairs rule is, in effect, a type of contractual choice of law. Commentators have debated whether this process creates a "race to the bottom" in which the states attract incorporation business by exploiting principal-agent problems resulting from the separation of ownership and control<sup>40</sup> or a "race to the top" that is disciplined by efficient capital markets.<sup>41</sup> Evidence refutes the former proposition.<sup>42</sup> Even closely held limited liability companies that are not traded in efficient capital markets have been shown to move

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<sup>38</sup> This statement assumes that a law can be inefficient only to the extent that it prevents people from acting, although a restrictive law may be efficient to the extent that it protects against erroneous choices such as those attributable to cognitive biases and asymmetric information.

<sup>39</sup> See Restatement (Second) of Conflict of Laws § 302(2) (1971) (stating general rule). See also *CTS Corp v Dynamics Corp of America*, 481 US 69, 91 (1987) ("A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs."); Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 Cal L Rev 29, 32 (1987) (describing unanimous agreement among courts that the state of incorporation can regulate a company's internal affairs).

<sup>40</sup> See William Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L J 663, 705 (1974) (concluding that the "race to the bottom" creates a need for federal legislation).

<sup>41</sup> See Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J Legal Stud 251, 254-58 (1977) (criticizing Cary and arguing that Delaware corporate law is unlikely to result from a race to the bottom since this would hurt the firms' ability to raise capital).

<sup>42</sup> For empirical evidence favoring the race to the top hypothesis, see Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J L, Econ, & Org 225, 279-81 (1985) (concluding that both race to the bottom and race to the top explanations are too simple to explain the empirical data); Peter Dodd and Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation*, 53 J Bus L 259, 261, 275-82 (1980) (presenting evidence that a corporation's move to Delaware does not reduce shareholder returns).

toward efficient provisions,<sup>43</sup> and toward an efficient level of uniformity.<sup>44</sup> Because firms are, in effect, no more than complex contracts,<sup>45</sup> the same beneficial effects of contractual choice of law may be produced in other settings.

In sum, even if legislators lack knowledge, motivation, and foresight to supply efficient laws, evolutionary theories suggest that efficient laws may nevertheless emerge through competition.<sup>46</sup> Individuals and firms who have an incentive to minimize their transaction and information costs and an ability to choose legal regimes that accomplish this goal over time may cause the law to move toward efficiency, if only because inefficient regimes end up governing fewer and fewer people and transactions.<sup>47</sup>

### C. The Effect of Exit on Efficient Laws

Although exit can eliminate *inefficient* laws, it can also reduce the benefits of *efficient* regulation. For example, federal environmental regulation is typically justified by evidence that businesses threatened to leave regulating states, making unilateral state regulatory efforts infeasible. Consider also *Lilienthal v Kaufman*,<sup>48</sup> where an Oregon court invalidated a contract formed in California to protect an Oregon spendthrift at the expense of a California creditor. If a California court reaches the opposite result, then a creditor could circumvent Oregon's effort to protect its spendthrifts simply by filing future lawsuits in California courts.

In designing a system that reduces the effect of inefficient laws while preserving government's ability to regulate efficiently, courts could either (1) try to determine which laws are efficient, or (2) apply rules that let affected parties make the determination themselves. This

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<sup>43</sup> See Ribstein, 73 Wash U L Q at 412–30 (cited in note 37).

<sup>44</sup> See Bruce H. Kobayashi and Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence for the Evolution of the Limited Liability Company*, 34 Econ Inquiry 464, 470–77 (July 1996) (providing empirical evidence for the proposition that state statutes will evolve toward an efficient level without the imposition of uniform laws).

<sup>45</sup> For a general discussion, see Henry N. Butler and Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 Wash L Rev 1 (1990).

<sup>46</sup> See Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J Pol Econ 211, 213 (1950) (observing that a study of the impersonal “economic natural selection” of the market may be more fruitful than that of individual motivation and foresight).

<sup>47</sup> There is also evidence of such evolution with respect to the demand for statutory forms. See Ribstein, 73 Wash U L Q at 430–31 (cited in note 37) (observing evolution in the rapid development of laws governing limited liability companies); Ribstein, 19 Del J Corp L at 1016–18 (cited in note 37) (arguing that clients will gravitate toward better commercial law, thus mobilizing interest groups to urge their state to join the competition in order to preserve business). For evidence of efficiency regarding the demand for uniform statutory provisions, see Ribstein and Kobayashi, 25 J Legal Stud at 168–69 (cited in note 28) (claiming that, in general, uniform laws that have the greatest net social benefit are also those adopted by the greatest number of states).

<sup>48</sup> 239 Or 1, 395 P2d 543 (1964).

Article emphasizes the latter alternative. Although the parties sometimes may not make the right choice because of information asymmetries, judgment biases, third-party effects, or bargaining imbalance, judicially imposed restrictions on exit are not necessarily the answer. Courts should instead rely on legislators to specify when party choice should not be enforced. Choice-of-law doctrines that attempt to glean the public policies of the implicated states ultimately cause more harm than good. Even assuming that courts can assess the strengths and weaknesses of each state's public policies accurately and disinterestedly, public policy inquiries thwart certainty and predictability. Ad hoc, case-by-case policy inquiries end up eliminating the benefits of party choice because the parties are unable to determine in advance what law will regulate their conduct.

Embodying limits on party choice solely in statutes not only provides more predictability but also tends to promote more efficiency-enhancing interest group competition than do judicial limits on choice of law. As Gary Becker has pointed out, when the burdens of special interest legislation become high enough, the burdened may overcome coordination costs and organize in opposition to the law.<sup>49</sup> This naturally limits interest groups' ability to effect wealth transfers. The extent of this constraint depends on how well the political process promotes interest group competition. As discussed in more detail below,<sup>50</sup> a choice-of-law rule that forces the legislature to specify prohibitions on contractual choice of law increases the likelihood of opposition by the disadvantaged group. This, in turn, reduces the likelihood that the law will be contrary to the public interest.

In general, a choice-of-law perspective adds new dimensions to the debate over the relative advantages of government regulation and private ordering.<sup>51</sup> The debaters typically focus on whether contracting parties should be permitted to waive statutory protections. We call attention to an alternative: the potential for opt out through choice of law in analyzing the nature and efficiency of regulation. The normative question is whether the parties should be able to opt out of a "mandatory" statute by choosing to be governed by an alternative regime. Contractual choice of law differs significantly from direct waiver.<sup>52</sup> Among other things, the parties' ability to evade laws is limited in the choice-of-law context to the choice of another state's laws. In addition, interest groups and legislators internalize at least some of

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<sup>49</sup> See Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q J Econ 371, 372-73, 381-88 (1983).

<sup>50</sup> See Part IV.A.2.

<sup>51</sup> For a general discussion, see Kobayashi and Ribstein, *Contract and Jurisdictional Competition* at 325 (cited in note 12).

<sup>52</sup> See Part IV.A.

the effects of their states' laws since the laws affect politically active parties located within the state, giving legislators an incentive not to deregulate inefficiently merely to attract out-of-state transactions. Contractual choice might therefore represent a reasonable compromise between oppressive laws and complete freedom from regulation.

In sum, choice-of-law rules should be designed with a view to how these rules affect the efficiency of substantive laws. To maximize efficiency, choice-of-law rules should, in general, facilitate individual choice. This involves enforcing choice-of-law clauses unless the legislature explicitly prohibits enforcement.<sup>53</sup> After discussing other approaches in Part II and contrasting those with ours, the rest of the Article develops our general principles in more detail.

## II. PROBLEMS WITH EXISTING THEORIES

This Part places our proposal in context by describing modes of conflict-of-laws analysis that have, until now, dominated judicial and academic thinking in the United States. This Part also explains how the efficiency criterion discussed above may lead to results that differ from those under current conflict-of-laws theories. Part II.A considers the vested rights approach reflected in the Restatement (First), which focuses solely on where a given event critical to the cause of action occurred. This approach seems irrelevant to the question of which governing law seems most efficient for the parties. Part II.B discusses interest analysis, which may produce results precisely contrary to the goals of an efficiency analysis because interest analysis bolsters the very legislative power that exit rules should seek to constrain. Indeed, for all of its arbitrariness, the vested rights theory comes closer to satisfying an efficiency criterion because its rule-based approach to choice of law perhaps unwittingly enables more *individual*, as opposed to *government*, choice. Part II.C discusses choice-of-law proposals that focus on the merits of the competing substantive laws. Part II.D describes Richard Posner's "comparative regulatory advantage" insights. Part II.E discusses proposals that attempt to include the factors that judges actually consider in making their choice-of-law decisions. Finally, Part II.F summarizes the differences between our proposal and predominant alternatives.

### A. Vested Rights

Early conflicts decisions in the United States focused on territoriality. Laws represented the exercise of state powers, and choice of law was viewed as the mechanism by which state powers were allo-

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<sup>53</sup> See Part III.E (discussing which statutes should be applied).

cated across competing states. Under territorial principles, each jurisdiction has authority to regulate people and events within its borders, while no jurisdiction possesses the power to control people and events outside of its borders.<sup>54</sup> Territoriality alone was insufficient to determine the applicable law when a dispute involved people, acts, and events spanning multiple jurisdictions. Some secondary principle was necessary to choose the governing jurisdiction among the territorial possibilities.

To resolve the dilemma, Joseph Beale, the Reporter of the Restatement (First), advanced the “vested rights” theory.<sup>55</sup> This approach is premised on the idea that substantive legal rights vest in a particular state and only that state can determine the extent of the rights created. Under the Restatement (First), rights arise according to the law of the place of the last act or event necessary to create a cause of action. For example, the law is generally supplied by the place of injury for tort rights,<sup>56</sup> the place of contract formation for contract validity,<sup>57</sup> and by the situs of real property for property rights.<sup>58</sup>

The fundamental problem with vested rights theory is that it gives no a priori reason why states’ powers should depend on a “vesting” location. There is no theoretical reason why the place of occurrence of one necessary element of a cause of action, such as contract formation, should be more important than the place of occurrence of any other element, such as contract breach. Without a guiding principle, there is no reliable way to tell where a given right might be said to have vested when the Restatement (First) or precedent is ambiguous or silent. Thus, as pointed out by Walter Wheeler Cook,<sup>59</sup> in reality, courts made choice-of-law decisions under their own conflicts law.<sup>60</sup> In other words, rather than relying on some fundamental principle, “a court never enforces foreign rights but only rights created by its own law,”<sup>61</sup> and its decisions are “guided by considerations of social and economic policy or ethics.”<sup>62</sup> These “considerations” hid in the misty

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<sup>54</sup> Joseph H. Beale, 1 *A Treatise on the Conflict of Laws* §§ 2.1, 5.2 (Baker, Voorhis 1935).

<sup>55</sup> For a summary of the vested rights theory, see Lea Brilmayer, *Conflict of Laws* 20–25 (Little, Brown 2d ed 1995). The vested rights approach was also advocated in England. See A.V. Dicey, *A Digest of the Law of England with Reference to the Conflict of Laws* xliii (Stevens & Sons 1896) (“General Principle No. 1—Any right which has been duly acquired under the law of any civilized country is recognized and, in general, enforced by English courts, and no right which has not been duly acquired is enforced, or, in general, recognized by English courts.”).

<sup>56</sup> Restatement (First) of Conflict of Laws § 378 (1934).

<sup>57</sup> *Id.* at § 332.

<sup>58</sup> *Id.* at §§ 211, 214, 216–23.

<sup>59</sup> Walter Wheeler Cook, *The Logical and Legal Bases of the Conflict of Laws*, 33 *Yale L J* 457 (1924).

<sup>60</sup> *Id.* at 462–63, 466–67.

<sup>61</sup> *Id.* at 475.

<sup>62</sup> *Id.* at 487.

fog of vested rights analysis, creating an opportunity both for confusion and for manipulation by judges.

While the criticisms of the Restatement (First) were largely valid, the critics nevertheless tended to commit the nirvana fallacy.<sup>63</sup> Because most legal solutions have both strengths and weaknesses, pointing out a fault in one solution or approach does not alone justify its substitution by another. Vested rights theory does have the important advantage from an efficiency perspective of enabling individual choice. The law selected usually depends fundamentally on where an individual acted rather than on the goals assumed to underlie competing state regulations as under government interest analysis. Moreover, the rules often generate results that are predictable as of the time when the parties engage in relevant conduct such as the making of the contract, acquiring an interest in property, or committing a tortious act. Even if people did not think about the rules in advance, they would normally expect the law to be that of the place where the relevant conduct occurs,<sup>64</sup> and therefore would be able to adapt their conduct to that law.

But the Restatement (First) is not entirely conducive to party autonomy, in part because it focuses on allocating sovereign powers. Significantly, the Restatement (First) has no provision enabling contracting parties to choose their governing law by contract, which Beale condemned as impermissible private legislation.<sup>65</sup> Moreover, the Restatement (First) rules have several “escape devices” courts can manipulate, thereby nullifying the parties’ ex ante choice. For example, courts applying these rules can ignore the law indicated in the rules if application of that state’s law would violate a strong public policy of the forum.<sup>66</sup> Unfortunately, the public policy exception has not been uniformly applied. Considerable uncertainty results when one court rejects an appeal to public policy and applies the racist laws of Nazi Germany to a contract dispute,<sup>67</sup> while another uses the public policy exception to avoid applying a foreign state guest statute.<sup>68</sup>

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<sup>63</sup> For early identifications of the “nirvana” problem, see Coase, 3 J L & Econ at 43 (cited in note 17) (warning that analysis of “ideal world” scenarios may be largely irrelevant); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J L & Econ 1, 1-4 (1969) (noting inferior policy proposals that result from nirvana reasoning).

<sup>64</sup> See Solimine, 24 Ga L Rev at 61 (cited in note 2) (noting that commentators on conflicts of law “observe that courts, and persons in general, tend to think in terms of territory”).

<sup>65</sup> See Joseph H. Beale, 2 *A Treatise on the Conflict of Laws* § 332.2 at 1079 (Baker, Voorhis 1935).

<sup>66</sup> See Restatement (First) of Conflict of Laws § 612.

<sup>67</sup> *Holzer v Deutsche Reichsbahn-Gesellschaft*, 277 NY 474, 14 NE2d 798 (1938). The New York Court of Appeals recognized a German legal defense to wrongful discharge based on the racial inferiority of Jews and refused to invoke a public policy exception. Id at 800.

<sup>68</sup> *Paul v National Life*, 352 SE2d 550 (W Va 1986). The foreign guest statute allowed auto passengers to recover from their host drivers only in cases where the driver was “guilty of willful and wanton misconduct.” Id at 550.

Perhaps the strongest impediment to predictability under the Restatement (First) is the problem of characterization.<sup>69</sup> Because application of Restatement (First) rules depends on the particular substantive area involved, if a future dispute could be characterized as involving issues in more than one legal area, parties were unable to determine *ex ante* the law that would ultimately be applied to that dispute. For example, suppose that an employer in Texas hires a Louisiana resident to work in Florida under a contract signed in Texas providing that the employee is subject to termination at the will of the employer. Suppose further that Texas law upholds this employment-at-will relationship, while at-will employment relationships violate Florida law, which gives a tort cause of action for wrongful discharge regardless of the contract terms. If the employer fires the employee working in Florida, should a Texas court apply Texas law, on the theory that the dispute arises out of a contractual relationship entered into in Texas, or Florida law on the theory that the action arises out of tortious conduct that occurred in Florida? Characterization issues routinely arise regarding common types of disputes such as contracts involving the transfer of property.<sup>70</sup> They also arise when a specific issue can be viewed as one of either substance or of procedure, since the forum law normally controls the latter but possibly not the former. Courts distinguish rules creating rights as substantive and rules describing how to obtain a remedy as procedural.<sup>71</sup> But the distinction breaks down in practice because the “right” has no value in litigation without the remedy and vice versa.

In short, although vested rights analysis enabled a measure of party autonomy, its lack of theoretical grounding, including anything resembling an efficiency analysis, its hostility to choice-of-law clauses, and its inherent ambiguity, make it unsatisfactory as an efficiency-based test.

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<sup>69</sup> See Lea Brilmayer, *Conflict of Laws: Cases and Materials* 124–25 (Aspen 4th ed 1995) (describing fact characterization as an “escape device” that is made worse by rigidity of the Restatement (First) approach).

<sup>70</sup> See, for example, *Burr v Beckler*, 264 Ill 230, 106 NE 206, 209 (1914) (holding that although the conveyed property was located in the forum state, law of place of mailing of note applied to defeat the capacity of a married woman to contract).

<sup>71</sup> See, for example, *Levy v Steiger*, 233 Mass 600, 124 NE 477, 477 (1919) (“It is elementary that the law of the place where the injury was received determines whether a right of action exists, and that the law of the place where the action was brought regulates the remedy and its incidents, such as pleading, evidence, and practice.”). See also *Grant v McAuliffe*, 41 Cal 2d 859, 264 P2d 944, 948–49 (1953) (concluding that matter of survival of a cause of action following wrongful death is a matter of procedure, governed by the law of the forum state).

## B. Interest Analysis

Most modern choice-of-law scholars join Cook in denouncing vested rights analysis as an arbitrary set of rules based on unsound theory.<sup>72</sup> Thus, courts and scholars have sought to set choice of law on a firmer footing. Most scholars now advocate, and courts now apply, some version of government interest analysis, which looks to the states' legislative interests in determining the applicable law. Part II.B.1 discusses the most famous version of this theory, as put forth by Brainerd Currie. Parts II.B.2 and II.B.3 discuss two refinements of interest analysis by William Baxter and Larry Kramer. All of these theories have in common an emphasis on the *government's* rather than the *individual's* interests.

### 1. Currie's interest analysis.

The single most prominent alternative to vested rights is Brainerd Currie's government interest analysis, which posits that choice-of-law decisions should effectuate government interests.<sup>73</sup> Currie believed that these interests, and therefore the applicable law, turn on whether the legislatures of involved states intended their laws to apply to a particular set of multistate facts.<sup>74</sup> Currie criticized territorial rules on the ground that they often operated to further the legislative policy of no interested state.<sup>75</sup> For example, if an Oregon spendthrift contracts with an Oregon creditor in California and Oregon enables the spendthrift to void the contract but California would enforce it, Currie could see Oregon's interest in protecting an Oregon spendthrift but not California's interest in protecting an Oregon creditor. Nevertheless, the place-of-contracting rule under the Restatement (First) leads to the application of California law. Currie cited other common-domicile examples to criticize, among other things, (1) the situs rule for distributing real property to out-of-state heirs;<sup>76</sup> (2) the place-of-the-accident

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<sup>72</sup> See Brilmayer, *Conflict of Laws* at 25–31 (cited in note 55) (summarizing academic attacks on the vested rights approach).

<sup>73</sup> See *id.* at 50–53 (describing Currie's methodology and highlighting the focus on governmental interests).

<sup>74</sup> *Id.* at 53.

<sup>75</sup> See Brainerd Currie, *Married Women's Contracts: A Study in Conflict-of-Laws Method*, 25 U Chi L Rev 227 (1958), reprinted in Brainerd Currie, *Selected Essays on the Conflict of Laws* ch 2 (Duke 1963) (discussing place-of-contract rule); Brainerd Currie, *Survival of Actions: Adjudication Versus Automation in the Conflict of Laws*, 10 Stan L Rev 205 (1958), reprinted in Currie, *Selected Essays* at ch 3 (discussing place-of-accident rule).

<sup>76</sup> Brainerd Currie, *Conflict, Crisis and Confusion in New York*, 1963 Duke L J 1, reprinted in Currie, *Selected Essays* at ch 14, 720 (cited in note 75).

rule to determine tort immunity;<sup>77</sup> and (3) the place-of-contract rule to determine an out-of-state married woman's capacity to contract.<sup>78</sup>

Currie's fundamental reliance on government interest is suspect in light of the analysis in Part I. Interest analysis appears to emphasize the political process or the interplay of interest groups over individuals' ability to choose the law that best suits their conduct. The precise nature of this emphasis depends on how courts determine government interests and legislative intent. It is infeasible to determine *the* legislative intent underlying the statute because legislators bring a variety of interests, motivations, and intentions to the lawmaking table.<sup>79</sup> Some may be voting for private interests,<sup>80</sup> others may be concerned with the public interest, and still others may not favor the statute but are log-rolling for a favorable vote on other legislation, perhaps even hoping that the executive will veto or a court will strike down the statute. The statute may be deliberately silent or ambiguous because its drafters sought to reconcile these diverse interests.

Currie's inquiry compounds these difficulties by searching for legislative intent about the territorial scope of the law. Since legislators rarely contemplate this issue, courts must resort to an exploration of constructive intent: What would the legislature have preferred if it had thought about the problem? Unfortunately, however, constructive intent proves no more fruitful than actual intent because it is not clear what principles should guide the construction.<sup>81</sup> One could plausibly

<sup>77</sup> Id at 719–21.

<sup>78</sup> Currie, *Married Women's Contracts* at 119 (cited in note 75) (arguing that a court should apply its own law to these contract disputes so it can "be sure at least that it is consistently advancing the policy of its own State").

<sup>79</sup> As noted by Frank H. Easterbrook:

Intent is empty. Peer inside the heads of legislators and you find a hodgepodge. Some strive to serve the public interest, but they disagree about where that lies. Some strive for reelection, catering to interest groups and contributors. Most do a little of each. And inside some heads you would find only fantasies challenging the disciples of Sigmund Freud. Intent is elusive for a natural person, fictive for a collective body. The different strands produce quite a playground—they give the judge discretion, but no "meaning" that can be imputed to the legislature.

Frank H. Easterbrook, *Text, History and Structure in Statutory Interpretation*, 17 Harv J L & Pub Pol 61, 68 (1994). In particular, assuming that a statute reflects some majority consensus is inconsistent with Arrow's theorem. See Kenneth J. Arrow, *Social Choice and Individual Values* (Yale 2d ed 1963). Arrow's Theorem holds, in very simple terms, that a collective decisionmaking body cannot be simultaneously collectively rational in the sense that the outcomes are what everybody wants rather than determined to some extent by the order of decisionmaking, and also decided according to fair collective decisionmaking processes. For a general discussion, see Maxwell L. Stearns, *Constitutional Process: A Social Choice Analysis of Supreme Court Decision Making* ch 2 (Michigan 2000).

<sup>80</sup> See *Kaczmarek v Allied Chemical Corp*, 836 F2d 1055, 1058 (7th Cir 1988) (noting that interest analysis requires treating "as the purposive act of a dedicated public-welfare maximizer what may actually be the result of an unprincipled political compromise").

<sup>81</sup> See Lea Brilmayer, *Interest Analysis and the Myth of Legislative Intent*, 78 Mich L Rev

argue that reference to the Restatement (First) rules is most appropriate since these rules prevailed when much legislation was enacted and are the basis of much actual legislation on choice of law.<sup>82</sup> Alternatively, legislators might want courts to defer to other states' legislatures in order to foster reciprocal relationships that can maximize the forum state's long-run interests.<sup>83</sup> In short, a constructive intent analysis lends itself to whatever approach the construing court might wish to use to resolve conflicts.

The real problems of Currie's approach from an efficiency standpoint begin with Currie's determinations about what policies *should* matter for purposes of determining constructive intent. Currie assumes that governments have parochial interests in protecting their own domiciliaries that conflicts law should effectuate.<sup>84</sup> This discriminatory application of state law could exacerbate the problem of inefficient legislation discussed above<sup>85</sup> because parochial interests can produce laws that tend to benefit locals while imposing costs on residents of other states. Nonresidents suffer from inherent lobbying disadvantages<sup>86</sup> because outsiders cannot vote for state legislators who support their interests. Moreover, outsiders may find it harder to coordinate if they are geographically dispersed and may have to spread lobbying resources across many states while local firms and individuals can concentrate on local legislation. A choice-of-law rule that emphasizes the interests of residents over those of non-residents would increase the effect of resident-favoring laws. An example is product liability

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392, 430 (1980) (arguing that the paucity of any hard evidence of legislative intent in conflict-of-laws cases means that any analysis necessarily "reflects the value preferences of the theoretician").

<sup>82</sup> See *id.* at 428.

<sup>83</sup> See note 114 and accompanying text.

<sup>84</sup> See Brilmayer, 78 Mich L Rev at 408 (cited in note 81) (noting that "[a] second objection to the interest analysts' methodology is its parochialism, for interest analysis assumes that protective and compensatory policies are intended to benefit residents alone").

<sup>85</sup> See Part I.A. The domiciliary-favoring approach does have some advantages from the standpoint of our analysis. In particular, Bruce Hay argues that interest analysis may reduce manufacturers' liability compared with the Restatement (First) because courts' recognition of states' protective interests in determining the applicable law increases the benefits states can offer to local manufacturers, and thereby enhances state competition to attract manufacturers. See Hay, 80 Georgetown L J at 627-32 (cited in note 2). However, while interest analysis may beat the territorial place-of-injury rule, as discussed in Part IV.D.1, the point-of-sale rule is preferable to both interest analysis and the Restatement (First) in increasing the efficiency of state product liability law.

<sup>86</sup> This is a central consideration under a political rights-based theory. See Lea Brilmayer, *Rights, Fairness, and Choice of Law*, 98 Yale L J 1277 (1989). For a similar argument, see Michael W. McConnell, *A Choice-of-Law Approach to Products-Liability Reform*, in Walter Olson, ed., *New Directions In Liability Law* 90 (Academy of Political Science 1988) (positing that the "right" substantive role for product liability law conflicts would be the rule that the state would choose if all production and consumption took place within its own borders).

laws that benefit local plaintiffs' lawyers at the expense of remote manufacturers.

Interest analysis further exacerbates this inefficiency by permitting plaintiffs to choose the law unilaterally and after they know how the law will affect each party's wealth. Specifically, the plaintiff chooses the law by choosing the forum. Currie's approach directs the forum to apply its own law except in the relatively rare situation when the foreign jurisdiction has an interest in applying its law *and* the forum is disinterested in the outcome of the dispute.<sup>87</sup> The plaintiff can choose a forum from among all of those with which the defendant has had enough contact to create a predicate for jurisdiction.<sup>88</sup> These contacts may be so insubstantial that a defendant who does not wish to be subject to a state's laws cannot easily structure its affairs to avoid application of the law.

## 2. Baxter: comparative impairment.

Some scholars sympathetic to Currie's basic approach have proposed modifications of interest analysis to alleviate some of its weaknesses. Part II.B.2 considers Baxter's comparative impairment theory, while the next Part discusses attempts, particularly by Larry Kramer, to more realistically ascertain legislative intent. These more recent versions of interest analysis share the central problem of Currie's original proposal in that they facilitate rather than discourage the application of inefficient laws.

Soon after Currie published his series of essays on choice of law, William Baxter published an article building on Currie's interest analysis.<sup>89</sup> While Baxter thought that Currie properly focused on governmental interests, he disagreed with Currie's proposed resolution of cases that presented a "true conflict" between the interests of the forum and of another state.<sup>90</sup> Currie had proposed the application of fo-

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<sup>87</sup> Under Currie's approach, the forum should apply its own law whenever it has an interest in the dispute, regardless of the presence of competing states' interests, or if no state has an interest. Combining this approach with the bias in favor of residents means in practical effect that forum law applies unless the parties share a domicile elsewhere. See Brilmayer, 98 Yale L J at 1315-17 (cited in note 86).

<sup>88</sup> Interest analysis has been attacked on the ground that it allows choice of the applicable law based simply on a state's power to exercise jurisdiction rather than resolving conflicts among potentially applicable laws. See Kermit Roosevelt III, *The Myth of Choice of Law: Rethinking Conflicts*, 97 Mich L Rev 2448, 2450-54 (1999) (arguing that "choice of law" among states with claims to jurisdiction masks the fundamental conflicts that should be more explicitly addressed). Currie defended his approach against charges that it encourages forum shopping in part by pointing out that plaintiff opportunism is limited by the need to find the defendant in a particular place. See Currie, *Survival of Actions* at 168-69 (cited in note 75). But this is not a significant constraint today given the increasingly national and international scope of our activities.

<sup>89</sup> See Baxter, 16 Stan L Rev at 1 (cited in note 3).

<sup>90</sup> *Id* at 8-9.

rum law to true conflicts in order to prevent the judges from acting as independent policymakers, a task for which Currie thought courts were unsuited. Baxter offered a “comparative impairment” approach that would enable courts to resolve true conflicts without requiring them to make policy. Under this approach, all choice-of-law problems would be resolved by reference to a hypothetical bargain among the states. Baxter’s intuition was that states would be willing to cede authority over cases in which they were relatively less interested in return for gaining authority over those cases in which they were relatively more interested.<sup>91</sup> Thus, courts should apply the law of the state that would suffer the greatest “comparative impairment” if its law were not applied.<sup>92</sup>

Comparative impairment arguably represents the approach most consistent with economic theory because it attempts to maximize the affected states’ joint utility.<sup>93</sup> However, a significant problem with Baxter’s approach from the standpoint of efficiency analysis is that comparative impairment focuses on maximizing *governments’* rather than *individuals’* interests. As we have noted, lawmakers may not be the public’s faithful agents.<sup>94</sup> Thus, governments’ interests need not coincide with social welfare. Baxter defended his rejection of individual interests by characterizing them as a zero-sum game since each party would want to apply the law that favors that party.<sup>95</sup> But this assumes that the parties choose the law *ex post*, after winners and losers have

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<sup>91</sup> See *id.* at 10.

<sup>92</sup> See *id.* at 18 (stating that “[t]he principle is to subordinate, in the particular case, the external objective of the state whose internal objective will be least impaired in general scope and impact by subordination in cases like the one at hand”).

<sup>93</sup> Compare Posner, *Economic Analysis of Law* at 645–46 (cited in note 2) (arguing that joint welfare is maximized by relying on the law of the state with the best “fit” to the circumstances of the dispute).

<sup>94</sup> See Part I.A. Baxter himself, no stranger to public choice, recognized that the states could not be trusted to perform objectively a comparative impairment analysis. See Baxter, 16 *Stan L Rev* at 23 (cited in note 3). An essential, but largely ignored, component of his proposal was the overruling of *Klaxon v Stentor Electric Manufacturing Co.*, 313 US 487 (1941) (holding that a federal district court judge sitting in diversity must apply the choice-of-law rules of the state in which it is located), to enable the federal courts, sitting in diversity, to develop a common law incorporating comparative impairment. Baxter, 16 *Stan L Rev* at 41–42 (cited in note 3). Baxter assumed that federal courts would analyze the choice more objectively. But, since the federal courts would be applying the “government interests” of state legislatures, even an objective determination of those interests does not solve these public choice problems. *Id.*

<sup>95</sup> Baxter pointed out that “[e]very choice-of-law case involves several parties, each of whom would prevail if the internal law of one rather than another state were applied. Each party is ‘right,’ ‘worthy,’ and ‘deserving’ and ‘ought in all fairness’ to prevail under one of the competing bodies of law and in the view of one of the competing groups of lawmakers.” Baxter, 16 *Stan L Rev* at 5 (cited in note 3). The court could choose among these competing laws only by superimposing its own “super-value judgment” onto the merits of the case. *Id.* Posner, *Economic Analysis of Law* at 645–46 (cited in note 2), similarly characterizes the problem, claiming that when “[b]oth states have an interest in the outcome of the suit. . . . [t]hese benefits are offsetting and can be ignored.”

been identified, and ignores the possibility of designing rules to emphasize ex ante choice of law.

Baxter's theory may lead to inefficient results for the additional reason that the parties cannot easily choose the law by altering their conduct because they cannot easily predict the results courts will reach under this approach.<sup>96</sup> *Bernhard v Harrah's Club*,<sup>97</sup> a California case applying comparative impairment, illustrates the difficulties. A patron was served alcohol at a Nevada tavern and casino and then drove to California where he collided with a motorcycle driven by the plaintiff. California law provided for tavern keeper liability for damages caused by intoxicated patrons if the tavern keeper continued to serve the patron after he became visibly intoxicated, while Nevada law insulated tavern keepers from civil liability. Although the court applied California law, it is not clear why comparative impairment justifies this result. To begin with, the impairment of state policies depends partly on the frequency of interstate contacts. If this were the only case of a California patron served in a Nevada tavern and thereafter causing injury on California highways, then it would matter little to the states' policies which law were applied. But if all drunk drivers who injure California residents were served alcohol in a Nevada tavern, or if all accidents caused by intoxicated patrons of Nevada taverns occurred in California, each state's policy would be thwarted by application of the other state's law. The determination is complicated by the fact that the reality probably lies at some indeterminate point between these extremes, and by the fact that, regardless of the frequency of accidents, the states' policies are likely to be impaired to similar degrees. Moreover, in order to weigh state policies, courts must determine how changes in legal rules might affect the relevant conduct, such as alcohol sales and DUI accidents, and compare effectively the impairment of the alternative regulatory goals of deterrence and distribution.<sup>98</sup>

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<sup>96</sup> The following argument in the text is drawn from William H. Allen and Erin A. O'Hara, *Second Generation Law and Economics of Conflict of Laws: Baxter's Comparative Impairment and Beyond*, 51 Stan L Rev 1011, 1014, 1031-33 (1999) (describing the ex ante uncertainty created by comparative impairment).

<sup>97</sup> 16 Cal 3d 313, 546 P2d 719 (1976). The California legislature subsequently overruled *Bernhard* by statute. See *Cory v Shierloh*, 29 Cal 3d 430, 629 P2d 8, 10 (1981).

<sup>98</sup> See Kramer, 90 Colum L Rev at 317 (cited in note 2) ("The problem is that Baxter is comparing apples and oranges—a regulatory policy of deterrence is qualitatively different from a distributive policy for allocating losses. There is no metric for making a comparison."). As to tort law's distribution and deterrence goals, see William L. Prosser, *Handbook of the Law of Torts* § 5 at 22-23 (West 4th ed 1971).

### 3. Kramer's expanded approach to legislative intent.

Larry Kramer modifies Currie's approach by proposing a more sophisticated look at legislative intent.<sup>99</sup> Courts should ascertain the domestic substantive purposes behind each state's law, using methods of interpretation similar to those used in resolving purely domestic conflicts between two potentially applicable laws within a single state.<sup>100</sup> Courts also should ascertain a state legislature's intent regarding extraterritorial application of its law by taking into account the state's choice-of-law rules, which reflect its policy regarding multi-state disputes.<sup>101</sup>

Kramer effectuates his system through five multi-state canons of construction: (1) "If there is a conflict between two states' laws, and failure to apply one of the laws would render it practically ineffective, that law should be applied."<sup>102</sup> (2) "In a conflict between a substantive policy and a procedural policy, the law reflecting the substantive policy should prevail unless the forum's procedural interest is so strong that the forum should dismiss on grounds of *forum non conveniens*."<sup>103</sup> (3) "[T]rue conflicts should be resolved by applying the law chosen by the parties, or, if no express choice is made, by applying whichever law validates the contract."<sup>104</sup> (4) "Where one of two conflicting laws is obsolete (i.e., inconsistent with prevailing legal and social norms in the state that enacted it), the other law should be applied."<sup>105</sup> (5) "Where two laws conflict, but the parties actually and reasonably relied on one of them, that law should be applied."<sup>106</sup>

These canons improve on Currie's approach from an efficiency standpoint by emphasizing private ordering while de-emphasizing forum law.<sup>107</sup> Moreover, Kramer's third, or contractual, canon is clearly

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<sup>99</sup> See Kramer, 90 Colum L Rev at 319-43 (cited in note 2) (describing a set of canons for statutory interpretation designed to capture legislative intent).

<sup>100</sup> The analogy between domestic and interstate conflicts makes sense and suggests a possible extension of our analysis. Parties may, in effect, avoid regulation by submitting to an alternative, less stringent, regime in the same jurisdiction. They may be able to do so, for example, by altering their transaction form. See Theodor Baums, *Corporate Contracting Around Defective Regulations: The Daimler-Chrysler Case*, 155 J Institutional & Theoretical Econ 119, 121-26 (1999) (explaining how the Daimler-Chrysler merger assumed an unusual form in order to effect the merger under German law).

<sup>101</sup> See Larry Kramer, *Return of the Renvoi*, 66 NYU L Rev 979, 1011 (1991) ("A state's approach to choice of law by *definition* establishes the state's rules of interpretation for questions of territorial scope."); Kramer, 90 Colum L Rev at 300-03 (cited in note 2). Like Baxter, Kramer proposed resolving true conflicts by reference to a hypothetical bargain among the states. 90 Colum L Rev at 315-16.

<sup>102</sup> Id at 323.

<sup>103</sup> Id at 324.

<sup>104</sup> Id at 329.

<sup>105</sup> Id at 334.

<sup>106</sup> Id at 336.

<sup>107</sup> Kramer's approach has been criticized for this attribute. See Louise Weinberg, *Against*

consistent with our approach.<sup>108</sup> Kramer asserts that most states have a general policy in favor of contractual freedom, as indicated by the growing acceptance of party autonomy.<sup>109</sup> Thus, unless the more restrictive state expresses a contrary intent, it presumably will defer to another state's policy favoring freedom of contract in order to advance the regulating state's more fundamental policy favoring freedom of contract.<sup>110</sup> The regulating state would not be overly concerned about evasion because the parties must choose some state's laws and must establish contacts with the state whose law they prefer.<sup>111</sup>

The central problem with Kramer's theory is that interest analysis remains at its core. Kramer's attempt to determine legislative intent more realistically than Currie may actually lead courts away from efficiency. Legislators might have incentives to restrict exit from inefficient laws in order to maximize the value of an interest group bargain. Accordingly, in the absence of explicit legislative direction, efficiency may demand a presumption against interstate application of state regulation rather than an automatic search for lawmakers' preferences. Moreover, Kramer's contractual canon rests uneasily with his emphasis on legislative intent. Indeed, Kramer suggests subordinating the contractual canon if it conflicts seriously with the first, or comparative impairment, canon. Yet, as discussed above in Part II.B.2, comparative impairment emphasizes the effectuation of legislative policy, which may reflect the defects of the underlying political process. In contrast to Kramer, we argue that this tension is best resolved by subordinating party choice only to an explicit statutory statement invalidating this choice.<sup>112</sup> Our proposal increases the effect

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*Comity*, 80 *Georgetown L J* 53, 54–55 (1991) (arguing that when the forum allows departures from its own law, it “is discriminatory and substantively damaging to the rule of law”).

<sup>108</sup> However, as explained more fully below in Part III.D, Kramer's rule of validation may be inconsistent with our principles favoring “bundling.” These principles are based to some extent on party autonomy. Parties that expressly choose a particular state's law may not want enforcement of provisions invalidated by that state. Bundling also has other advantages in this context. If the contract is upheld by validating state law but otherwise subject to the law of the state chosen, the outcome might not be in accord with the regulatory policies of either of the relevant states. By “unbundling” the states' contract laws, the rule of validation encourages parties to attempt to thwart government restrictions.

<sup>109</sup> See Kramer, 90 *Colum L Rev* at 330–31 (cited in note 2) (“Even the Restatement (Second)—which mimics its predecessor in other areas—advocates letting the parties choose the applicable law in contract cases. More importantly, so does the Uniform Commercial Code.”).

<sup>110</sup> See *id.* at 330 (“[W]hile all states have laws restricting or limiting parties' power to make contracts, these laws are exceptions to a more general, pervasive policy favoring freedom of contract. Under this canon, then, each state is ‘compensated’ for subordinating its restrictive policies by the advancement of its more fundamental policy of freedom of contract when that policy conflicts with the restrictive laws of other states.”).

<sup>111</sup> *Id.* at 333–34 (noting that the transaction costs needed to create a “true conflict” through a connection to two states mitigate the potential for evasion).

<sup>112</sup> Because canons of construction often are inconsistent with one another, our emphasis on predictability indicates that courts should rely only on explicit statutory statements rather

of beneficial laws (that is, maximizes *B-B*) while minimizing both the enactment and the effect of harmful laws (that is, minimizes *C-C*).

Kramer's theory also emphasizes state reciprocity. Kramer criticized Currie for ignoring the possibility that states might want to defer to other states' interests in order to foster comity<sup>113</sup> and reciprocity,<sup>114</sup> prevent forum shopping,<sup>115</sup> and promote efficient litigation behavior. He views conflict of laws as an iterative prisoner's dilemma game in which each state has a strong incentive to cooperate because the long term gains from cooperation exceed the short term benefits to defecting by applying forum law. This analysis unrealistically ignores the practical difficulties of achieving reciprocity,<sup>116</sup> particularly in light of the courts' competing incentives to entice plaintiffs or favor local litigants.<sup>117</sup> Defection is likely because state courts cannot easily monitor, let alone discipline, the uncooperative courts of other states.<sup>118</sup> But more importantly from the standpoint of our theory, even if the states do cooperate, there is no reason to assume that the outcome of this cooperation would be to enhance efficiency or individual autonomy.

### C. Judicial Evaluation of Substantive Policy

Some choice-of-law analysts have avoided government interest analysis by falling into the very trap Currie sought to avoid—establishing courts as independent policymakers. David Cavers, writing long before Currie, criticized earlier theories that, while avoiding Beahm artificiality, nevertheless committed what Cavers thought to be the same sin of being *jurisdiction-* rather than *law-selecting*.<sup>119</sup> Cavers believed that courts should weigh the policies behind the conflicting substantive laws.<sup>120</sup> Willis Reese similarly emphasized the need to formu-

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than other tools of statutory construction. Also, explicit statements in the legislative history may be unreliable because the staff of a single legislator may be able to insert comments after a law is enacted. And a court interpreting a foreign statute is even more likely to mistake the relevance of particular pieces of legislative history.

<sup>113</sup> See id at 313 (“[S]tates share what are usually called ‘multistate policies’ that may point toward the application of another state’s law: policies like comity toward other states, facilitating multistate activity and providing a legal regime where enforcement is uniform and predictable.”).

<sup>114</sup> See id at 314 (“From a selfish and parochial point of view, then, it may still be in State A’s interests to apply other states’ laws in some true conflicts in State A courts, thereby inviting reciprocal action that advances State A policies in cases brought elsewhere.”).

<sup>115</sup> See id at 313–14 & n 115, 340–41.

<sup>116</sup> See Part V.C.

<sup>117</sup> See Hay, 80 Georgetown L J at 617 (cited in note 2) (arguing that states can serve both of these goals by adopting pro-plaintiff choice-of-law rules and pro-manufacturer product liability laws).

<sup>118</sup> See Sterk, 142 U Pa L Rev at 1008–10 (cited in note 32) (noting enforcement and information problems that undercut the emergence of stable reciprocity).

<sup>119</sup> See Cavers, 47 Harv L Rev at 178 (cited in note 16).

<sup>120</sup> Id at 190 (arguing that judges dispense justice in individual cases by reference to social

late policy-based rules, which requires an explicit choice between the conflicting states' laws.<sup>121</sup>

Perhaps most prominent among the substance-based choice-of-law proponents is Robert Leflar, whose approach has been adopted in a few states.<sup>122</sup> Leflar thought courts should use five "choice-influencing considerations" in choosing governing law,<sup>123</sup> the most important of which was the "better rule of law."<sup>124</sup> Leflar justified his conclusion on the ground that choosing more favorable law is inherent in what courts actually have done and in the way lawyers actually argue cases, even if both camouflage this practice by quietly manipulating the choice-of-law rules. Indeed, Leflar observed that courts often make a choice-of-law determination, and then rely on the choice-of-law theories that support the court's conclusion.<sup>125</sup> Stewart Sterk has similarly minimized the importance of choice-of-law theory.<sup>126</sup>

The problem with letting courts choose the "better" substantive law is that, because of both information and agency costs of judicial decisionmaking,<sup>127</sup> there is little reason to assume that judges' policy decisions would be significantly more reliable than those made by legislators or by the parties themselves. As discussed above, judges may have self-interested reasons for adopting forum-oriented choice-of-law rules and may be faithful agents of the legislature in effectuating legislators' interest group deals. Indeed, Leflar recognized that courts normally view the forum's law as "better."<sup>128</sup> Thus, it may be better to improve both legislative and judicial incentives by increasing affected parties' opportunity to choose among competing legal regimes.<sup>129</sup> Moreover, even well motivated judges lack the investigative

policies embodied in state law).

<sup>121</sup> Willis L.M. Reese, *Choice of Law: Rules or Approach*, 57 Cornell L Rev 315, 321-23 (1972). See also Joseph William Singer, *Real Conflicts*, 69 BU L Rev 1, 79-80 (1989) (concluding that courts initially should focus on substantive justice and the substantive policy that underlies the particular legal field).

<sup>122</sup> See Symeon C. Symeonides, *Choice of Law in the American Courts in 1997*, 46 Am J Comp L 233, 253 & n 107 (1998) (stating that in 1997, Arkansas, Minnesota, New Hampshire, Rhode Island, and Wisconsin followed the "Better Law" approach advocated by Leflar).

<sup>123</sup> See Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 NYU L Rev 267, 282-304 (1966).

<sup>124</sup> See Brilmayer, *Conflict of Laws* at 71 (cited in note 55).

<sup>125</sup> Robert A. Leflar, *Choice of Law: A Well-Watered Plateau*, 41 L & Contemp Probs 10, 11-12 (Spring 1977).

<sup>126</sup> See Sterk, 142 U Pa L Rev at 952 (cited in note 32) ("[I]n many cases reaching the 'correct' choice of law result is and should be less important to judges than other substantive law considerations.").

<sup>127</sup> See text accompanying notes 25-33.

<sup>128</sup> Leflar, 41 NYU L Rev at 298-99 (cited in note 123).

<sup>129</sup> Our reliance on an efficiency analysis does not make our approach comparable to a search for the better law, since we seek the best procedural rules for determining the applicable law rather than a way to pick the most efficient law.

and policymaking apparatus necessary to evaluate reliably the relative efficiency of various laws.

#### D. Comparative Regulatory Advantage

Judge Richard Posner has criticized interest analysis on the ground that “[t]he issue ought not to be interests; it ought to be which state’s law makes the best ‘fit’ within the circumstances of the dispute.”<sup>130</sup> To illustrate, Posner has defended the Restatement (First) *lex loci delicti* rule<sup>131</sup> on the ground that “the tort law of the state where the accident occurs is likely to be the law most closely attuned to conditions in the state affecting safety, such as climate, terrain, and attitudes toward safety.”<sup>132</sup> This suggests that choice of law should take into account lawmakers’ relative abilities to obtain information about the legal rules that should govern the case. As a result, the place of the accident probably has the “comparative regulatory advantage”<sup>133</sup> with regard to creating optimal incentives to take care in that jurisdiction.

Posner’s comparative regulatory advantage insight fits comfortably into an efficiency approach to choice of law. It makes particular sense as a kind of default rule where there is little way for the parties to choose the applicable law no matter what the choice-of-law rules.<sup>134</sup> Thus, as discussed below,<sup>135</sup> the comparative regulatory advantage theory is most useful in accident and property law.

Rigorous application of comparative regulatory advantage might, however, clash with efficiency considerations. The basic problem is that it calls for case-by-case judicial determinations that promote ad hoc judicial decisionmaking and minimize the parties’ ability to engage in ex ante planning.<sup>136</sup> Making a comparative regulatory advantage determination in each case might involve fine distinctions such as those between conduct-regulating and loss-allocating rules within tort law.<sup>137</sup> Rules such as negligence might be rationalized as deterring harmful conduct, while others, such as guest statutes and other immu-

<sup>130</sup> Posner, *Economic Analysis of Law* at 646 (cited in note 2).

<sup>131</sup> See text accompanying note 190.

<sup>132</sup> *Kaczmarek v Allied Chemical Corp*, 836 F.2d 1055, 1058 (7th Cir 1988). See also Posner, *Economic Analysis of Law* at 646 (cited in note 2) (advocating choice of the state law with regulatory advantage); Solimine, 24 Ga L Rev at 59–64 (cited in note 2) (discussing advantages of territorialism in terms of economic analysis).

<sup>133</sup> Posner, *Economic Analysis of Law* at 646 (cited in note 2).

<sup>134</sup> See Part IV.A.3.

<sup>135</sup> See Parts IV.E–F.

<sup>136</sup> For example, Posner determines that an inquiry into the purpose behind each state’s statute of limitations is necessary to determine which state’s statute most appropriately applies. Posner, *Economic Analysis of Law* at 646 (cited in note 2). He also notes that the place of the accident might turn out to be inappropriate if both parties are residents of another state. *Id.*

<sup>137</sup> Baxter, 16 Stan L Rev at 11–12 (cited in note 3) (using automobile accident to illustrate complexity of these two different and competing policies).

nities, seem best suited for allocating losses.<sup>138</sup> While the place of the accident has the comparative regulatory advantage in conduct-regulating rules, the place of the parties' common domicile might have the comparative regulatory advantage in resolving loss-allocating issues. But the distinction breaks down in practice. For example, a comparative negligence rule might be either conduct-regulating or loss-allocating. Although damage caps may appear to be about loss-allocation, they can affect repeat-player tortfeasors. Limiting the funds available to compensate the families of children who die from vaccination profoundly affected drug companies' willingness to produce the vaccines.<sup>139</sup> To avoid the uncertainty inherent in these questions, this Article suggests rules for specific categories of cases that mesh comparative regulatory advantage and choice-maximizing considerations.<sup>140</sup>

A second way comparative regulatory advantage might clash with efficiency considerations concerns optimal bundling of legal rules.<sup>141</sup> Because some loss-allocating rules affect conduct, an issue-by-issue analysis threatens to break up state laws that work together. Separating rules into "loss-allocating" and "conduct-regulating" makes it harder for states to fine-tune their tort law bundles. Thus, an issue-by-issue approach might erode protections against fraudulent claims for state A accidents involving state B residents while it undermines deterrent effects of tort law for state B accidents involving state A residents.

## E. Descriptive Versus Normative Choice-of-Law Theories

Some approaches to choice of law purport to reflect what the courts actually are doing rather than presenting a normative theory of how they *should* choose law. In general, descriptive arguments claim

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<sup>138</sup> See David F. Cavers, *The Choice-of-Law Process* 60 & n 6, 173–76 & n 59, 300 (Michigan 1965) (discussing implications of two approaches and forging a principle for applying them according to the circumstances of each case); Baxter, 16 *Stau L Rev* at 11–13 (cited in note 3); Albert A. Ehrenzweig, *Guest Statutes in the Conflict of Laws—Toward a Theory of Enterprise Liability Under "Foreseeable and Insurable Laws": I*, 69 *Yale L J* 595, 598–600 (1960) (criticizing cases interpreting the scope of guest statutes). This assumes that a driver is unlikely to take any more or less care driving on the basis of whether his guest passenger could sue him for injuries in the event of an accident. Presumably his concern for his own personal safety and any damage that might result to his car already provides the driver with incentives to take care.

<sup>139</sup> These problems led to the National Vaccine Injury Compensation Program, 42 USC §§ 300aa-10 et seq (1994). Under the Act, Congress eliminated product liability for vaccines. 42 USC § 300aa-11. In its place, the Act provided for the creation of a pool of funds that is financed by vaccine manufacturers. 42 USC § 300aa-10. The manufacturers each pay into the fund a portion of their vaccine sales proceeds. Victims (and their families) of non-negligent vaccine injuries are now compensated exclusively from this fund.

<sup>140</sup> See Part IV.

<sup>141</sup> See Part III.D.

that the courts' conflicts decisions take certain considerations into account regardless of the formal method the judges purport to be using. Cook's initial criticisms of Beale's formalistic approach were that courts actually were making choice-of-law decisions using criteria unstated in the vested rights approach.<sup>142</sup> Currie criticized the Restatement (First) rules by pointing out the many places where state courts used "escape devices" to reach more intuitively satisfying results.<sup>143</sup> Others, such as Leflar,<sup>144</sup> advocated their own proposals on descriptive grounds.

Descriptive choice-of-law theories are potentially useful in helping predict future results from past cases. The resulting clarity has advantages over seemingly disparate court holdings, including facilitating ex ante choice of law consistent with our efficiency approach. But a descriptive theory has value in this sense only in comparison to a regime in which courts say one thing and do another. It says nothing about the merits of any particular clearly expressed rule.

A descriptive theory may not only reveal more clearly what the courts are doing, but also show whether these results are efficient. The efficiency claim is analyzed more fully below.<sup>145</sup> For now the claim should be treated skeptically because it appears inconsistent with the discussion above of how judges may serve their own, interest groups', or legislators' interests rather than those of society as a whole.<sup>146</sup> Applying that general theory to choice of law, judges may favor particular interest groups such as local lawyers who would want to attract litigation,<sup>147</sup> and in-state litigants who have the most influence on judicial selection. Judges also may favor forum law, partly to serve the legislators that determine judges' pay and perquisites, and partly because this simplifies the judges' task. Indeed, studies of case law show that the dominant modern interest analysis has pro-plaintiff, pro-resident and pro-forum biases.<sup>148</sup>

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<sup>142</sup> See text accompanying notes 59–62.

<sup>143</sup> See Currie, *Married Women's Contracts* at 99–107 (cited in note 75) (describing cases and criticizing the opportunistic use of escape devices).

<sup>144</sup> See Leflar, 41 NYU L Rev at 324–25 (cited in note 123).

<sup>145</sup> See Parts III and V.A.

<sup>146</sup> See Part I.A.2.

<sup>147</sup> See Solimine, 24 Ga L Rev at 73 (cited in note 2) (noting that judges may favor the bar through decisions that will generate litigation, and the bar may fund judicial election campaigns).

<sup>148</sup> See Patrick J. Borchers, *The Choice-of-Law Revolution: An Empirical Study*, 49 Wash & Lee L Rev 357, 377 (1992) (finding choice-of-law decisions under the Restatement (First) to be more evenhanded than under each of the modern approaches); Solimine, 24 Ga L Rev at 81–89 (cited in note 2) (presenting an empirical study suggesting that modern approaches lead to more pro-plaintiff outcomes). Stuart Thiel, *Choice of Law and the Home Court Advantage: Evidence*, 2 Am L & Econ Rev (forthcoming 2000), found that while states utilizing the modern approach clearly use forum law more often than states using the Restatement (First), there was little difference at the margin between the two groups of states with respect to recovery-favoring choice-of-law determinations. The pro-plaintiff/pro-resident bias initially appears inconsistent with

There has, indeed, been a kind of race to the bottom in choice of law. Although judges began with a rule-based approach that might have deterred them from indulging their own preferences by making departures more obvious, the courts have developed more open-ended, standard-based approaches that facilitate more discretionary judicial decisionmaking. This evolution may be attributed to a kind of prisoner's dilemma game among the states. That is, even if the Restatement (First) is socially optimal, individual states and their courts gain by abandoning this approach. Courts in the larger states such as New York<sup>149</sup> and California<sup>150</sup> could compete for litigation business and otherwise serve their self-interest by rejecting the constraints of the Restatement (First).<sup>151</sup> The large states' more attractive markets make it hard for parties to avoid contacts that create a basis for exerting jurisdiction.<sup>152</sup> The smaller states could not easily compete by giving potential defendants a sanctuary from lawsuits. Thus, courts in the smaller states would have little incentive to sacrifice their own self-interest by forgoing the modern approach. In short, it would not pay for most state courts to retain the Restatement (First) approach.<sup>153</sup> To

George L. Priest and Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J Legal Stud 1, 17 (1984), which demonstrated that litigated disputes are biased toward those that are on the margin, so that plaintiff win rates should tend toward fifty percent. However, since the choice-of-law issue is only a part, and sometimes a small part, of the entire dispute, results may vary at the margin across jurisdictions. Compare Michael Solimine, *The Quiet Revolution in Personal Jurisdiction*, 73 Tulane L Rev 1, 46 (1998) (noting that personal jurisdiction issue may be cheap enough to appeal even when the probability of winning is low).

<sup>149</sup> This is evidenced by the evolution of an interest-type analysis in guest statute cases such as *Neumeier v Kuehner*, 31 NY2d 121, 286 NE2d 454 (1972) (applying Ontario guest statute in wrongful death of an Ontario domiciliary who was killed when a car driven and owned by a New York resident collided with a train in Ontario); *Tooker v Lopez*, 24 NY2d 569, 249 NE2d 394 (1969) (refusing to apply Michigan guest statute protection to an accident in Michigan involving a New York automobile and two New York domiciliaries); *Babcock v Jackson*, 12 NY2d 473, 191 NE2d 279 (1963) (refusing to apply the place-of-tort rule to an accident that occurred in Canada but involved a New York guest and host).

<sup>150</sup> See, for example, Justice Traynor's opinion embracing interest analysis in *Reich v Purcell*, 67 Cal 2d 551, 432 P2d 727 (1967) (analyzing the interest of three states in a wrongful death action occurring in Missouri but involving Ohio plaintiffs and a California defendant), as well as his earlier opinion in *Bernkrant v Fowler*, 55 Cal 2d 588, 360 P2d 906 (1961) (refusing to apply California statute of frauds in an oral contract involving Nevada resident and Nevada land, even though vendor may have been domiciled in California at time contract was made).

<sup>151</sup> For the order of state supreme court adoption of modern choice-of-law theories, a rough but imperfect proxy for our proposition, see Michael E. Solimine, *The Impact of Babcock v. Jackson: An Empirical Note*, 56 Albany L Rev 773, 777 (1993).

<sup>152</sup> For a discussion of how markets operating in conjunction with jurisdictional rules can discipline choice of law, see Part V.D.

<sup>153</sup> See *Palgrave Dictionary* at 392-94 (cited in note 1). Interestingly, most of the states that have retained the Restatement (First) are contiguous to one another and located in the southeastern United States. See Symeon C. Symeonides, *Choice of Law in the American Courts in 1996: Tenth Annual Survey*, 45 Am J Comp L 447, 459 (1997) (noting that Restatement (First) states for torts include Alabama, Georgia, Maryland, North Carolina, South Carolina, Virginia and West Virginia). Mobility and market transactions for residents of these states seem to be

be sure, a dynamic might develop through jurisdictional and interest group competition that overcomes these barriers to efficiency.<sup>154</sup> That is particularly true now that innovations in business, communications, and transportation, such as the Internet, give firms more flexibility about where to do business. For now, however, there is reason to doubt the efficiency of at least some of the rules courts have developed.

Are existing normative choice-of-law theories likely to produce efficient results? The legal academics who propose these theories have considerable power in promoting their views not only because of their direct participation in law reform through organizations such as the American Law Institute, but also because they can confer prestige on judges by praising their decisions. Legal academics, like judges and legislators, are not necessarily motivated to act in the public interest.<sup>155</sup> Law professors stand to gain fame and fortune by advocating sweeping new theories, and need not bear the costs when these theories go awry. When they are involved in law reform, academics have a strong interest in seeking to privilege the academic positions they have staked out.<sup>156</sup>

At the same time, there is something to be said for normative theories.<sup>157</sup> As discussed below,<sup>158</sup> a clear theory can serve as a focal point that augments the effect of jurisdictional and interest group competition in moving the law toward efficiency. Moreover, normative theories can provide useful clarity and predictability. This is illustrated by contrast with a system that lacks a clear theory. The Restatement (Second) has been characterized as a kind of grand description, accommodating all of the various judicial approaches to choice of law.<sup>159</sup> The Restatement (Second)'s choice-of-law "rules" are only baseline presumptions that courts can ignore if a multifactored, contact-based analysis indicates that another state's law most appropriately applies.<sup>160</sup>

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relatively more confined to other Restatement (First) states than would be the case for those states that have abandoned the rules.

<sup>154</sup> See Part V.D.

<sup>155</sup> See Ribstein, 61 *Geo Wash L Rev* at 1024–30 (cited in note 28) (discussing legal academics' role in ALI's corporate governance project).

<sup>156</sup> *Id.* at 1026–29 (arguing that academics garner power and prestige through advancement of their views in the ALI's corporate governance code and therefore may "use the code to fore-close debate rather than encourage it").

<sup>157</sup> This Article, of course, reflects our support for a normative theory—specifically, one that is process oriented.

<sup>158</sup> See Part V.D.

<sup>159</sup> See William A. Reppy, Jr., *Eclecticism in Choice of Law: Hybrid Method or Mishmash?*, 34 *Mercer L Rev* 645, 655–66 (1983) (arguing that part of the Restatement (Second)'s "eclecticism" arises from courts who graft "Currie-style interest analysis" or some other independent method to the most significant relationship standard).

<sup>160</sup> Compare Jason E. Pepe, Comment, *Kansas's Conflict of Laws Rules for Insurance Contract Cases: It's Time to Change Policies*, 46 *U Kan L Rev* 819, 828–29 (1998) (noting that, under the Restatement (Second), some jurisdictions essentially ignore the presumptive rule in favor of

This ends up sanctioning whatever the courts want to do, thereby contributing to the judicial agency costs discussed above.<sup>161</sup> Moreover, it frustrates parties who seek to determine the law applicable to conduct before they engage in it.

## F. Summary

None of the above approaches relies squarely on efficiency or attempts to use efficiency as a comprehensive guidepost for developing a choice-of-law approach. Modern choice-of-law theory centers on state rather than party interests and ignores the costs of uncertainty and forum shopping. Moreover, all prior choice-of-law proposals ignore the important implications of public choice theory. Perhaps ironically, the Restatement (First), which formally pays the least attention to anything resembling policy considerations, actually is most likely to lead to efficient results because its clear rules promote predictability and enable individual choice.

### III. EFFICIENCY-MAXIMIZING PRINCIPLES FOR CHOICE OF LAW

Having contrasted the basic thrust of our choice-of-law approach with other theories, this Article turns to developing a more detailed set of default rules that can promote efficiency. This Part elaborates on the basic choice-of-law principles that such rules should reflect. Part IV describes specific rules derived from these principles.

In general, this Article advocates the enforcement of private contracts and the application of default rules designed to choose the law at the time of the relevant conduct rather than later through plaintiffs' choice of forum. Consistent with economic analyses in other areas, the parties are more likely to maximize their joint utility if they must choose prior to the conduct triggering a dispute rather than after the dispute arises. *Ex post* choice becomes a zero-sum game, but *ex ante* choice can create mutual benefits.

At the same time, choice-of-law decisions also must preserve government's ability to regulate where externalities create inefficiencies. Thus, courts should enforce a clearly expressed legislative intent to have a specific law applied extraterritorially notwithstanding a contractual choice-of-law clause.<sup>162</sup> The strong interest group support that would be necessary for such an expression itself suggests the efficiency of that underlying law.<sup>163</sup>

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the most significant relationship test, and citing several case examples).

<sup>161</sup> See text accompanying notes 25–33.

<sup>162</sup> See Part III.E (discussing which statute should be applied).

<sup>163</sup> See Part IV.A.2.

The main difference between our system and those that have dominated so far is the important one of emphasis. Prevailing choice-of-law approaches, while providing some scope for exit by contract or domicile (under interest analysis) or by physical movement (the Restatement (First)), take *government* interests as their starting point. Our theory, on the other hand, takes individual choice as its starting point. Subject to legislative veto, courts should choose private markets over political ones.

The proposed approach is normative rather than descriptive. As discussed above, it is not clear that state court judges have tended over time toward efficient results in conflicts cases.<sup>164</sup> But while this Article advocates change, its approach is not a radical departure from current theories. It rests fundamentally on the principles underlying contractual choice of law that courts and legislators now apply in many areas, including such nontraditional areas as prenuptial agreements,<sup>165</sup> securities fraud,<sup>166</sup> and RICO<sup>167</sup> liability. To the extent that the theory reaches results different from those under current law, the difference is attributable to our emphasis on *ex ante* choice and predictability.<sup>168</sup>

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<sup>164</sup> See Part II.E.

<sup>165</sup> A provision in the Uniform Premarital Agreement Act § 3(7) (1983) enables parties to choose the law that will be used to interpret their agreement. See 9B *Uniform Laws Annotated* 371, 373 (West 1987). Several courts have gone further, enabling the parties to use choice-of-law clauses to ensure the validity of their agreement. See, for example, *Elgar v Elgar*, 679 A2d 937, 944 (Conn 1996) (using New York law to validate New York prenuptial agreement in Connecticut court); *Carr v Kupfer*, 296 SE2d 560, 562 (Ga 1982) (using Maryland law to uphold validity of prenuptial agreement that chose Maryland law, though adjudicated in Georgia); *In re Estate of Massello*, 1997 Del Ct LEXIS 23, \*7 (using Pennsylvania law to invalidate prenuptial agreement choosing Pennsylvania law but adjudicated in Delaware).

<sup>166</sup> Seven federal circuits have permitted parties to international transactions to opt out of liability for securities fraud under U.S. law through forum-selection clauses despite antiwaiver provisions in the Securities Act of 1933, 15 USC § 77n (1994), and the Securities Exchange Act of 1934, 15 USC § 78cc(a) (1994). See *Roby v Corporation of Lloyd's*, 996 F2d 1353, 1366 (2d Cir 1993); *Allen v Lloyd's of London*, 94 F3d 923, 930–32 (4th Cir 1996); *Haynsworth v The Corporation*, 121 F3d 956, 969–70 (5th Cir 1997); *Bonny v Society of Lloyd's*, 3 F3d 156, 162 (7th Cir 1993); *Richards v Lloyd's of London*, 135 F3d 1289, 1296–97 (9th Cir 1998); *Riley v Kingsley Underwriting Agencies, Ltd*, 969 F2d 953, 957–58 (10th Cir 1992); *Lipcon v Underwriters at Lloyd's, London*, 148 F3d 1285, 1297–99 (11th Cir 1998). See also *Shell v R.W. Sturge, Ltd*, 55 F3d 1227, 1231–32 (6th Cir 1995) (forum-selection clause enforceable despite public policy behind Ohio's security statutes).

<sup>167</sup> See *Roby*, 996 F2d at 1366 (finding that choice-of-law clause precluded RICO claims since application of English law also can deter persistent misconduct); *Richards*, 135 F3d at 1296 (following *Roby* and ruling that the RICO claim had no effect on choice of law); *Lipcon*, 148 F3d at 1299 n 20 (ruling that validity of choice-of-law clause was unaffected by RICO claim). No circuits have held to the contrary.

<sup>168</sup> For another choice-of-law proposal emphasizing pre-specification of the law by the parties rather than case-specific adjudication, see Michael J. Whincop and Mary Keyes, *Policy And Pragmatism in the Conflict of Laws* 34–43 (Ashgate forthcoming 2000). Consistent with our approach, Whincop and Keyes rely on the efficiency benefits of private ordering in generating choice-of-law principles. However, unlike our approach, they do not focus on the dynamic and systemic public choice aspects of choice of law. One important consequence of this is their reli-

### A. Enforcement of Contractual Choice

We begin with the enforcement of contractual clauses specifying the state whose law will apply to future disputes between the parties.<sup>169</sup> The strongest advantage of contractual choice is that it promotes competition among legal regimes that helps to discipline interest group bargains within each state. Legal restrictions on contractual choice increase the cost of exiting inefficient laws and thereby reduce the disciplinary effect of contractual choice.

At the same time, if the contracting process is flawed, enforcing contractual choice might be inefficient. The choice-of-law clause may be included in an “adhesion” contract one party imposes on another.<sup>170</sup> Even if the clause is not unconscionable, it may evade regulation that reflects concerns about asymmetric information or bargaining power. And a choice-of-law clause might be a Trojan horse concealing a term of the chosen law that is onerous to the non-drafting party.

Concerns about the contracting process, even if well grounded, do not necessarily justify broadly prohibiting choice-of-law clauses. A state might appropriately require that choice-of-law provisions be highlighted in the contract.<sup>171</sup> If a choice-of-law clause might represent a disguised means of imposing terms favorable to the drafter, the state might require that those terms be specified in the choice-of-law provision. For example, if a party chooses a state’s law in order to take advantage of damage caps available in that state, a law requiring the party to disclose the cap in the chosen state’s law would mitigate any information asymmetries. The state might also require the contract to disclose any mandatory rules that the choice of law would circumvent, although the benefits of such a law might be outweighed by the costs of requiring parties to anticipate what laws might apply but for the choice-of-law clause. And party choice can and should be limited to

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ance on judicial “pragmatism,” in contrast to our reliance on statutory solutions to overinclusive choice rules.

<sup>169</sup> We discuss here only the contractual specification of a jurisdiction. Asset-protection laws that shield assets from the reach of the law that governs the contract may present different problems. See Stewart E. Sterk, *Asset Protection Trusts: Trust Law’s Race-to-the-Bottom?*, 85 Cornell L Rev 1035 (2000) (discussing how certain states have attracted business by enacting laws making it easier for a settlor to protect a trust’s assets from creditors’ claims). As to judgment proofing, see Lynn M. LoPucki, *The Essential Structure of Judgment Proofing*, 51 Stan L Rev 147 (1998) (arguing that by dividing large entities into “asset-owning and operating companies,” a company can reduce the size of assets exposed to liability and become judgment proof); Lynn M. LoPucki, *The Death of Liability*, 106 Yale L J 1, 5 (1996) (examining how computer technology has dramatically lowered the cost of judgment-proofing and that social norms are eroding as a deterrent). See also Larry E. Ribstein, *Limited Liability Unlimited*, 24 Del J Corp L 407, 438–40 (1999) (discussing and criticizing LoPucki theory).

<sup>170</sup> See Romano, 107 Yale L J at 2406–07 (cited in note 7) (discussing court reluctance to enforce choice-of-law clauses in some adhesion contracts).

<sup>171</sup> See Part III.E (discussing which state’s law should be applied).

choosing an entire body of state law in order to mitigate potential opportunism.<sup>172</sup> Thus, even if courts should not always enforce contractual choice of law, regulation generally should favor procedural measures short of outright prohibition.

Even if regulation cannot eliminate contracting flaws, it is important to keep in mind that any inefficiency from enforcing contractual choice is mitigated by the fact that such contracts do not necessarily nullify efficient regulation.<sup>173</sup> The parties avoid a mandatory rule only by opting into a different regulatory regime. Consequently, they can opt out of regulation only if another jurisdiction chooses not to regulate. Legislators in the state whose law is chosen are subject to discipline by their own constituents and contributors. This helps ensure that problems addressed by the regulating state are not simply ignored or disregarded. To be sure, regulators sometimes may not be subject to political discipline. In the extreme case, the jurisdiction may be a sparsely populated “haven for miscreants.”<sup>174</sup> But lawmakers concerned about rogue jurisdictions should restrict the available choices rather than ban all choice. For example, the parties might be permitted to choose only the laws of U.S. states, which are governed by a common constitution, a common legal system, and common cultural norms.<sup>175</sup>

## B. Choice-Facilitating Rules

Courts often must choose law in situations where the parties themselves have not explicitly contracted for the applicable law. Even in these situations there is room for a choice-maximizing approach. Under modern choice-of-law approaches people know the applicable law only after they have acted, and therefore have difficulty fashioning their conduct so as to select or conform to the governing law. The modern approaches are biased toward applying the law where the plaintiff chooses to sue.<sup>176</sup> At the extreme, the *lex fori* rule, followed in a couple of states, applies forum law whenever the Constitution permits.<sup>177</sup> In these cases, defendants cannot easily predict the governing

<sup>172</sup> See Part III.D.

<sup>173</sup> See Whincop and Keyes, *Policy and Pragmatism* at 35–36, 39–41 (cited in note 168); Michael J. Whincop and Mary Keyes, *Statutes' Domains in Private International Law: An Economic Theory of the Limits of Mandatory Rules*, 20 Sydney L Rev 435, 446–48 (1998).

<sup>174</sup> See Kobayashi and Ribstein, *Contract and Jurisdictional Competition* at 346 (cited in note 12).

<sup>175</sup> See Part IV.A.2 (discussing legislative restrictions on contractual choice).

<sup>176</sup> See Thiel, 2 Am L & Econ Rev (cited in note 148); Borchers, 49 Wash & Lee L Rev at 366 (cited in note 148); Solimine, 24 Ga L Rev at 50 (cited in note 2) (describing the modern approach as “pro-recovery” and “pro-forum”).

<sup>177</sup> For a treatment of the *lex fori* approach, see Brilmayer, *Cases and Materials* at 361–66 (cited in note 69) (noting that two U.S. states, Kentucky and Michigan, have experimented with

law because they might be sued in any of several jurisdictions they contacted. The flexibility of interest analysis or the Restatement (Second) creates similar problems. For example, under any of the modern approaches, a seller who (1) negotiates with a buyer in the buyer's domicile state A, (2) accepts the contract at its branch office in state B, and (3) is headquartered in state C, might be subject to the law of any one of these three states.

Instead of seeming to draw law *ex post* from out of a hat, choice-of-law rules should maximize the parties' ability to choose their applicable law by controlling the location of their activities.<sup>178</sup> The rules should be clear and should turn on a single fact, such as the place of contract offer or acceptance, or the place of the accident or negligent conduct. Commentators have advocated the use of clear rules for several reasons that reflect concerns for efficient litigation, including reducing litigation costs and discouraging forum shopping.<sup>179</sup> This Article emphasizes clear rules' additional advantage of facilitating the parties' choice of the laws that govern their conduct.

Clarity alone does not ensure that the parties can predict the law before they act.<sup>180</sup> For example, *lex fori*, although clear, facilitates party

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the approach).

<sup>178</sup> In determining *ex ante* predictability, it may be risky to rely on parties' "expectations" because these may be shaped by legal rules. See Richard Michael Fischl, *Some Realism About Critical Legal Studies*, 41 U Miami L Rev 505, 527–28 n 73 (1987). On the other hand, some data indicates that the law may be irrelevant in shaping the parties' expectations. See Pauline T. Kim, *Norms, Learning, and Law: Exploring the Influences on Workers' Legal Knowledge*, 1999 U Ill L Rev 447; Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 Cornell L Rev 105, 133–46 (1997) (analyzing survey data suggesting that workers fail to grasp the legal realities of at-will employment). Moreover, given the ambiguous nature of modern choice-of-law rules, even parties who know the law could not form meaningful expectations about it. On the other hand, if courts were widely to adopt choice-facilitating rules based on clear *ex ante* notice to the parties, expectations and choice may converge. For example, under the clearer rules fashioned under the vested rights approach, application of a law other than that of the place of contracting to determine the contract validity was held unfairly to surprise the parties and therefore to violate due process. See *New York Life Insurance Co v Dodge*, 246 US 357, 376–77 (1918) (concluding that to apply a Missouri statute to a contract made in New York would lead to the "impairment of that liberty of contract guaranteed to all by the Fourteenth Amendment"). See also note 182 (discussing importance of unfair surprise under due process).

<sup>179</sup> See Michael H. Gottesman, *Draining the Dismal Swamp: The Case for Federal Choice of Law Statutes*, 80 Georgetown L J 1, 11–13 (1991) (arguing that federal choice-of-law statutes are needed to reduce litigation costs and enable rational planning); Maurice Rosenberg, *The Comeback of Choice-of-Law Rules*, 81 Colum L Rev 946, 950 (1981) (agreeing with Reese's rejection of a "no-rules" approach); Reese, 57 Cornell L Rev at 322–23 (cited in note 121) (condoning abandonment of a search for the state with the greatest interest where "the court finds that the task would be disproportionately time consuming"). See also Cavers, 47 Harv L Rev at 192–93 (cited in note 16) (advocating use of rules as long as they grow out of policy considerations).

<sup>180</sup> One might argue that *ex ante* certainty does not shape the parties' conduct because the parties can decide their course of action based on the probability of the courts' applying particular rules. However, making this determination is costly. Also, realistically assuming that parties are risk averse, this approach adds deadweight, risk-bearing costs. Moreover, even if the par-

choice ex post rather than ex ante. By promising plaintiffs that they will get the law where they choose to sue, *lex fori* can make states beacons for plaintiffs. States can therefore attract litigation business for local courts and lawyers by enacting pro-plaintiff legislation.<sup>181</sup>

The choice-facilitating principle meshes well with other fundamental choice-of-law concerns. Due process, which demands that a party not be unfairly surprised, focuses on the parties' expectations when they act.<sup>182</sup> The choice-facilitating principle is also consistent with the principle that it is unfair to subject people to the burdens of a jurisdiction's law unless they somehow sought its benefits.<sup>183</sup> Moreover, choice rules that provide ex ante notice of the law encourage the parties to tailor their conduct to conform to that law, thereby enhancing the law's deterrent value. Although choice-of-law rules that enhance ex ante predictability may seem to have little effect in a context like accident law where actors do not pay attention to governing legal standards,<sup>184</sup> these rules can affect the behavior of repeat players such as manufacturers and insurance companies who do pay careful attention to the law.<sup>185</sup>

To achieve predictability in choice of law, clear rules must minimize characterization issues. Characterization problems are inherent in all rule-based systems. As discussed above in the context of the Re-

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ties can shape their conduct through this Bayesian approach, the result may be inefficient if the courts apply a legal rule that is unsuited for the particular situation. An approach based on maximizing ex ante predictability allows the parties to pick the most efficient rule. We are indebted to Michael Whincop for raising this issue.

<sup>181</sup> Even a choice-of-law rule that operates randomly would be less perverse from this perspective because reducing plaintiffs' ability to predict what law the forum would apply also reduces states' incentives to skew their substantive laws toward plaintiffs' interests.

<sup>182</sup> See *Home Insurance Co v Dick*, 281 US 397, 410 (1930) (holding that a declared public policy cannot be used to bind a party with no relationship or dealings with a state); *Allstate Insurance Co v Hague*, 449 US 302, 327 (1981) (Stevens concurring) (claiming that a policy against "unfair surprise" has guided the Court's precedents on choice of law); *Phillips Petroleum Co v Shutts*, 472 US 797, 837-38 (1985) (Stevens dissenting) (arguing that "the underlying theory of choice-of-law due process" is that parties may plan and act upon "legitimate expectations concerning the subsequent legal consequences of their actions").

<sup>183</sup> See *Home Insurance*, 281 US at 410 (distinguishing defendants who had never been to Texas from other parties who had enjoyed the benefits of being in the state).

<sup>184</sup> See Symposium, *Choice of Law: How It Ought to Be*, 48 Mercer L Rev 623, 665 (1997) (remarks of David Currie); *id* at 663 (remarks of John Rees, Jr.); Sterk, 142 U Pa L Rev at 983, 1013 (cited in note 32).

<sup>185</sup> See William M. Landes and Richard A. Posner, *The Economic Structure of Tort Law* 14-19 (Harvard 1987) (classifying tort law as a public good that is unlikely to attract a great deal of interest among the general public, but noting that certain affected groups might place tort law high on their legislative agenda); Christopher Bruce, *The Deterrent Effects of Automobile Insurance and Tort Law: A Survey of the Empirical Literature*, 6 L & Pol 67, 90-91 (1984); Elisabeth M. Landes, *Insurance, Liability, and Accidents: A Theoretical and Empirical Investigation of the Effect of No-Fault Accidents*, 25 J L & Econ 49, 50 (1982) (arguing that states with tort restrictions have more fatal accidents than states without restrictions).

statement (First),<sup>186</sup> ambiguity in the characterization of a claim or issue creates opportunities for manipulation by the courts. Ambiguity and manipulation make it hard for actors to determine at the time of their conduct which law will apply to any resulting dispute. To alleviate this problem, the applicable choice-of-law rule should turn on facts, which are harder for courts to manipulate than legal categories. Thus, courts should focus on whether the parties have bargained with each other<sup>187</sup> instead of asking whether a case involves a “contract” or “tort.”

### C. Comparative Regulatory Advantage as a Default Rule

The parties may not be able to contract for or otherwise choose the applicable law prior to the relevant conduct. For example, parties normally do not choose, in any meaningful sense, the location of automobile accidents, emergency medical treatment, or other significant but unplanned events. Although accident law is arguably part of the bundle of laws the parties select by choosing their domicile, it is usually too small a part for the choice of domicile to be meaningful in this respect.

Even in cases where choice-maximization is not dominant and the courts must rely on some other principle, courts should look to the underlying individual, rather than government, interests that a choice-maximizing system serves. Thus, where party choice is not feasible, courts should apply the law of the state with the comparative regulatory advantage.<sup>188</sup> Although the courts rather than individual parties would be selecting the law, comparative regulatory advantage is still more focused on individuals’ welfare than approaches based on interest analysis.<sup>189</sup> Comparative regulatory advantage looks to government’s *ability* to regulate efficiently rather than to government’s *interest* in extending its regulatory influence. For example, the *lex loci delicti* rule is “the law most closely attuned to conditions in the state affecting safety, such as climate, terrain, and attitudes toward safety.”<sup>190</sup> Legislators normally are most familiar with and likely to focus on local conditions. Even if legislators are not always properly motivated to act on their information, other things equal it is better that they be informed. Accordingly, if affected parties concerned for their mutual advantage could effectively contract on the issue, they presumably

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<sup>186</sup> See Part II.A.

<sup>187</sup> See Part IV.D (discussing product liability and malpractice claims).

<sup>188</sup> See Part II.D. As discussed in the text accompanying notes 194–95, our approach contrasts with Posner’s in examining regulatory advantage at a general level rather than with respect to each issue in the case.

<sup>189</sup> See Part II.B.

<sup>190</sup> See note 132 and accompanying text.

would choose the law of the place with the comparative regulatory advantage.<sup>191</sup>

Determining which state has the comparative regulatory advantage may, however, be difficult where cases present both loss-distribution and deterrence issues.<sup>192</sup> Courts should solve this dilemma by applying categorical rules that clarify the applicable law at the time of the relevant conduct even if these rules do not perfectly fit specific cases under a comparative regulatory advantage analysis. As discussed below in Part IV, this means applying a place-of-injury rule for accidents and a situs rule for land.

One might argue that a precise policy match on a case-by-case basis is more important than clarity when the transaction costs of choosing are so high that even a clear rule is unlikely to guide the parties' choice. Thus, commentators and courts have asserted that rules stressing predictability, which would include our choice-maximizing approach, are irrelevant for torts.<sup>193</sup> Instead, they assert, carefully tailored case-by-case decisionmaking is preferable.

However, clear categorical rules serve several important purposes even in this context. First, the bundling principle discussed in the next subsection implies that courts should apply a single state's law to all substantive legal issues involved in a claim. Second, a rule that operates clearly, whether ex post or ex ante, economizes on litigation costs and tends to discipline judges who may use muddy standards to cover their private preferences.<sup>194</sup> Third, categorical rules that provide clear ex ante notice of the applicable law help affected parties shape their conduct to the applicable law whether or not they choose that law. Fourth, categorical rules that make the law clear ex ante are helpful whenever choice is feasible. The parties might even incur high transaction costs to avoid states that inadequately protect property, are excessively harsh on tortfeasors, or provide little compensation to victims.

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<sup>191</sup> This is obviously a kind of "hypothetical bargain" analysis. The hypothetical bargain approach has come under attack in the contract setting because it ignores information asymmetries that enable the advantaged party to behave opportunistically in contract formation. See Ian Ayres and Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 *Stan L Rev* 1591 (1999); Ian Ayres and Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 *Yale L J* 729 (1992); Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale L J* 87 (1989). For a criticism, see Barry E. Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 *Stan L Rev* 1547 (1999). This debate is irrelevant in the present context where the parties normally do not contract around the "default" rule. In other words, the hypothetical bargain is likely to remain purely hypothetical rather than serving as a mechanism for opportunistic contracts.

<sup>192</sup> See text accompanying note 98.

<sup>193</sup> See, for example, *Nesladek v Ford Motor Co*, 46 F3d 734, 738 (8th Cir 1995); *Mitchell v Craft*, 211 S2d 509, 513-14 (Miss 1968); *Heath v Zellmer*, 35 Wis 2d 578, 151 NW2d 664, 672 (1967); Leflar, 41 *NYU L Rev* at 310-11 (cited in note 123).

<sup>194</sup> See Part I.A.2.

By facilitating choice at the margins, *ex ante* clarity can provide at least enough discipline to deter egregious laws.

#### D. Depeceage and Bundling

Courts applying the more modern approaches to choice of law typically engage in “depeceage,” meaning that they apply different states’ laws to the different legal issues involved in a single legal claim.<sup>195</sup> Thus, one state’s law might determine whether defendant acted “negligently” while another state’s law might determine whether plaintiff’s cause of action is barred by defendant’s immunity to suit. Courts inevitably apply some depeceage whenever foreign substantive law applies, if only because it has long been assumed that they are entitled to apply their own procedural rules.<sup>196</sup>

In general, a theory that attempts to facilitate or replicate party choice seemingly needs to be implemented on an issue-by-issue basis. Forcing the parties to “bundle” laws together by choosing the laws of only a single jurisdiction reduces their ability to choose the best set of rules since they must take the good with the bad, just as a seller’s bundling reduces consumer choice.

Bundling, however, has several important benefits that outweigh its costs in constraining party choice of law. First, limiting contractual choice to a single state’s law may help prevent bargaining or information disparities from influencing the choice. If designating parties must accept both favorable and unfavorable legal rules, it is harder for them to use contractual choice of law to insert one-sided terms in contracts.<sup>197</sup> A bundling constraint therefore might reasonably substitute for more burdensome restrictions on choice of law. To be sure, bundling does not necessarily prevent exit from mandatory rules because a party might find a state’s lax law beneficial enough to outweigh costs its other laws impose. An example might be a lender’s choice of a state whose law does not cap interest rates. But bundling is better than trying to decide whether a law, such as one against usury, is efficient.<sup>198</sup> Bundling, in effect, lets the market make the ultimate determination by constraining exit from laws *except* those that heavily burden one of

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<sup>195</sup> See Symeon C. Symeonides, Wendy Collins Purdue, and Arthur T. Von Mehren, *Conflict of Laws: American, Comparative, International* 128 (West 1998).

<sup>196</sup> See Eugene F. Scoles and Peter Hay, *Conflict of Laws* § 3.8 at 57 (West 2d ed 1992) (noting medieval origins of substance/procedure distinction).

<sup>197</sup> Conversely, selecting a state’s entire law arguably provides greater opportunities to conceal the offending provision from the other party. This suggests that bundling ought to be prohibited rather than required. However, if concealment is a concern, the appropriate remedy may be a disclosure rule rather than outlawing the choice. See Part III.A.

<sup>198</sup> The general problem is described in the text accompanying note 13.

the parties. This helps ensure that the laws serve parties' joint interests.

Second, legislators may enact a given law only because of its expected interaction with a complementary law. For example, it would be clearly inappropriate to apply a state's wrongful death rule without its damage cap, which may have been an important condition on the adoption of the wrongful death statute. Unbundling can cause analogous but less obvious problems in many other situations.<sup>199</sup> For example, state A might provide broad recovery for injuries but adopt immunities to prevent the fraudulent and collusive claims that such broad recovery might encourage. In contrast, state B might let all injured plaintiffs sue for compensation, but forbid direct actions, cap damages, limit negligence per se, and apply a narrow *res ipsa loquitur* doctrine. These bundles reflect different decisions about the optimal combination of legal standards, administrative enforcement, criminal penalties, and civil liability that work together to encourage safe driving. To ensure that the applicable state laws do, in fact, promote safe driving, the same state's laws should apply to the standard of conduct, the extent of liability, and the negligence per se rule. This implies a different result from that under comparative regulatory advantage, which might apply a domicile-state rule on negligence per se and a *lex loci* rule on legal standards.<sup>200</sup>

Third, bundling encourages interest groups to make investments in lobbying that accurately reflect the law's effect on the group's members.<sup>201</sup> This, in turn, enhances the beneficial effect of interest group competition and thereby constrains the deadweight social costs of laws. A law's effect on an interest group depends on how the law interacts with other laws. For example, truckers would not invest heavily in overturning a low speed limit if the speed limit were not enforced and did not trigger civil liability. Moreover, if a proposed law works with other laws significantly to harm an interest group, the threatened group is much more likely to mobilize in opposition to the proposed law.<sup>202</sup> The point here is not that the resulting bundle is optimal but rather that bundling can constrain the inefficiency of a state's laws.

Fourth, bundling can reduce the parties' uncertainty about the law that governs their conduct. Without bundling, parties would have

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<sup>199</sup> See Allen and O'Hara, 51 *Stan L Rev* at 1035–36 (cited in note 96).

<sup>200</sup> In other words, the court should not characterize the negligence per se rule as a loss-distribution rule that applies to local residents, and the rest as conduct-regulating rules that apply at the point of conduct or harm. See *id.* For the contrary view, see Baxter, 16 *Stan L Rev* at 13 (cited in note 3) (arguing that the negligence per se rule will predominate when the accident involves out-of-state parties).

<sup>201</sup> See note 49 and accompanying text.

<sup>202</sup> See text accompanying note 49.

to predict which law a court will apply to each issue in the case. With bundling, the parties need only make a single prediction that is probably no harder to make than each of the separate predictions that depeage requires.

Rigid application of bundling might require application of a single state's law to both procedural and substantive issues. A state may enact a substantive statute only because its excesses are tempered by the state's procedural rules. However, strong considerations support an exception to bundling for procedural rules. The forum has a strong comparative regulatory advantage regarding procedural rules in that it knows best how to fashion procedures suited to its particular litigation environment. Moreover, permitting a court to operate under a single set of procedural rules enhances judicial economy. Although the same might be said for some substantive rules, in this case the advantages of facilitating ex ante choice outweigh those of increased litigation efficiency. Indeed, ex ante choice is irrelevant for procedural rules since most parties are not likely to adjust their conduct depending on which procedures apply.

Given the general advantages of bundling, and the specific reasons for distinguishing procedural rules, the latter should be narrowly defined for choice-of-law purposes to include only those rules that are applied uniformly across different types of cases regardless of the nature of issues those cases raise. For example, the subsequent repair rule in tort law, although technically an evidence rule, should be characterized as substantive for choice of law because of its deterrence implications. The same analysis applies to the parol evidence rule. For difficult characterization issues, courts could look to the forum's procedure code for guidance.<sup>203</sup> If the code does not contain a rule addressing the issue, the forum presumably lacks a significant interest in uniform application and the issue can be treated as substantive for choice-of-law purposes.

#### E. Statutory Override

An exception to our default rule is necessary in order to preserve the benefits of efficient laws. The vested rights approach responded to this problem by creating an exception to the rules if their application would violate a fundamental public policy of the forum.<sup>204</sup> Our version of this longstanding public policy exception refers only to exceptions explicitly mandated by statute. As explained in Part I.C, the shift from

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<sup>203</sup> See *Sampson v Channell*, 110 F2d 754, 757 & n 8, 761-62 (1st Cir 1940) (suggesting that since the Federal Rules of Civil Procedure did not address the issue, federal interest in uniformity was questionable).

<sup>204</sup> See note 66 and accompanying text.

court to legislative determination of public policy promotes both certainty and predictability.

We advocate enforcing a specific prohibition or restriction on choice of law in a statute of the state whose law would apply according to the principles stated in Parts III.B and III.C above notwithstanding the contractual choice of law clause. For example, courts should consult a statute of the place of sale in product liability cases<sup>205</sup> in determining whether to enforce a sales agreement that specifies that the law of some other jurisdiction governs their relationship. Courts also should apply any statutory rules of the default jurisdiction, such as notice and disclosure requirements, that restrict enforcement of choice-of-law clauses.<sup>206</sup>

Moreover, statutes might apply where the public policy exception ordinarily would not arise—that is, where a state eschews rather than prefers its law. A state whose law is contractually chosen might specifically forbid, or include disclosure or other rules that restrict, the enforcement of choice-of-law clauses that choose its law, and then the prohibition or restriction should be respected, as long as the statute does not unconstitutionally discriminate.<sup>207</sup> This case is likely to be rare because parties normally will take account of such prohibitions in making the choice. A more likely case is when the parties do not contractually designate the applicable law and a statute of the state chosen according to the default rule specifies that its law should not be applied. Again, the forum court should respect the statute. Clear statutes that replace default rules can provide tailoring to specific circumstances (for example, concerning comparative regulatory advantage) without the loss of predictability entailed in applying case-by-case judicial rules.

Special problems for our approach are presented when forum law prohibits or restricts enforcement of choice-of-law provisions. Because the forum is chosen *ex post*, the parties may not be able to predict *ex ante* whether their choice is valid. Moreover, the forum probably does not have the comparative regulatory advantage in regulating over the state chosen under our default choice-of-law rules. On the other hand, a state court presumably cannot ignore a statute that specifically prohibits the courts from enforcing all choice-of-law clauses in litigation within the state. We take account of this constraint. However, as in the above situations, we advocate interpreting forum statute constraints

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<sup>205</sup> See Part IV.D.1.

<sup>206</sup> Although these rules are often described as “procedural” protections, parties focus on these requirements *ex ante*. Because the precise form of these contractual prerequisites will vary across the states, reference to default state law can significantly enhance certainty.

<sup>207</sup> See Brilmayer, *Conflict of Laws at 78–79* (cited in note 55) (discussing potential constitutional restrictions on the discriminatory application of state laws).

on choosing other law to apply only where forum law would apply in the absence of the clause. Unless a statute manifests a clear contrary intent, courts should assume that the legislature intended only to prohibit evasions of its own law. In addition, courts must apply local state statutes specifying choice-of-law rules that differ from those this Article advocates.

This reliance on statutory exceptions to our general approach does not contradict our skepticism expressed above in Part I.A about the efficiency of statutory substantive law. Rather, we claim only that *if* exceptions to our approach are to be made, courts should not be the ones to make them. As noted above, legislative exceptions are unavoidable to the extent that courts cannot ignore forum state statutes. Also, courts should respect non-forum statutes to the extent indicated above because this is the most efficient way to preserve the effect of beneficial laws. Legislative determinations are superior to judicial ones because they are more likely to provide notice to parties, are more likely to be subject to retroactivity challenges when they fail to provide notice, and, as discussed below in Part IV.A.2, are more likely to be subject to powerful interest group opposition if they are inefficient.

## F. Renvoi

The renvoi problem arises in every rule-based choice-of-law system. Specifically, when court X decides that Y state law applies, should court X apply Y substantive law, or should it apply Y choice-of-law rules even if this would point to state Z because this is what a Y state court litigating the case would do? The vested rights approach offered no satisfactory solution because using territoriality to find the applicable state does not clarify whether that state's law controls choice of law. Currie argued that the renvoi problem disappears under interest analysis because the inquiry focuses solely on which state's substantive policies should control the outcome.<sup>208</sup> If, however, interest analysis attempts to ascertain which states have an interest in determining the outcome of a dispute, then that state's choice-of-law rule reveals something about its preferences. If a state Y court would apply state X law to these facts, it must not care much about effectuating its policies in this case.<sup>209</sup> Since it is important to determine state Y's policies, the renvoi problem remains.

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<sup>208</sup> See Brainerd Currie, *Notes on Methods and Objectives in the Conflict of Laws*, 1959 Duke L J 171, reprinted in Currie, *Selected Essays* at ch 4, 184-85 (cited in note 75) (concluding that the closest approximation of the renvoi problem would exist only when neither state has an interest in the outcome, in which case the forum state should apply its own law on the simple basis of convenience).

<sup>209</sup> See Kramer, 66 NYU L Rev at 1011-12 (cited in note 101).

Our approach cuts through much of the renvoi problem by minimizing the role of legislative power and intent and emphasizing party choice. If the parties have explicitly contracted for the applicable law, courts should interpret the contract as referring to the substantive law of the state chosen in the clause in the absence of a contractual statement to the contrary. This reasonably assumes that the parties did not mean to deliberately hide the issue by incorporating a renvoi analysis in their choice-of-law decision. The same principle should apply in fashioning a default rule for situations where party choice is significant but there is no explicit contract. If parties must investigate additional procedural issues to forecast the laws governing their conduct, they are less able to direct their conduct in light of the applicable rule. Finally, renvoi is unsuitable even where party *ex ante* choice normally is not feasible, as in accident cases. The state with the comparative regulatory advantage is best able to regulate the underlying conduct,<sup>210</sup> but it most likely has no comparative advantage in determining the law that applies to that conduct.

Renvoi may be relevant under our approach to the limited extent that a foreign state statute compels it. If, according to the analysis in Part III.E, the forum must respect the choice of law specified in a statute of the default state or the state chosen in a contract, then application of the foreign choice-of-law statute would entail an acceptance of the renvoi.

#### IV. DEVELOPING THE FRAMEWORK

This Part elaborates on the general principles set forth in Part III by deriving choice-of-law rules for particular types of legal disputes. In general, we favor giving parties the ability to choose the applicable law or, where party choice is impracticable, to select the law of the state with the comparative regulatory advantage. The proposed rules reach similar results to those under the Restatement (First) territorial rules except that they focus on enhancing private ordering rather than on states' ability to regulate within their borders.

##### A. Contracts

Contract is the most straightforward application of our approach. Current law permits courts to override contractual choice of law where it lacks a sufficient relationship to the chosen state or contravenes an interested state's policy. However, we believe that courts should enforce contractual choice-of-law and choice-of-forum clauses irrespective of whether the parties have any contact with the chosen

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<sup>210</sup> See Part III.C.

jurisdiction.<sup>211</sup> Legislatures can, however, qualify enforcement of choice-of-law clauses, thereby providing a mechanism for effectuating efficient mandatory rules.<sup>212</sup> We also propose a clear default rule for those contracts that do not include a choice-of-law clause. This rule would replace the Restatement (First)'s confusing bifurcated performance/validity rule,<sup>213</sup> and the Restatement (Second)'s vague "significant relationship" and "contacts" test.

### 1. Choice-of-law clauses.

Our approach to enforcing choice-of-law clauses differs from the more restrictive approach in the Restatement (Second).<sup>214</sup> Under Restatement (Second) § 187(2), the parties cannot choose their own governing law for mandatory rules such as validity, where choice of law matters most, if:

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.<sup>215</sup>

Although these limitations reflect valid concerns about party choice of law, they are potentially broader than necessary to effectuate these concerns. The first, or "substantial relationship," test arguably helps ensure that chosen states internalize some effects of inefficiently lax laws by enabling those states to regulate only those who have a connection with the state. However, whether or not the *contracting* parties are subject to the law, the state presumably is constrained by other affected residents.<sup>216</sup> The second, or "fundamental policy," limitation is presumably intended to protect against evasion of efficient state regulation. However, other methods can protect the parties with

<sup>211</sup> For a fuller analysis of contractual choice of law, see Larry E. Ribstein, *Choosing Law By Contract*, 18 J Corp L 245 (1993). As discussed in this Article, enforcement of contractual choice of law may depend on enforcement of the parties' contractual choice of forum since courts have strong incentives to enforce the law of the forum and, as discussed below, this result is encouraged by application of interest analysis.

<sup>212</sup> See Part III.E (discussing which state statutes should be applied).

<sup>213</sup> See notes 227–28 and accompanying text.

<sup>214</sup> Restatement (Second) of Conflict of Laws § 187.

<sup>215</sup> *Id.* § 187(2)(a)–(b).

<sup>216</sup> See text accompanying note 52.

less intrusion on efficient ex ante choice of law. The parties may be unable readily to determine ex ante whether a court will find that the chosen law is within this restriction. But procedural requirements, such as requiring disclosure of significant regulation under the law that would apply in the absence of contract, can protect the non-drafting party without threatening predictability.<sup>217</sup> A legislature also might impose substantive restrictions on the types of regulation the parties may agree on to govern their contracts.<sup>218</sup>

In practice, courts applying the Restatement (Second) rule have generally enforced contractual choice of law.<sup>219</sup> Thus, the U.S. rule ends up functioning somewhat like the apparently more liberal rule articulated in the leading U.K. case of *Vita Food Products, Inc v Unus Shipping Co*,<sup>220</sup> which enforced a provision applying English law to a transaction whose only connection with England was the choice-of-law clause. Moreover, several states, including California, Delaware, New York, and Texas, have promulgated statutes that, to varying degrees, clarify the enforcement of contractual choice-of-law clauses.<sup>221</sup> In the end, then, our proposal may enhance ex ante predictability without fundamentally altering the current law on contractual choice.

## 2. Legislative restrictions on contractual choice.

General choice-of-law rules can only roughly approximate how best to balance party autonomy and government regulatory authority in individual cases. Our principles therefore are default rules that courts should apply only in the absence of an explicit legislative statement to the contrary. Clear and simple default rules not only aid the parties but also help the legislature ascertain when a statutory choice-of-law provision might be necessary. It is important, however, that any legislative restrictions on contractual choice be explicit. For example, a statutory rule that prohibits waiver of the statutory protections should not apply to choice of law unless it explicitly refers to choice of law.<sup>222</sup> As long as the legislature must specify the effect of contractual choice, interest group competition will help constrain any

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<sup>217</sup> See Part III.A.

<sup>218</sup> See Part III.E (discussing which state statutes should be applied).

<sup>219</sup> Symeonides, 46 Am J Comp L at 273 (cited in note 122).

<sup>220</sup> [1939] A C 277.

<sup>221</sup> Ribstein, 19 Del J Corp L at 1003–06 (cited in note 37) (summarizing Delaware statute on choice-of-law clauses and comparing it to statutes in three other states).

<sup>222</sup> This is supported by federal decisions regarding application of U.S. securities and anti-racketeering laws to international transactions. See notes 166–67. Our approach contrasts with that of Currie, who would assume that the legislature implicitly has decided the choice-of-law issue simply by enacting the underlying substantive law. See Currie, *Married Women's Contracts* at 107–08 (cited in note 75). See also *Lilienthal*, 395 P2d at 549 (holding in favor of extraterritorial application of spendthrift law despite lack of explicit legislative requirement).

resulting inefficiency.<sup>223</sup> Opposing and proponent groups can assess the costs and benefits of the statute net of exit effects  $C_e$  and  $B_e$ , and set their lobbying costs accordingly. By contrast, relying on case-by-case adjudication means that lobbying costs must reflect the likelihood that judges will hold in favor of extraterritorial application<sup>224</sup> and not merely the relative costs and benefits of the different exit rules. Thus, interest groups may fail to organize in opposition to a restriction because of the possibility that courts will let them avoid the restriction through a choice-of-law clause. Conversely, interest groups favoring the restriction on contractual choice may not mobilize because of the possibility that courts would interpret an anti-waiver provision to extend to choice of law.

Although legislatures would determine the enforceability of choice-of-law clauses, courts would continue to interpret these clauses. Consistent with the need for clear rules, courts should enforce choice-of-law clauses only if they are explicit. In the absence of an explicit clause, the default rules discussed in the next section should apply. Enforcing unarticulated expectations fosters ex post judicial determinations at the expense of ex ante choice.

The entire contract is, of course, subject to general contract rules including those on unconscionability and bad faith.<sup>225</sup> The unconscionability doctrine helps guard against the most egregiously one-sided contracts, while bad faith rules help protect against unfair surprise from an overly literal interpretation of contract provisions. These general procedural protections, along with those that might specifically apply to choice-of-law provisions,<sup>226</sup> provide more balanced protections than the vague and potentially sweeping rules in the Restatement (Second).

### 3. Default rules.

What law should apply to contracts when the parties have not explicitly selected a particular state's law? The Restatement (First) provides that the law of the place of contracting applies to validity issues and the law of the place of performance applies to performance-related contract issues.<sup>227</sup> This bifurcated rule makes some sense.

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<sup>223</sup> See text accompanying note 49.

<sup>224</sup> For example, courts might hold that contractual choice would violate a state's "public policy." Restatement (Second) of Conflict of Laws § 187(2)(b).

<sup>225</sup> See Part III.E (discussing which state laws should be applied).

<sup>226</sup> See Part III.A.

<sup>227</sup> Restatement (First) of Conflict of Laws at §§ 332, 358. The Restatement (Second) provides no rule at all, instead relying on a vague collection of factors and guidelines. Section 188 directs courts to choose the law of the state "with the most significant relationship to the transaction and the parties," lists contacts that courts should take into account "according to their relative importance with respect to the particular issue," and states that if negotiation and perform-

Whatever the choice-of-law rule, the parties will look to the law of the place of performance in order to allocate the burdens and benefits concerning such performance-related regulatory issues as interest rates, spendthrift protection, employment, and workplace rules. This focus on the law of a particular state reduces the parties' costs of considering that state's law on performance-related contract issues and may lead the parties to expect that law to be applied.

The problem with a rule bifurcated between place-of-performance and place-of-contracting is that it leaves choice of law to be settled by an ex post judicial decision about whether an issue is one relating to performance or validity. It therefore does not provide the clear identification of background rights that is conducive to party choice and control of conduct. In other words, a specific default rule that applies to both performance and validity issues is better than a general standard that courts "tailor" to specific facts.<sup>228</sup> A place-of-performance rule does not work for all contract issues because the place of performance may not be ascertainable without an ex post judicial interpretation of the contract. To be sure, for some contracts, such as those made over the telephone or the Internet, the place of contract may be ambiguous. In the telephone case, the best choice is the offeree's location, because this is the only one about which both offeror and offeree are likely to be informed. Similarly, in the Internet case, the default rule should be the *buyer's* location. Although this might subject sellers to several state laws, they can protect themselves by contracting with buyers for the application of a particular state's law. This solution makes particular sense because sellers are in a position to control the transaction form through their websites.<sup>229</sup> A default rule that favors buyers gives sellers an incentive to clarify the applicable law by contract rather than capitalizing on buyers' confusion.

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ance are in the same state, that state's law usually applies with some exceptions.

<sup>228</sup> "Tailoring" refers to the process by which courts generate a series of very narrowly applicable rules, usually as a result of applying a general standard to particular facts. For a general discussion, see Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U Chi L Rev 1391, 1403-08 (1992) (distinguishing between "tailored" and "untailored" rules). For an application of the tailoring principle to choice of law, see Whincop and Keyes, *Policy and Pragmatism* at 47, 120-21 (cited in note 168) (concluding that tailoring is appropriate for cases of continuing harmful externalities). See also Michael Whincop and Mary Keyes, *Putting the 'Private' Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 Melb U L Rev 515, 536-39 (1997) (advocating more general role for tailoring). We suggest tailoring concerning the intent underlying a specific law rather than in applying the law to the facts of the particular case. This kind of tailoring is better done by the legislature than by the courts.

<sup>229</sup> See Jack L. Goldsmith, *Against Cyberanarchy*, 65 U Chi L Rev 1199, 1214 (1998) (discussing how access to Internet sites could be conditioned "on consent to a particular legal regime"). See also Part IV.E.

A possible problem with an across-the-board place-of-contract default rule concerns optimal bundling of legal rules. In general, a state's contract validity rules interrelate, and therefore ought to be bundled, with that state's performance rules, since the duties placed on the parties might well turn on the ease with which the parties can enter into a contract. However, in some situations bundling among contract rules might be inconsistent with efficient bundling between contract and non-contract regulations in the state of performance. Under the approach discussed in Part III.E, the performance state generally would not be able to avoid this problem by legislating on choice of law because the court usually would look only to appropriately explicit statutes in the place of contract or the forum. But making the place of performance the default state would interfere with the predictability advantages of looking to the place of contract. A better solution would be to leave it to the affected parties to select contractually the performance state if optimal bundling is important in the specific case.

## B. Business Associations

Courts long have applied the law contractually selected by the parties to a corporation—that is, the law of the state of incorporation. The rule should be, and is being, extended to other business associations. This rule is consistent with, and lends support to, the arguments justifying enforcement of choice-of-law clauses in non-business-association contracts.<sup>230</sup> Indeed, as discussed below, corporations have been distinguished from other types of contracts in this respect mainly for historical reasons. As with other contractual choice of law, the rule has been, and should be, qualified only by an explicit forum state statute.

### 1. The corporate internal affairs rule.

As already discussed, theory and available data suggest that competition for public corporation law is efficient.<sup>231</sup> There is also theory and data supporting similar conclusions regarding competition for the law governing informal firms. The latter data are particularly interesting given the lack of either an efficient market or the presence of franchise taxes to motivate legislators.<sup>232</sup> Any business association is a multi-lateral and integrated contract among several actors who often have contacts with many different states. Thus, it may be particularly costly to apply multiple state rules to various aspects of corporate governance. Accordingly, this Article advocates a strong version of the

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<sup>230</sup> For a general discussion, see Ribstein, 18 J Corp L at 245 (cited in note 211).

<sup>231</sup> See note 41 and accompanying text.

<sup>232</sup> See notes 43–44.

“internal affairs” rule, according to which the law of the state of formation applies to matters covered by the chosen law of business associations, regardless of firm type.

One might wonder why strong contractual choice through selection of the formation state is more widely recognized for business firms than for conventional contracts.<sup>233</sup> Institutional economists have shown the fundamental economic similarity between business associations and other contracts as mechanisms for economizing on transaction costs.<sup>234</sup> As some commentators have noted, the need for certainty and uniformity does not justify the courts’ almost complete deference to the law of the chartering state in corporation cases.<sup>235</sup> Firms might resolve conflicts between mandatory and non-mandatory rules by complying with the former,<sup>236</sup> and between multiple mandatory rules through litigation and *stare decisis* or collateral estoppel.<sup>237</sup> However, having to comply with mandatory rules, or litigating conflicts between mandatory rules, can be costly for firms. Instead, business firms may punish states that do not recognize foreign incorporation by withdrawing assets and other contacts. Moreover, states may have recognized that refusal to grant foreign corporations privileges would invite retaliation in kind, thereby devaluing their own incorporation privileges.

Legal theory has accommodated these developments through the courts’ early acceptance of the idea that the corporation is not an ordinary contract, but rather a legal “person” created and endowed with

<sup>233</sup> The two sets of rules are compared in Ribstein, 18 J Corp L 245 (cited in note 211). For a discussion of the rules for non-corporate contracts, see Part IV.A.

<sup>234</sup> For some important theoretical contributions, see Sanford J. Grossman and Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J Pol Econ 691 (1988); Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (Free Press 1985); Eugene F. Fama and Michael C. Jensen, *Separation of Ownership and Control*, 26 J L & Econ 301 (1983); Steven Cheung, *The Contractual Nature of the Firm*, 26 J L & Econ 1 (1983); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J Pol Econ 288 (1980); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J L & Econ 233 (1979); Michael Jensen and William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure*, 3 J Fin Econ 305 (1976); Armen A. Alchian and Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am Econ Rev 777 (1972).

<sup>235</sup> See Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 Wash U L Q 445, 449–50 (1991) (arguing that deference to the state of incorporation in *CTS* has invited states to enact self-interested anti-takeover statutes); Buxbaum, 75 Cal L Rev at 37–47 (cited in note 39) (discussing a series of contexts in which serious problems of state law conflicts would be glossed over by deference to law of the chartering state); Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 Yale L J 137, 137 (1955) (attacking legislation that would permit local corporations to avoid local laws through opportunistically incorporating in another state).

<sup>236</sup> See Latty, 65 Yale L J at 141 (cited in note 235) (making a similar point about choice-of-law clauses generally).

<sup>237</sup> See Buxbaum, 75 Cal L Rev at 51 (cited in note 39) (discussing the preclusive effect of precedent in the choice-of-law context).

certain attributes by the chartering state.<sup>238</sup> This “entity” theory has more recently spread to unincorporated firms.<sup>239</sup> The entity theory not only insulates corporate liabilities from the owners’ individual assets, but also links the corporation to the state of creation. This, in turn, provides a stronger legal basis for enforcing the parties’ choice than a mere contractual designation.

## 2. Extensions beyond corporations.

Enforcement of contractual choice ultimately may spill over from the corporate context. For one thing, distinctions between corporations and other types of business associations rapidly are breaking down. The Restatement (Second) deals with contractual choice in firms such as general and limited partnerships by subjecting them to the same qualifications as other types of contracts rather than applying the stronger corporate rule. While the Restatement attempts to justify the distinction on the ground that the parties to a partnership may have no real expectation concerning the applicable law,<sup>240</sup> that is plainly not true for non-corporate limited liability firms whose owners clearly select the applicable law by filing a certificate in a particular state. In any event, this distinction may be breaking down as legislators increasingly provide explicitly for enforcement of formation state law for new entities such as limited liability companies and limited liability partnerships.<sup>241</sup>

Contractual choice of law is also expanding to informal firms, particularly general partnerships. The Revised Uniform Partnership Act includes a default choice-of-law rule applying the law of the place of the chief executive office to “relations among the partners and between the partners and the partnership,”<sup>242</sup> that is explicitly subject to contrary agreement.<sup>243</sup> This replaces the complex Restatement (Second) contract rules with a simple default rule.<sup>244</sup> The application of contractual choice to partnerships ultimately may reduce the tradi-

<sup>238</sup> For discussions of the effect of the legal person fiction on choice of law, see Larry E. Ribstein, *The Constitutional Conception of the Corporation*, 4 S Ct Econ Rev 95, 97–100 (1995); Willis L.M. Reese and Edward M. Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 Colm L Rev 1118, 1121–22 (1958).

<sup>239</sup> See, for example, Uniform Partnership Act of 1997 (“RUPA”) § 201(a), in 6 ULA (West Supp 2000). (“A partnership is an entity distinct from its partners.”)

<sup>240</sup> See Restatement (Second) of Conflict of Laws § 294, Cmt b (“[I]f [the partners] have not provided that their obligations should be determined by the local law of a given state, it is probable they did not have any precise expectations with respect to that issue.”).

<sup>241</sup> See Larry E. Ribstein and Robert R. Keatinge, *Ribstein & Keatinge on Limited Liability Companies* ch 13 (West 2000).

<sup>242</sup> RUPA § 106(a).

<sup>243</sup> RUPA limits opt out by limited liability partnerships. See text accompanying note 255.

<sup>244</sup> For criticism of this rule, see Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J Small & Emerging Bus L 249 (1997).

tionally high degree of uniformity of partnership law.<sup>245</sup> The resulting competition and variation may lead to the development of more efficient partnership law.

Expanded enforcement of contractual choice in business firms may further affect enforcement in non-business-association contracts. As discussed above, the different treatment of the two categories cannot be explained by inherent economic distinctions between these two transaction categories.<sup>246</sup> Courts therefore may reason by analogy from business associations to other types of contracts. Legislative expansion is also possible. One of the authors has suggested making available a “contractual entity” mechanism by which relationships that may or may not be classified as economic “firms,” such as franchise relationships, can escape owners’ vicarious liability for their agents’ acts by making a public filing analogous to a certificate of incorporation.<sup>247</sup> This would be the logical path of development of the expanding concept of limited liability.

### 3. Limitations on application of formation state law.

Contractual choice of law for business associations might be limited in three significant ways. First, the choice extends only to internal governance matters and limited liability. In other words, shareholders cannot on their own, through the certificate, choose the law that applies to the firm’s dealings with third parties except with respect to the rules on limited liability. While this principle seems obvious, the qualification as to limited liability creates ambiguities. For example, does the formation state govern the agency power of corporate agents to bind the firm in third party transactions, or exceptions to limited liability under “veil-piercing” law? These matters are closely connected to those that are subject to the formation state’s law, such as agents’ management power. It therefore arguably follows that formation state law should apply even if the matters also might be viewed as applying to specific dealings with third parties.

Second, a couple of states have laws applying their own corporation laws to “pseudo-foreign” firms that are incorporated elsewhere but substantially located locally.<sup>248</sup> Although these laws are troublesome on policy grounds because they threaten the security of contrac-

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<sup>245</sup> The Uniform Partnership Act (1914) has been adopted substantially verbatim in all states except Louisiana. See Uniform Partnership Act, 6 ULA 125–26 (West Master ed 1995 & Supp 1999) (listing adopting states).

<sup>246</sup> See text accompanying notes 233–37.

<sup>247</sup> For a general discussion, see Ribstein, 24 Del J Corp L at 407 (cited in note 169).

<sup>248</sup> See Cal Corp Code § 2115(a) (West 1990 & Supp 2000); P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 Duke L J 1, 66–67 (discussing progression in New York statutes applying New York corporation law to foreign corporations with requisite domestic presence).

tual choice, and may even be unconstitutional,<sup>249</sup> they comport with our general approach. As discussed above, explicit legislative restrictions on contractual choice comport with our theory since interest groups' willingness to buy more restrictive laws constrains potential inefficiency. Thus, for example, states would be unlikely to impose restrictions on "pseudo-foreign" firms where this would cause corporations to avoid contacts with the state to the detriment of local markets, and thereby to cause harm to lawyers and others who gain from such contacts. Not surprisingly, pseudo-foreign restrictions are limited to California and New York, which have enough market power to avoid being punished by exit of the affected firms. While these states might be viewed as exploiting locational monopolies, even they are constrained by competition to avoid severe limits on corporations. To be sure, these laws might lead to inefficient results by making it difficult for firms bound to large states to escape inefficient laws. However, the constraints on this inefficiency are significant in determining whether constitutional limits are appropriate. Moreover, our claim regarding enforcement of forum statutes is not that these statutes are always efficient, but that relying on these statutes is superior to enforcing judicial choice-of-law rules even in the absence of a statute.<sup>250</sup>

Third, formal incorporation arguably should be mandatory for contractual choice. This issue arises regarding choice-of-law statutes that ensure application of the state's law to certain large transactions.<sup>251</sup> Should a firm be able to incorporate in a state where incorporation fees are low while choosing to apply Delaware corporation law to all of the firm's internal affairs under the Delaware choice-of-law statute?<sup>252</sup> This would create a sort of "platypus" that is both mammal (a Delaware contract) and reptile (a corporation organized under state X law).<sup>253</sup> In the converse situation, a Delaware court applied Delaware law to a shareholders' agreement of a Delaware corporation that selected New Jersey law.<sup>254</sup> Analogously, the Revised Uniform Partnership Act applies a limited liability partnership's formation state law rather than a different law chosen in the partnership agreement.<sup>255</sup>

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<sup>249</sup> For discussions of the constitutional issue, see the authorities cited in note 238.

<sup>250</sup> See Part III.E.

<sup>251</sup> For a general discussion, see Ribstein, 19 Del J Corp L 999 (cited in note 37).

<sup>252</sup> See *id.* at 1022–25 (discussing this type of business formation).

<sup>253</sup> This problem cannot be resolved by requiring bundling. The question is not whether to bundle, but whether to apply the entire law chosen through incorporation or the entire law chosen through a choice-of-law clause.

<sup>254</sup> *Rosenmiller v Bordes*, 607 A2d 465, 469 (Del Ch 1991) (ruling that the "present dispute falls squarely within the internal affairs doctrine" and so Delaware has a greater interest in regulation than New Jersey).

<sup>255</sup> See RUPA § 103(b)(9).

There are several arguments for prohibiting alternative choice in this situation. Permitting contracts to override application of formation state law may create confusion because of the collision of two choice-of-law rules. However, an interpretation rule requiring the parties to make explicit their intent to opt out of the default choice-of-law rule would reduce or eliminate the confusion. A stronger argument is that states should have a property right in their business laws, and therefore be able to charge parties franchise and other fees for using these laws, in order to give legislators appropriate incentives to improve their laws.<sup>256</sup> This argument might apply more to publicly held than to closely held firms. In the latter case, incorporation fees may be a less important motivator than lawyers' gains in litigation and planning business from use of their local law. However, in the absence of high incorporation fees, the property right in the law might be viewed as belonging to lawyers rather than to the "state." Lawyers might have an interest similar to the state's in coupling the use of the statute with local formation since formation would provide a basis for litigating locally. On the other hand, lawyers engaged in transactional work might want to give their state law away to firms basically for free for the same reason that software firms give away Internet browsers—to generate secondary business.<sup>257</sup>

In the final analysis, the question of whether to enforce "platypus" firms should be settled in the same way as restrictions on pseudo-foreign corporations<sup>258</sup> and on contractual choice of law generally: Courts should apply the law chosen in the contract unless the legislature explicitly imposes a state-of-incorporation rule irrespective of contract. In other words, the mere existence of an incorporation procedure should not in itself negate contractual choice without an explicit legislative statement to that effect.<sup>259</sup> As with other restrictions on contractual choice of law, this would help ensure the efficiency of mandatory rules by forcing the restriction's proponents to incur the extra political costs of obtaining interstate application of local law.

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<sup>256</sup> For a discussion of the importance of these incentives, see Romano, 1 *J L, Econ, & Org* 225 (cited in note 42). The same considerations do not justify overriding explicit contractual choice in other contexts where the state can gain from parties' use of the law wholly apart from contractual choice. For example, a state may fashion its real property law in order to increase the value of owning land in the state. This increases property tax revenues whether or not the parties choose situs law to govern contracts relating to the land.

<sup>257</sup> The latter explanation appears inconsistent with the RUPA rule explicitly tying formation and choice of law. See note 255 and accompanying text.

<sup>258</sup> See text accompanying notes 248–50.

<sup>259</sup> The statement might resemble that in RUPA, discussed in note 255 and accompanying text.

### C. Marriage

Marriages, like business associations and commercial contracts, are an appropriate context for enforcement of contractual choice. As with corporations, courts generally have enforced the parties' choice of law, in this case exercised by choosing where to marry, except where contrary to "public policy."<sup>260</sup> We support enforcing the parties' choice as to the contractual aspects of marriage, once again subject only to a contrary domicile statute and not to judicial rule. Allowing the spouses to select their marriage jurisdiction allows for competition among marriage regimes. Moreover, in marriage as in corporations there is a strong need for certainty.<sup>261</sup>

Marriages differ from more conventional contracts and business associations mainly in regard to the external effects of marriage in the spouses' domicile. Because of the family's central role in society, marital status is fraught with tradition and social values and plays an important signaling role. States use marriage law to define the types of relationships they want to encourage through subsidies, as distinguished from those they wish to discourage both by not conferring subsidies and even by criminal penalties.<sup>262</sup> Accordingly, a state's liberal marriage law might help the local tourist trade but impose costs where the couple returns to live. There is also a somewhat greater justification for state paternalism given the emotional nature of the decision, its significance to the married couple,<sup>263</sup> and the absence of efficient markets to discipline choice of marriage partners.

Despite these differences, traditional choice-of-law rules concerning marriage are closely analogous to the strong contractual choice that applies to business associations.<sup>264</sup> The rules emphasize contractual choice by giving the parties considerable power to specify which marriage regime applies. The law of the state where the parties marry generally determines validity in the absence of the strong countervailing public policy of some other state closely connected with the marriage.<sup>265</sup> The marriage rule, like the one for corporations, has been rationalized on the basis that marriage is a privileged status that is

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<sup>260</sup> See text accompanying note 265.

<sup>261</sup> See Scoles and Hay, *Conflict of Laws* § 13.8 at 445 (cited in note 196).

<sup>262</sup> See F.H. Buckley and Larry E. Ribstein, *Calling a Truce in the Marriage Wars*, 2001 U Ill L Rev (forthcoming).

<sup>263</sup> Although the significance of the decision gives the spouses incentives to seek information, a state may legislate paternalistically, for example, to protect an immature person from erring about an important decision.

<sup>264</sup> See Note, *In Sickness and in Health, in Hawaii and Where Else?: Conflict of Laws and the Recognition of Same-Sex Marriage*, 109 Harv L Rev 2038, 2053 (1996).

<sup>265</sup> See Restatement (Second) of Conflict of Laws § 284; Restatement (First) of Conflict of Laws § 132; Scoles and Hay, *Conflict of Laws* § 13.5 at 438 (cited in note 196).

created by the state whose laws sanction the marriage,<sup>266</sup> implying that another state should not question this status. The courts also apply a strong policy favoring certainty regarding the validity of a marriage.<sup>267</sup> Consistent with these views, courts usually uphold marriages that are valid where made even if barred by domicile law.<sup>268</sup> Also, many state statutes specifically provide that a marriage valid where entered into is valid everywhere.<sup>269</sup>

The increasing attention being paid to same-sex marriage challenges the contractual approach to marriage and may signal a wider role for restrictions on contractual choice.<sup>270</sup> Accordingly it is important to consider how far courts should go in enforcing contractual choice of the state of celebration. Courts traditionally have taken potential externalities and paternalism problems into account in the context of the public policy exception.<sup>271</sup> A potential antidote is constitutionally to require states to recognize foreign same-sex marriage under the Full Faith and Credit Clause.<sup>272</sup> The public policy exception leaves much latitude to courts and therefore compromises the security of marriage. However, the full faith and credit antidote may not give sufficient attention to states' justifications for refusing to recognize nonstandard marriages.

Applying contractual choice of law to marriage, including same-sex marriage, may be a useful compromise between these extremes.<sup>273</sup> Under this approach, because marriages are typically considered valid everywhere if they are valid in the state of celebration,<sup>274</sup> courts would treat the contractual elements of marriage like other contracts.<sup>275</sup> Domicile state legislatures would make their own choices about non-contractual elements such as marriage subsidies and parenting rules.

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<sup>266</sup> See *Maynard v Hill*, 125 US 190, 210–11 (1888); Scoles and Hay, *Conflict of Laws* § 13.1 at 430 (cited in note 196).

<sup>267</sup> See Scoles and Hay, *Conflict of Laws* § 13.8 at 445 (cited in note 196).

<sup>268</sup> *Id.* at 444–45 (describing cases upholding marriages that occurred following divorce, even though the law of the domicile state would not have permitted the divorce).

<sup>269</sup> *Id.* at 439.

<sup>270</sup> See Buckley and Ribstein, 2001 U III L Rev (cited in note 262).

<sup>271</sup> See Michael E. Solimine, *Competitive Federalism and Interstate Recognition of Marriage*, 32 Creighton L Rev 83, 94–96 (1998).

<sup>272</sup> See Larry Kramer, *Same-Sex Marriage, Conflict of Laws, and the Unconstitutional Public Policy Exception*, 106 Yale L J 1965, 1978 (1997).

<sup>273</sup> See Buckley and Ribstein, 2001 U III L Rev (cited in note 262).

<sup>274</sup> The applicable law would be that of the place of *celebration* rather than one merely specified in a contract between the spouses. Requiring the future spouses to leave home and travel to another jurisdiction to marry under a more liberal law helps to ensure that the spouses have made a considered decision, thereby allaying possible paternalism concerns. It also allows the domicile state to send a signal concerning its disapprobation of the marriage, helping it to preserve its own more traditional marriage rules. See *id.*

<sup>275</sup> The precise distinction between contractual and non-contractual elements of marriage is discussed in Buckley and Ribstein. See *id.*

Moreover, explicit domicile state legislation might restrict the validity of same-sex marriages.

#### D. Market Torts

Contracting for the applicable law is feasible not only with regard to claims that are technically characterized as “contracts,” but also for some claims that are conceptually torts because they result in tort-like injuries.<sup>276</sup> Courts often do not apply choice-of-law clauses to tort actions arising out of contractual relationships.<sup>277</sup> This distinction may reflect a concern that victims of tort-type injuries cannot bargain effectively over the applicable law. However, since potential tort victims ultimately bear the costs of their choices, they may have a stronger incentive to evaluate accurately the appropriate legal standard of care than would a judge or jury.<sup>278</sup>

To be sure, tort victims may have judgment biases that infect their assessment of potential tort risks.<sup>279</sup> They also may have less access to relevant information than the product seller who proposes the choice-of-law clause. But even if these problems raise legitimate concerns about complete waiver of liability, they do not necessarily justify barring the less drastic choice among liability rules. The benefits of enabling the parties *ex ante* to resolve ambiguities about the legal standard that will govern their conduct outweigh the costs of enabling party choice. This enables the parties to internalize the incentives that the law hopes to create.

Accordingly, there is a strong justification for a default legal rule favoring enforcement of choice-of-law clauses. As with contracts generally, the rule would be subject to explicit statutory override.<sup>280</sup> Thus, legislators might ban contractual choice for tort-type injuries.<sup>281</sup> They also might consider specifically addressing potential information asymmetries or the risk of contracting for minimal liability regimes by adopting explicit disclosure rules<sup>282</sup> or substantive limits on choice of

<sup>276</sup> See generally Michael J. Whincop and Mary Keyes, *The Market Tort in Private International Law*, 19 Nw J Intl L & Bus 215 (1999).

<sup>277</sup> See, for example, *Wagoner v Leach Co.*, 1999 Ohio App LEXIS 3152, \*40; *Klock v Lehman Brothers Kuhn Loeb, Inc.*, 584 F Supp 210, 215 (S D NY 1984).

<sup>278</sup> See Paul H. Rubin, *Courts and the Tort-Contract Boundary in Product Liability*, in Buckley, ed., *The Fall and Rise of Freedom of Contract* at 119–20 (cited in note 12).

<sup>279</sup> For discussions of cognitive errors and their effects on private judgments, see Cass R. Sunstein, *Cognition and Cost-Benefit Analysis*, Chicago John M. Olin Law & Economics Working Paper No. 85, 9–19 (1999); Christine Jolls, Cass R. Sunstein, and Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 Stan L Rev 1471 (1998); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 Vand L Rev 1499 (1998).

<sup>280</sup> See Part IV.A.2.

<sup>281</sup> See Part III.E (discussing which statutes should be applied).

<sup>282</sup> Compare Gottesman, 80 Georgetown L J at 14 (cited in note 179) (noting that liberal

law rather than barring contractual choice altogether.<sup>283</sup> This may lead to clearer and more precise legal rules than courts can devise on a case-by-case basis.

With respect to disputes that courts might characterize as involving tort issues between contracting parties who have not designated the law governing their relationship, courts should apply the law governing contract disputes rather than a place-of-injury or other tort conflicts rule. Among other things, this would minimize characterization difficulties that bedevil borderline causes of action such as breach of fiduciary duty and inducing breach.<sup>284</sup> As with enforcing explicit contractual choice of law, applying contract choice-of-law default rules to all causes of action arising out of the contract therefore would enhance ex ante predictability and the parties' ability to choose the applicable law.

The following subsections apply this analysis to two of the most important categories of market torts: product liability and professional malpractice.

### 1. Product liability.

Although product liability is usually today seen as a tort action, it began with, and is still conceptually linked to, the sale of a product. Sales law embodied in the Uniform Commercial Code governs this transaction. Where contract privity rules and liability waivers barred contract recovery, tort characterization protected injured consumers. But whether or not suits for product injuries are technically based in tort or contract, the parties should be able contractually to choose the law that best suits their relationship.

In the absence of an explicit contract, courts should apply the law of the state where the product was sold rather than that of the state where the plaintiff was injured. Several commentators have recognized the advantages of a point-of-sale rule for choice of law.<sup>285</sup> Most

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enforcement of choice-of-forum clauses in product sales conflicts can leave the purchasers unwittingly bound to litigate in a forum with pro-manufacturer rules).

<sup>283</sup> See text accompanying note 172.

<sup>284</sup> See, for example, *Nedlloyd Lines BV v Superior Court*, 3 Cal 4th 459, 834 P2d 1148, 1155 (1992) (enforcing a choice-of-law clause despite litigant's attempts to characterize the cause of action as a non-contract claim).

<sup>285</sup> See, for example, O'Hara and Ribstein, 48 Mercer L Rev at 769 (cited in note 23); Allen and O'Hara, 51 Stan L Rev at 1046 (cited in note 96); Whincop and Keyes, 19 Nw J Intl L & Bus at 263 (cited in note 276); Solimine, 24 Ga L Rev at 89-90 (cited in note 2); McConnell, *Choice-of-Law Approach* at 98-99 (cited in note 86) (arguing that a point-of-sale rule would tend to optimize level of product liability law among the states). Compare P. John Kozyris, *Choice of Law for Products Liability: Whither Ohio?*, 48 Ohio St L J 377, 383-85 (1987) (arguing that the place of the product's intended use should become the principal connection in choice-of-law determinations).

importantly for our purposes, the rule permits both manufacturers and consumers to choose the laws that best fit their activities and preferences. Manufacturers can choose where to distribute their product based on the law at the point of sale, while consumers potentially have notice of the applicable law because they know where they have bought the product. A point-of-sale rule maximizes manufacturers' ability to set prices based on the applicable liability rule and consumers' ability to determine their preferred tradeoff between price and safety level.<sup>286</sup>

By contrast, the traditional place-of-injury rule exposes manufacturers to the potential application of any law where the product happened to cause injury.<sup>287</sup> Manufacturers could not easily avoid a state's expansive liability laws even by refusing to sell in that state. Under interest analysis, any forum probably can find some basis for applying its law, so the law of any state with jurisdiction over the manufacturer might apply.<sup>288</sup> Interest analysis therefore gives states incentives to adopt stringent product liability rules that transfer wealth from manufacturers to injured plaintiffs and their lawyers in order to attract litigation and benefit the local trial bar.<sup>289</sup>

It might be said that a place-of-sale rule facilitates a race to the bottom because of bargaining and information asymmetries between manufacturers and consumers. Given these asymmetries, states might tailor their rules for manufacturers in order to maximize sales tax revenues and benefits for local merchants. If so, a place-of-sale rule would weaken product safety. But this race-to-the-bottom argument is not persuasive for several reasons. First, because a place-of-sale rule lets manufacturers avoid states only by refusing to sell there, it primarily enables sellers to avoid only particularly harsh laws rather than to embrace particularly favorable ones. Manufacturers can take full advantage of a lax regime only by concentrating all of their sales there. Since states with the largest markets are also likely to have the largest local consumer interest groups, manufacturers have a market incentive to remain subject to relatively pro-consumer laws. Second,

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<sup>286</sup> A possible problem with a point-of-sale rule is that in consolidated mass tort cases it may result in the application of many different laws in the same proceeding, possibly even defeating the ability to bring the case as a class action. See Whincop and Keyes, 19 Nw J Intl L & Bus at 263 (cited in note 276). The question in this situation is whether reducing litigation costs *ex post* has greater overall benefits than increasing *ex ante* predictability.

<sup>287</sup> See McConnell, *Choice-of-Law Approach* at 98–99 (cited in note 86).

<sup>288</sup> See Solimine, 24 Ga L Rev at 71 (cited in note 2) (identifying the pro-plaintiff bias and forum shopping opportunities that complicate containing costs and benefits within a state). To be sure, interest analysis may be preferable in this respect to territorial rules. See note 291.

<sup>289</sup> Compare Lea Brilmayer, et al, *A General Look at General Jurisdiction*, 66 Tex L Rev 721, 747 (1988) (noting that expansive general jurisdiction burdens outside corporations who compete with in-state corporations, and “provides a boon to the local bar, a group that is hardly without influence in local politics”).

choice of law is most important in the context of national products markets, where information sources such as consumer advocates, national advertising, Consumer Reports, and the Internet ameliorate information asymmetries, and educated, informed, and technically adept consumers help set prices.<sup>290</sup> These sources can warn consumers of any reduced legal protection where products are sold. Third, the alternative place-of-injury rule is not necessarily better for *consumers* as a general class because it transfers the effective choice to *lawyers* and *plaintiffs*, who may not have incentives to seek the price/safety trade-off that is most beneficial for consumers.

Manufacturers might prefer a place-of-manufacture or manufacturer's domicile rule to the place-of-sale rule. Rules geared to the manufacturer's location secure a single tort standard for all of a manufacturer's sales and give states an incentive to compete for tax revenues by offering products laws that are favorable to manufacturers.<sup>291</sup> However, such rules would be inefficient because they do not facilitate the parties' *mutual* choice of law. Consumers could not easily determine what law applies under a manufacturer-focused rule, especially where the seller owns or buys from factories all over the world. Even manufacturers ultimately might prefer a place-of-sale rule because they will bear some consumer information costs in competitive markets.

Parties could contract for a law other than that of the place of sale, including the place of manufacture or the manufacturer's home office.<sup>292</sup> Under current doctrine, a court might characterize this contractual choice as an adhesion contract or, more specifically, a contract that is contrary to the "fundamental policy" of an involved state under Restatement (Second) § 187(2)(b).<sup>293</sup> A potential problem with contractual choice is that, unlike under the place-of-sale default, manufacturers could have all of their sales governed by the law of a state in which consumers have little political power. However, it is probably more significant in this context that, as with the place-of-sale rule, the contractual choice would be disciplined by national products markets.<sup>294</sup> In any event, barriers to contractual choice in this setting do appear to be shrinking. The Supreme Court has led the way under

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<sup>290</sup> See Alan Schwartz and Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U Pa L Rev 630, 655-56 (1979).

<sup>291</sup> Indeed, because of the potential for such competition, interest analysis has been said to lead to more defendant-oriented product liability laws than the Restatement (First) place-of-injury rule. See Hay, 80 Georgetown L J at 617 (cited in note 2).

<sup>292</sup> The chosen law might have no connection with either party. However, this is unlikely in practice because manufacturers want to choose the law of a place where they have some political leverage.

<sup>293</sup> See text accompanying note 215.

<sup>294</sup> See text accompanying note 290.

federal law in enforcing closely related choice-of-forum<sup>295</sup> and choice-of-adjudicator<sup>296</sup> clauses in contract settings that lacked explicit bargaining over the contract term.

Like the other rules we propose, judicial rules enforcing contractual choice and otherwise applying the default place-of-sale law in products cases would be subject to explicit legislative modification.<sup>297</sup> States could impose substantive and procedural statutory limits on contractual choice in these cases. Competition between well organized manufacturer and trial lawyer interest groups would help ensure the overall efficiency of local statutes. Even without explicit legislation, courts should level the contractual playing field by requiring manufacturers to select an entire body of state law rather than picking only favorable terms.<sup>298</sup>

## 2. Professional malpractice and ethical rules.

Like product liability, professional malpractice is a tort that occurs within a contractual relationship, in this case between the professional and the client. However, the outcome of the choice-of-law decision is less likely to hinge on whether the claim is treated as contract or tort in malpractice than in product cases. In malpractice cases, the place of injury is likely to be the same as where the parties formed their relationship and the malpractice occurred.<sup>299</sup>

An important consequence of claim characterization in malpractice cases under our theory concerns enforcement of contractual choice of law. The benefits of contractual choice are, if anything, even stronger in this context than for product liability. Without the ability to contract for their applicable law, national accounting or law firms, like manufacturers, might be subject to different and inconsistent state laws. On the other hand, the idiosyncratic nature of professional services, and the fractionalized markets that state licensing and different legal and medical specialties create, weaken potential market discipline as compared with product liability. The important compensating factor is that professional ethics rules give clients some protection from informational asymmetries and overreaching.

What choice-of-law rules should apply to professional services in the absence of contractual designation? A “place-of-services” default

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<sup>295</sup> See *Carnival Cruise Lines v. Shute*, 499 US 585, 593–94 (1991) (upholding forum selection clause despite fact that the parties did not bargain over its content).

<sup>296</sup> See *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 US 477, 483–84 (1989) (upholding arbitration clause in dispute under federal securities law).

<sup>297</sup> See Part III.E (discussing which statute should be applied).

<sup>298</sup> See Part III.D.

<sup>299</sup> As discussed below, that place may not be clear. Also, this unity of place might disappear as professional relationships move to the Internet. See text accompanying note 386.

rule provides the same choice-maximizing mutual notice for health services as a place-of-sale rule for product liability because the patient's body must be presented at the doctor's office. However, for intellectual services such as law and accounting, the analogous rule is less clear. Legal services, for example, might be sold at the attorney's office, at the client's home or office, or electronically at neither place. In general, under our approach, the courts should apply a clear rule rather than a standard that courts tailor to particular facts.<sup>300</sup> Moreover, the default rule arguably should favor the consumer because of the professional's informational advantage and the ability to choose the governing law in the services contract. At the same time, however, professional ethics rules and norms often prevent the professional from actively seeking business from particular clients,<sup>301</sup> making it more likely that the client has sought service from the professional. A rule based on the location of the professional's office is therefore likely to involve lower total information costs as compared to one based on the client's office or residence. Moreover, unlike manufacturers, professional norms may preclude lawyers from discriminating among clients in order to avoid application of protective rules.

As in product liability and other contract cases, the above rules are subject to potential statutory modification. Legislatures can bar contractual choice in malpractice cases, limit the rules that can be chosen, or impose disclosure or other procedural constraints.<sup>302</sup> For example, the statute might require as a prerequisite to enforcement that the choice-of-law clause be explicitly embodied in a retainer agreement and disclose the effect of the clause,<sup>303</sup> and that the client obtain independent professional advice. Although such rules might prevent some efficient bargains, they would still be preferable to an absolute bar.

As indicated above, liability rules may interrelate with ethical rules. This raises the question whether lawyers and clients ought to be able to contract for the governing ethical regime along with the liability rule. Choice of ethical regime is a complex and difficult issue that is appropriately left for separate discussion. However, it is worth noting that the foregoing analysis of malpractice choice of law arguably also applies to ethics rules. Given the long history of state regulation of the professions, it seems unlikely in the near term that states would let

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<sup>300</sup> See text accompanying notes 193–94.

<sup>301</sup> This is, of course, true for lawyers. See generally Charles W. Wolfram, *Modern Legal Ethics* § 14.2.5 at 785–90 (West 1986) (discussing historical development of ethical prohibition against attorney solicitation of clients).

<sup>302</sup> See Part III.A.

<sup>303</sup> Existing lawyer ethics rules may impose similar duties. See, for example, Model Rule of Professional Conduct 7.1(a) (ABA 1993) (providing that omission of necessary facts can render advertisement misleading or false); Or Code of Professional Responsibility DR 2-101(A) (2000) (available in Westlaw OR-RULES database) (prohibiting misleading representations to clients).

lawyers designate the rules of any state unrelated to either the firm or its individual lawyers. But as the practice of law migrates to the Internet, state boundaries might disappear and competition and contractual choice of law might emerge here as in other areas.<sup>304</sup>

In the meantime, the rules regarding choice of ethical regime for lawyers and other professionals should at least be clear enough to enable the parties to conform their conduct to the applicable rule. The American Bar Association's Model Rules of Professional Conduct mostly accomplish this objective by generally applying the ethical rules of the state where the lawyer is admitted to practice.<sup>305</sup> The drafters recognized the need for "relatively simple, bright-line rules" governing lawyers.<sup>306</sup> This rule does not, however, address the plight of multi-state law firms. Because ethical rules can affect the firm's structure,<sup>307</sup> the rules need to apply at the firm level, based for example on the location of the principal office, rather than that of the individual office or lawyer.

#### E. Non-Market Torts

Where explicit contracts are not feasible, default choice-of-law rules should empower the state with the comparative regulatory advantage. We have left until now precisely how such an approach would apply to torts between strangers. There are several potential choices for non-market torts: (1) the law of the place of the injurer's conduct; (2) the law of the place where the injury manifested itself; (3) the law of the victim's domicile; and (4) the law of the tortfeasor's domicile.

The difficulty of fashioning choice-of-law rules for accident cases under a comparative regulatory advantage approach concerns tort rules' competing functions of regulating conduct and distributing

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<sup>304</sup> See text accompanying note 386.

<sup>305</sup> See Model Rule of Professional Conduct 8.5(b) (ABA 1997). If the lawyer is admitted to practice in two or more states, then the forum rule applies to litigation-related breaches if the lawyer is admitted there. For other breaches, the law of the state in which the lawyer "principally practices" governs unless the "particular conduct clearly has its predominant effect in another jurisdiction in which the lawyer is licensed." *Id.* This latter qualification has been criticized for creating unnecessary uncertainty. See Jeffrey L. Rensberger, *Jurisdiction, Choice of Law, and the Multistate Attorney*, 36 S Tex L Rev 799, 833-37 (1995); Mary C. Daly, *Resolving Ethical Conflicts in Multijurisdictional Practice—Is Model Rule 8.5 the Answer, an Answer, or No Answer at All?*, 36 S Tex L Rev 715, 760-61 (1995).

<sup>306</sup> See American Bar Association, *Reports with Recommendations to the House of Delegates* 4 (ABA 1993). Not all lawyers agree that the ABA's rule-based approach is appropriate. See Gregory B. Adams, *Reflections on the Reaction to Proposed Rule 8.5: Consensus of Failure*, 36 S Tex L Rev 1101, 1105 (1995) (noting that "the ultimate failure of proposed Rule 8.5 is that it ignores the very state interests that have created the impetus for the revision"). The Restatement (Third) of the Law Governing Lawyers § 5 cmt h (Proposed Final Draft 1998), proposes a multi-factored approach similar to the Restatement (Second).

<sup>307</sup> See Larry E. Ribstein, *Ethical Rules, Agency Costs and Law Firm Structure*, 84 Va L Rev 1707 (1998).

losses.<sup>308</sup> The place of defendant's conduct arguably has the advantage in generating conduct rules, while the place of injury and of the parties' domiciles might be better situated to decide issues that allocate losses, such as those pertaining to survival of actions, immunities and damages. The Restatement (Second) applies a "most significant relationship" test, taking into account the above factors in addition to the place where the parties' relationship is centered.<sup>309</sup> The Restatement (First) generally looks to the place of the wrong.<sup>310</sup> Consistent with our emphasis on clarity and predictability, we advocate a single "place of injury" rule.

Because of the need for categorical rules that bundle all issues and provide clear ex ante notice of the applicable law to facilitate choice and shape conduct, a single rule should apply in accident cases regardless of the precise issue involved.<sup>311</sup> The rule should apply the law of the place of injury. This rule is superior to one based on the place of conduct where this differs from the place of injury.<sup>312</sup> Both the tortfeasor and the plaintiff generally both know and can exercise some control over the place of injury, while plaintiffs may not know the place where the wrongful conduct occurred.<sup>313</sup> To be sure, a place-of-injury rule might create problems for insurers because they might be better able to predict the insured's conduct than they can the place of injury. But as long as the rule is clear, insurers can set rates reasonably accurately.<sup>314</sup> A fortiori, a place-of-injury rule provides better notice for both parties than one based on either plaintiff's or defendant's domicile.

<sup>308</sup> See note 137 and accompanying text.

<sup>309</sup> Restatement (Second) of Conflict of Laws § 145.

<sup>310</sup> Restatement (First) of Conflict of Laws §§ 378–79. This is defined as "where the last event necessary to make an actor liable for an alleged tort takes place." Id at § 377.

<sup>311</sup> See text accompanying notes 193–94.

<sup>312</sup> Criminal liability is a possible special case in which the place of conduct should apply. States typically do not enforce each other's criminal laws. See Scoles and Hay, *Conflict of Laws* § 3.17 at 74–77 (cited in note 196). See also *The Antelope*, 23 US (10 Wheat) 66, 123 (1825) ("The Courts of no country execute the penal laws of another."). However, we focus here on civil liability. In that context, criminal laws can be viewed as an exogenous constraint that must be taken into account in determining the applicable civil law. In any event, intentional acts are likely to produce injury where the conduct occurs.

<sup>313</sup> Whincop and Keyes also would apply a place-of-injury rule, but for the different reason that the place of conduct might be able to externalize the harm with a lax law. See Whincop and Keyes, *Policy and Pragmatism* at ch 6 (cited in note 168); Whincop and Keyes, 19 Nw J Intl L & Bus at 232–36 (cited in note 276). They cite the problematic situation of upstream polluters. In the usual case, however, accidents occur randomly under circumstances in which states cannot systematically externalize accident costs through lax tort rules.

<sup>314</sup> Regina Austin, *The Insurance Classification Controversy*, 131 U Pa L Rev 517, 547 (1983) (discussing how the insurance industry assigns numerical values to a myriad of factors in order accurately to assess risk).

The place-of-injury rule is particularly useful where information broadcast over the Internet or by other media causes harm simultaneously in many places to people who never entered the state where the conduct occurred.<sup>315</sup> Examples include defamation, invasion of privacy, infliction of emotional distress, and fraud. A possible objection is that the place-of-injury rule might subject defendants to litigation in remote places and under regulation they could not have anticipated.<sup>316</sup> Defendant's web page might be legal where it is posted but defamatory or otherwise wrongful in other states where the page can be accessed.<sup>317</sup> If defendant cannot control the reach of its messages, a place-of-injury rule would effectively empower the state to regulate conduct everywhere. In defamation, for example, the defendant's statements injure the plaintiff anywhere the statement is published.<sup>318</sup> In the Internet context, then, the place of injury becomes any place where the statement is downloaded. The place-of-injury rule therefore appears excessively to empower a regulating state because the fear of liability anywhere could deter defendants from sending messages everywhere. However, this objection fades on closer analysis. First, the parties suffer greater disadvantages under a conduct rule. A plaintiff receiver cannot easily determine from where the message originated, and therefore cannot easily decide not to receive messages based on their state of origin. More importantly, if a plaintiff is not the receiver, as for example, with defamation, the receiver's knowledge is legally irrelevant. Thus, permitting a defendant to rely on lax regulation in its own state might let that state thwart other states' regulatory efforts. Second, defendant's plight is not as serious as it might first appear because a state probably cannot exercise personal jurisdiction over the defendant based merely on a receiver's downloading.<sup>319</sup> Moreover, emerging technologies such as blocking software can enable a broad-

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<sup>315</sup> See Goldsmith, 65 U Chi L Rev at 1235-39 (cited in note 229) (arguing that traditional choice-of-law analysis can be adapted to cyberspace). But see David R. Johnson and David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 Stan L Rev 1367, 1402 (1996) (concluding that general conflicts analysis cannot adequately treat Internet problems).

<sup>316</sup> See Johnson and Post, 48 Stan L Rev at 1374-75 (cited in note 315) (noting absence of physical borders in cyberspace that typically notify individuals that they may be assuming new legal obligations).

<sup>317</sup> See Henry H. Perritt, Jr., *Jurisdiction in Cyberspace*, 41 Vill L Rev 1, 3 (1996) (asking “[w]hose substantive legal rules apply to a defamatory message that is written by someone in Mexico, read by someone in Israel by means of an Internet server located in the United States, injuring the reputation of a Norwegian?”).

<sup>318</sup> See *Keeton v Hustler Magazine, Inc.*, 465 US 770, 777 (1984). For a general discussion, see Russell J. Weintraub, *Commentary on the Conflict of Laws* 355-58 (Foundation 3d ed 1986) (discussing advantages and disadvantages of place-of-publication approach).

<sup>319</sup> See Goldsmith, 65 U Chi L Rev at 1216-21 (cited in note 229) (arguing that jurisdiction over Internet activity will necessarily be limited to parties with a presence or assets in the state or that took special efforts to thwart the state's regulations).

caster to control the access to its broadcasts.<sup>320</sup> Given such technology, applying the law of the receiver's address creates incentives for the defendant to block access by those in jurisdictions that wish to preclude the dissemination.<sup>321</sup>

The place-of-injury rule presents difficulties when latent injuries manifest themselves outside the place of initial impact. Again, comparative regulatory advantage is not conclusive in making the choice because of the competing purposes of tort law. The victim's domicile, where the injury is normally manifested and where the victim receives support and treatment, arguably has the advantage in determining the appropriate extent of compensation. On the other hand, the place where the conduct, and therefore the initial impact, occurs has the advantage in regulating the conduct. Again, *ex ante* clarity should be determinative. Both the injurer and the victim have notice that the state where the injury occurred might determine their rights and liabilities, while the injurer may have little notice of the potential application of the law of a state to which the victim traveled after the initial conduct and impact.

## F. Property

The law of the state where land is located typically governs disputes over real property.<sup>322</sup> These include disputes about land use,<sup>323</sup> title,<sup>324</sup> ownership interest,<sup>325</sup> testamentary disposition,<sup>326</sup> or intestate succession.<sup>327</sup> The traditional *situs* rule has changed little in recent years.<sup>328</sup> However, modern interest analysts criticize its broad application.<sup>329</sup> For example, William Baxter thought it "obvious that the *situs* choice rule is defective on its face because the relationships relevant for choice

<sup>320</sup> *Id.* at 1224–30 (describing technological advances that enable direction and control of information flow). Although recipients may be able to screen messages, they cannot effectively anticipate harmful messages. Moreover, recipient blocking is ineffective where the harm is to third parties, as with defamation.

<sup>321</sup> A possible problem is that Internet addresses can be used remotely. In order to facilitate jurisdictional choice, the user's address arguably should control over the place of actual receipt.

<sup>322</sup> See Beale, *Conflict of Laws* § 214.1 at 939 (cited in note 54) ("Every question arising with regard to land is to be governed by the law of the *situs*.") (emphasis added); Scoles and Hay, *Conflict of Laws* § 19.1 at 743 n 2 (cited in note 196) (stating that the application of the law of the *situs* to nearly all issues related to land has long been the prevailing rule).

<sup>323</sup> See Scoles and Hay, *Conflict of Laws* § 19.1 at 744 (cited in note 196).

<sup>324</sup> *Id.* at 746 & n 3.

<sup>325</sup> *Id.*

<sup>326</sup> *Id.* at 804–09.

<sup>327</sup> *Id.* at 796–97 & nn 1–4.

<sup>328</sup> *Id.* at 743 (observing relatively little change in conflict-of-law rules in property compared to tort and contracts).

<sup>329</sup> See, for example, Robby Alden, Note, *Modernizing the Situs Rule in Real Property Conflicts*, 65 *Tex L Rev* 585 (1987) (arguing that *situs* rule is anachronistic and sometimes unconstitutional); Baxter, 16 *Stan L Rev* at 15–17 (cited in note 3).

criteria are those between sovereigns and people, not those between sovereigns and property.”<sup>330</sup>

Despite such criticisms, we advocate general application of the situs rule. The rule is not as arbitrary as the critics suggest. Beginning with the assumption that the parties are not in a position effectively to choose the law, as in intestate succession cases, the default rule of comparative regulatory advantage would control. First, the situs state most likely has the comparative regulatory advantage over such issues as land use, zoning and nuisance laws.<sup>331</sup> Second, situs states also have a comparative regulatory advantage regarding title issues because clarity of title affects the price and availability of title insurance and therefore the transferability of land to its most highly valued uses.<sup>332</sup> Third, the situs state has the comparative regulatory advantage in determining the optimal fragmentation of property. Laws that excessively fragment ownership interests discourage optimal property use. Michael Heller has shown how state property law regarding such diverse issues as the nature and extent of title, zoning and subdivision rules, property taxes and registration fees, and the Rule Against Perpetuities, all reflect concerns about the optimal division of property.<sup>333</sup> These concerns vary from state to state depending on the local economic environment.

The ex ante clarity of the situs rule is also significant under our approach for choice maximization and other purposes. Although the parties virtually always know the situs of land, they may not know the location of all the interested parties or the place of contracting for a land interest. Significant conduct such as title recording and property maintenance occurs in the situs, and the situs does not change over time.<sup>334</sup> Armed with ex ante notice, the parties are better able to shape

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<sup>330</sup> Baxter, 16 Stan L Rev at 16 (cited in note 3).

<sup>331</sup> Baxter thought the situs rule also appropriate for land use rules. See *id.* (“Persons who live in the vicinity of the property are the intended beneficiaries of many property laws, such as the laws of nuisance, and the location of the property and hence of those people often should control the applicability of those laws.”). See also Scoles and Hay, *Conflict of Laws* § 19.1 at 744 (cited in note 196) (“Land use control is an important and pervading interest of the *situs* and its law seems an appropriate standard for that use.”) (emphasis added).

<sup>332</sup> Compare Scoles and Hay, *Conflict of Laws* § 19.1 at 744 (cited in note 196) (noting that a state’s “interest in regularity of title to its land . . . reflects concern over the optimum economic development and security of the market, so third parties who rely on the public record, or the land’s physical features, use or occupation, should be able to look to the situs law for guidance in these matters”), with Baxter, 16 Stan L Rev at 16 (cited in note 3) (“[A]s to competing claims of ownership, situs is not a reliable choice criterion.”).

<sup>333</sup> See Michael A. Heller, *The Boundaries of Private Property*, 108 Yale L J 1163 (1999).

<sup>334</sup> Of course, practical considerations relating to title also justify a situs rule even apart from choice maximization. Clarity of title depends on whether a single state’s law controls the issue of who possesses an interest in land. Without a situs rule, defects in title might be very difficult to trace.

their conduct to the applicable law and make decisions about where to own and how to value property.

Clarity requires minimization of characterization issues. Under the vested rights approach, courts had to determine whether a dispute involving a contract for the sale or use of land was one of contract or of property.<sup>335</sup> Similarly, it may not be clear whether the validity of a testamentary disposition of property should be treated as a property dispute determined according to situs or a will dispute determined according to the law of the testator's domicile. As discussed above,<sup>336</sup> to maximize ex ante predictability, characterization should be based on facts rather than legal theories. Thus, all disputes concerning ownership of land should be decided according to situs law or the law to which a situs statute refers unless the forum legislates specifically to mandate its courts to apply local law to protect local (for example spousal) interests.

Consistent with this Article's approach to contractual choice,<sup>337</sup> the parties can contract around the situs state's property rule. Because a contract or will might involve property in several states, the contractual choice-of-law option enables parties to select a single set of rules to govern validity and construction.<sup>338</sup> At the same time, a state that seeks to assert an interest in local property, for example to prevent excessive fragmentation of property interests, retains the power explicitly to invalidate contractual choice.<sup>339</sup>

In contrast to real property, a situs rule for moveable and intangible property could cause confusion. For titled property such as motor vehicles, the state where the property is titled should serve as the situs, by analogy to real property. Moreover, courts should enforce contractual designations of the applicable law to clarify property issues in this context. In the remaining cases, the rule that is the most predictable at the time of the relevant conduct, and therefore most choice-enabling, is that based on the owner's domicile.

## V. IMPLEMENTING THE FRAMEWORK

Public choice theory reveals the defects of courts and legislatures that, in turn, explain the inferiority of modern conflicts law and the

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<sup>335</sup> See Scoles and Hay, *Conflict of Laws* § 19.4 at 747–51 (cited in note 196).

<sup>336</sup> See text accompanying note 187.

<sup>337</sup> See Part III.A.

<sup>338</sup> Compare Scoles and Hay, *Conflict of Laws* § 20.5 at 804–05 (cited in note 196) (noting the “difficulty in making a will devising land in several states conform to the varying requirements in each”). The contract option also constrains inefficient laws where situs states seek to exploit locational monopolies in legislation concerning their property. See Michael J. Whincop and Mary Keyes, *Towards an Economic Theory of Private International Law* 39 (unpublished manuscript).

<sup>339</sup> See Part IV.A.2.

advantages of an efficiency-based approach. It seems to follow that our choice-of-law proposal constitutes little more than wishful academic musings. If interest groups and other agency costs can prevent government from generating efficient resolutions to social problems, then how can government generate efficient choice of law? This Part explores whether efficient choice of law is possible and which government institutions, if any, should take the lead in assisting in the production of efficient choice of law. Section A explains the problems of relying solely on state law and the inability of federal diversity jurisdiction to solve the problem. Section B shows that federal adoption of our proposal, although superficially promising, also is not likely to solve these problems. Sections C and D then discuss cooperation and competition as alternative long-run methods of overcoming impediments to state adoption.

### A. Impediments to State Adoption

State courts are unlikely suddenly to turn from politics to efficiency in choice of law. First, state judges may prefer to help their residents by applying forum law.<sup>340</sup> Second, state judges might prefer to adhere closely to the local case law, statutes, and jury instructions they know rather than to spend time learning foreign law. Third, in response to local bar pressures,<sup>341</sup> judges may apply forum law, which increases the demand for forum lawyers' expertise.<sup>342</sup> In light of these considerations, it is not surprising that judges have favored modern interest analysis, with its bias in favor of forum law. Fourth, even if some judges do focus on the virtues of clear choice-of-law rules,<sup>343</sup> developing an efficient body of choice-of-law rules requires consistent application of efficiency principles across many state courts. Spontaneous coordination on this scale seems unlikely.

Because federal courts are less likely than state courts to be biased in favor of local interests and forum state law, they theoretically could help promote efficient choice of law in federal diversity cases even if they purport to apply state conflicts rules. There is some data

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<sup>340</sup> See Part I.A.2.

<sup>341</sup> See Part I.A.2.

<sup>342</sup> It might be argued that judges serve the public interest by adding to the stock of precedent available for future litigation in the forum. See O'Hara and Ribstein, *Conflict of Laws and Choice of Law* at 634 (cited in note 1); Thiel, 2 *Am L & Econ Rev* (cited in note 148). However, more precedents are not necessarily better if they conflict and thereby create uncertainty, or if they impose inefficient choice-of-law rules.

<sup>343</sup> A prominent example is *Paul v National Life*, 352 SE2d 550, 554 (W Va 1986) ("The lesson of history is that methods of analysis that permit dissection of the jural bundle constituting a tort and its environment produce protracted litigation and voluminous, inscrutable appellate opinions, while rules get cases settled quickly and cheaply:").

supporting this proposition.<sup>344</sup> However, because a federal court sitting in diversity must apply the choice-of-law principles followed in the state in which it is located,<sup>345</sup> federal courts are as unlikely as the state courts to coordinate around general principles of party choice. Moreover, state courts always could trump federal diversity precedents. The most that can be said for federal judicial resolution is that federal courts provide an alternative, competing forum that can inarguably discipline state choice of law. However, federal judges hold diversity jurisdiction in low regard.<sup>346</sup> This suggests that proposals for greater federal court involvement,<sup>347</sup> or for overruling *Klaxon Co v Stentor Electric Manufacturing Co*,<sup>348</sup> have little chance of success.

Finally, constitutional implementation of our general proposal is infeasible. The Court's hands-off approach to choice of law<sup>349</sup> would seem to preclude judicial adoption of a comprehensive constitutional system of choice-of-law rules. The best hope is for marginal assistance. The Court might constitutionally mandate enforcement of choice-of-law contracts in some situations.<sup>350</sup> The Court also could require non-discriminatory choice of law, thereby encouraging courts to apply an even-handed system like our proposed choice-maximizing rules.<sup>351</sup>

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<sup>344</sup> See Ribstein, 18 J Corp L at 284–85 (cited in note 211) (finding that federal courts sitting in diversity are more likely to enforce choice-of-law clauses than state courts).

<sup>345</sup> *Klaxon Co v Stentor Electric Manufacturing Co*, 313 US 487, 496 (1941) (holding that in diversity cases, the federal court must decide conflict of laws issues according to the prevailing law in the state in which it sits).

<sup>346</sup> See, for example, *Federalization of Crimes: Chief Justice Rehnquist on Federalization of Crimes*, 33 Prosecutor 9, 15 (Mar–Apr 1999) (quoting Justice Rehnquist's remark that federal diversity jurisdiction should be repealed); Judith Resnick, *The Federal Courts and Congress: Additional Sources, Alternative Texts, and Altered Aspirations*, 86 Georgetown L J 2589, 2616 (1998) (noting that federal court judges have campaigned against diversity jurisdiction for nearly a century); Henry J. Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 Harv L Rev 483 (1928) (summarizing the history of diversity jurisdiction in order to set up a re-examination of the doctrine).

<sup>347</sup> See Scott Fruehwald, *Choice of Law in Federal Courts: A Reevaluation*, 37 Brandeis L J 21 (1998–99); Patrick S. Borchers, *The Origins of Diversity Jurisdiction, the Rise of Legal Positivism, and a Brave New World for Erie and Klaxon*, 72 Tex L Rev 79, 124–25 (1993); Harold L. Koru, *Big Cases and Little Cases: Babcock in Perspective*, 56 Alb L Rev 933, 938–39 (1993); Linda S. Mullenix, *Federalizing Choice of Law for Mass-Tort Litigation*, 70 Tex L Rev 1623, 1631 (1992); Baxter, 16 Stan L Rev at 23 (cited in note 3). See also Roosevelt, 97 Mich L Rev at 2538 & n 264 (cited in note 88) (advocating that the federal courts impose constitutional restrictions on state choice of law rather than using diversity jurisdiction to help).

<sup>348</sup> 313 US 487, 496 (1941). See, for example, Fruehwald, 37 Brandeis L Rev at 22 (cited in note 347); Borchers, 72 Tex L Rev at 118–23 (cited in note 347); Baxter, 16 Stan L Rev at 41–42 (cited in note 3).

<sup>349</sup> See, for example, *Allstate Insurance Co v Hague*, 449 US 302, 319–20 (1981) (affirming Minnesota Supreme Court decision to apply Minnesota law to an accident involving two Wisconsin residents, despite that court's questionable choice-of-law analysis and constitutional arguments against the decision).

<sup>350</sup> See Ribstein, 18 J Corp L at 287–98 (cited in note 211).

<sup>351</sup> See Roosevelt, 97 Mich L Rev at 2518–19 (cited in note 88) (proposing a general constitutional approach to choice of law based on states' applying their choice-of-law rules

## B. Federal Legislation

Given the impediments to state coordination, federal choice-of-law legislation is arguably the best way to implement our proposal. Congress could act under its general Commerce Clause power<sup>352</sup> or its specific power under the Full Faith and Credit Clause.<sup>353</sup> Federal legislation could take several possible forms. A statute could impose a general choice-of-law approach on the states. Narrower statutes could solve the choice-of-law problem relating to specific issues, such as product liability. Congress could adopt a federal statute ensuring enforcement of contractual choice-of-forum or choice-of-law clauses.

A federal choice-of-law statute might generate political support despite its usurpation of traditional state lawmaking authority. Federal choice-of-law legislation would comport with Jonathan Macey's support-maximizing theory of federalism.<sup>354</sup> Macey pointed out that federal legislators will refrain from federalizing an area of law if they would lose more support than they would gain from acting. This might occur if federal regulation would dissipate a substantial state capital investment in regulation,<sup>355</sup> if the political-support-maximizing outcome varies markedly across states due to varying economic, social, or political environments,<sup>356</sup> or if controversial issues threaten damaging political opposition from special interest groups.<sup>357</sup> None of these conditions apply to a federal choice-of-law statute. When one state specializes in the formulation of valuable regulation, as for example with Delaware corporate law and Connecticut insurance law, party choice enhances the value of that asset. When the environments vary, our approach enables each state to exercise its comparative regulatory advantage rather than substituting federal substantive policy. And as long as the federal statute, consistent with our approach, preserves

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evenhandedly).

<sup>352</sup> US Const Art I, § 8, cl 3.

<sup>353</sup> US Const Art IV, § 1.

<sup>354</sup> Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 Va L Rev 265, 267 (1990).

<sup>355</sup> Id at 276–81. “Delaware’s dominant position in the market for corporate charters represents a valuable capital asset that generates revenues for Delaware corporations, corporate lawyers, investment bankers, and for the state itself. . . . These capital assets would be destroyed if the federal government enacted a pervasive system of federal corporate law that preempted the field.” Id at 279.

<sup>356</sup> Id at 281–84. Macey notes that “[t]he issue of gun control is a good example of this phenomenon. In general, states with largely urban populations tend to favor gun control while states with rural populations often prefer to provide citizens with broad rights to own and carry guns.” Id at 281.

<sup>357</sup> Id at 284–90. For example, Macey notes that “[a]bortion involves an issue in which uncertainty and risk exist at all levels of political life. Very few politicians can afford to take a stand on this issue without risking serious political repercussions. Thus, for Congress, the political-support-maximizing solution to the abortion issue is to shift the risk of error to the states.” Id at 290.

some state power to enact statutes preventing party choice of law in particular settings, states could retain some control over politically contentious issues.

Indeed, federal legislators not only would avoid loss of support, but might gain political support through federal choice-of-law legislation. A federal choice-of-law statute would serve the uniquely federal interest of enhancing international trade. Foreign companies concerned about the risk of exposure to unfavorable state law or liability in several states might avoid trading with the United States.<sup>358</sup> National interest groups favoring increased foreign trade might therefore support federal choice-of-law rules.

On the other hand, there is reason to be skeptical about the prospects for an efficient federal choice-of-law statute. Congress has done virtually nothing on choice of law in two hundred years. One of the few instances in which Congress has acted is the Defense of Marriage Act.<sup>359</sup> DOMA ended up favoring a specific, powerful, interest group, namely the religious right, and it did so only by confirming the relatively clear and narrow principle that states could refuse to recognize same-sex marriages validly celebrated in other states. In other words, Congress acted *against* recognition of another state's law. Apart from whether DOMA is bad policy,<sup>360</sup> it illustrates the difficulty of relying on Congress to fix defects in state choice-of-law rules. Congress will respond to interest group pressures on particular issues rather than necessarily in a way that is consistent with an efficient choice-of-law system.

### C. Cooperation

It has been argued that the states are players in a repeat-play game and have long-run incentives to cooperate over choice of law.<sup>361</sup> More precisely, for cooperation to be feasible, the present discounted value of each state's long-run gains from cooperation must exceed that of its short-run gains from defecting. If states can monitor each other through written judicial opinions, they can develop an atmosphere of reciprocity that motivates them to apply other states' laws

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<sup>358</sup> This consideration has influenced the Court in civil procedure cases. See, for example, *Helicopteros Nacionales de Columbia, SA v Hall*, 466 US 408, 418–19 (1983) (holding that the minimal activities of a foreign corporation within a state were insufficient for that state to assert general jurisdiction over the corporation); *The Bremen v Zapata Off-Shore Co*, 407 US 1, 8–9 (1972) (holding that forum-selection clause should be upheld because of interest of preserving and expanding trade).

<sup>359</sup> 28 USCA § 1738C (West Supp 1999).

<sup>360</sup> See Buckley and Ribstein, 2001 U Ill L Rev (cited in note 262).

<sup>361</sup> Brilmayer, *Conflict of Laws* at 181–218 (cited in note 55); Kramer, 90 Colum L Rev at 342–44 (cited in note 2) (applying prisoner's dilemma to model choice-of-law situation between states).

even when it is not obviously in their interests to do so. Because more efficient choice of law could increase aggregate welfare, cooperation might dominate defection in the iterated prisoner's dilemma.

Cooperation among state courts depends critically on their ability to monitor and discipline defections. The classic tit-for-tat enforcement strategies<sup>362</sup> would be difficult to implement, especially because monitoring other states' choice-of-law decisions is costly.<sup>363</sup> Moreover, it might be years before an interstate dispute arises that enables a disadvantaged state to retaliate against the defector,<sup>364</sup> and in any event the Full Faith and Credit Clause may restrict retaliation.<sup>365</sup> Larger plaintiff-favoring states, which were the first to abandon the Restatement (First), have more opportunity to defect than smaller states because they handle a larger volume of interstate litigation.

A larger problem with interstate cooperation is that it is not clear that this can be modeled as a game among the "states," as distinguished from courts and legislators whose private interests might differ from those of the state as a whole.<sup>366</sup> Although "states" may gain in the long run from reciprocity, powerful interest groups or self-interested lawmakers may reject an efficiency-maximizing approach. On the other hand, statutes may be more valuable to interest groups if other states enforce them and reciprocation might enhance such enforcement. Courts, too, might enhance the value of their precedents through reciprocal recognition.

The data so far on adoption of uniform laws, a key mechanism for achieving cooperation,<sup>367</sup> provides reason to suspect the feasibility of achieving such cooperation through a uniform conflicts law.<sup>368</sup> To be sure, there is evidence that states generally adopt uniform laws where uniformity is efficient.<sup>369</sup> Prominent examples include the Uniform Commercial Code and the Uniform Child Custody Jurisdiction Act.<sup>370</sup>

<sup>362</sup> For a general discussion, see Robert Axelrod, *The Evolution of Cooperation* (Basic Books 1984).

<sup>363</sup> See Kramer, 90 Colum L Rev at 343 & n 228 (cited in note 2) (noting that monitoring and punishing defections will be among the most likely impediments to cooperation).

<sup>364</sup> This and other enforcement problems are discussed in Sterk, 142 U Pa L Rev at 1008-11 (cited in note 32) (observing that the discounting of potential gains from cooperation is likely to be very high, that judges cannot be realistically viewed as agents of the state, that harms are suffered by litigants and not judges, and that defection will not always be obvious to each court).

<sup>365</sup> See note 394 and accompanying text.

<sup>366</sup> Sterk, 142 U Pa L Rev at 1009 (cited in note 32), notes the difficulty of treating the judges as a single player. Increased difficulty is generated by adding legislators into the analysis.

<sup>367</sup> See Brilmayer, *Conflict of Laws* at 187-93 (cited in note 55); Kramer, 90 Colum L Rev at 344 (cited in note 2).

<sup>368</sup> For a contrary view of the likely success of a uniform choice-of-law code, see Larry Kramer, *On the Need for a Uniform Choice of Law Code*, 89 Mich L Rev 2134, 2149 (1991).

<sup>369</sup> See Ribstein and Kobayashi, 25 J Legal Stud at 131 (cited in note 28) (presenting empirical study of state adoptions of uniform laws).

<sup>370</sup> 9 ULA § 115 (1968). The Parental Kidnapping Prevention Act, 28 USC 1738A (1994), is

In the latter case, potential injuries from non-uniformity were felt equally across all states and were significant relative to the minor effect on state litigation. On the other hand, efficient uniformity failed regarding statutes of limitations.<sup>371</sup> Longer statutes of limitations are a means for lawyers, an important interest group, to maximize use of their local fora. There is little reason to believe that choice of law, also a set of procedural rules that affect lawyers' interests in the forum state, would meet a different fate.

Even if uniformity emerges in this area, the result may not be optimal. This is a potential problem not only with uniform laws but also with other mechanisms for achieving uniformity. Lea Brilmayer has suggested that the American Law Institute foster state cooperation with the adoption of a third restatement.<sup>372</sup> But experience in other areas has demonstrated that, when policymakers rather than restaters conduct an ALI project, the result can reflect the private interests of the rule makers.<sup>373</sup>

Finally, evolutionary game theory, involving dynamic processes with repeated plays and learning, might be used to show that states ultimately will adopt efficient choice-of-law rules. The problem is that evolutionary game theory can lead to many other equilibria as well depending on the operative assumptions concerning, among other things, payoffs from cooperation and defection, and risk.<sup>374</sup> Accordingly, its predictions are not very convincing. Moreover, to the extent that evolutionary game theory assumes that "states" are the relevant actors, and therefore ignores the political agency problem, it shares the same problem as other game theoretic approaches.

#### D. Exit, Competition, and Interest Groups

The discussion so far in this Part might lead one to conclude that the very factors that make our approach to choice of law desirable also make it impossible to effectuate. Although choice of law theoretically might mitigate the effect of inefficient interest group transfers, the winning interest groups may be powerful enough to prevent

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the analogous federal law.

<sup>371</sup> Ribstein and Kobayashi, 25 J Legal Stud at 139 (cited in note 28).

<sup>372</sup> Brilmayer, *Conflict of Laws* at 213–18 (cited in note 55).

<sup>373</sup> See Alan Schwartz and Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U Pa L Rev 595, 596–97 (1994) (arguing that ALI and National Conference of Commissioners on Uniform State Laws tend to promote the interests of their members); Robert E. Scott, *The Politics of Article 9*, 80 Va L Rev 1783, 1785 (1994) (arguing that certain financial institutions and their supporters "played a significant role in the drafting and ratification of Article 9" of the UCC); Ribstein, 61 Geo Wash L Rev at 986–87 (cited in note 28) (commenting that the principal drafters—lawyers and law professors—all stand to gain from the corporate governance code).

<sup>374</sup> For a general discussion, see Randal C. Picker, *Simple Games in a Complex World: A Generative Approach to the Adoption of Norms*, 64 U Chi L Rev 1225 (1997).

choice-of-law reforms. This Section shows that there may be a way out of this conundrum: Jurisdictional competition could create sufficient pressure on the states over time to induce them to adopt efficient reforms.

Jurisdictional competition differs significantly from cooperation because it requires neither coordination nor interstate monitoring. It can achieve efficient results in several ways. First, interest groups other than lawyers can coordinate in litigation as well as around legislative action<sup>375</sup> and thereby foster the gradual evolution of efficient choice-of-law rules. Here, interest group competition within jurisdictions can help produce efficient laws.

Second, states may be pressured to adopt choice-of-law rules that facilitate exit. Regardless of the initial choice-of-law rule, people and firms can avoid a state's law by avoiding all contacts with the state. This can impose costs on interest groups in the state who do business with the exiting firms. These groups may seek to retain those who otherwise would physically flee by allowing them to contract out of application of the state's law.<sup>376</sup> Indeed, as noted above,<sup>377</sup> business firms' mobility seems to be the best explanation for the strong contractual choice rule applying to corporations. The credibility of an exit threat turns on the advantages such as resources and markets the exiting party derives from the jurisdiction. A small state may risk losing more with inhospitable choice-of-law rules than a large one because firms can avoid jurisdictional contacts with the former at lower cost.<sup>378</sup> Moreover, increasing international trade and competition may be able to constrain even the larger U.S. states.

Third, even interest groups that favor a particular state regulation might accede to choice-favoring rules to enable the law's passage or significantly to reduce the costs of lobbying for the law.<sup>379</sup> Rather than simply avoiding contacts with the regulating jurisdiction, disadvantaged groups may decide to remain in the jurisdiction and fight proposed interest group transfers. The larger the regulatory "tax" imposed on the disadvantaged group, the more likely it will incur the costs of opposing the law. Because it increases the costs of legislation, prohibiting contractual choice will tend to increase opposition to the law. Thus, to minimize lobbying costs and ensure passage, the propo-

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<sup>375</sup> For a general discussion, see Bailey and Rubin, 14 *Intl Rev L & Econ* at 467 (cited in note 18) (showing that, as with legislative interest groups, litigants will have differing abilities to organize and push for legal change).

<sup>376</sup> See Kobayashi and Ribstein, *Contract and Jurisdictional Competition* at 331-32 (cited in note 12).

<sup>377</sup> See text accompanying note 237.

<sup>378</sup> See text accompanying notes 149-53.

<sup>379</sup> See O'Hara, *Opting Out of Regulation*, 53 *Vand L Rev* (cited in note 13).

ment groups may agree to permit contractual choice.<sup>380</sup> In other words, interest groups will determine their support or opposition based on the costs and benefits of the statutes net of the effect of exit,  $B - B_e$  and  $C - C_e$ , respectively. The question is whether the proponent interest group gains more from substantively weakening the statute (lower  $B$ ) or from allowing exit (higher  $B_e$ ). It may prefer the latter alternative because of the transaction costs of exit or the statute's application to existing contracts.<sup>381</sup>

Fourth, lawyers may play a role in pushing the law toward enforcement of jurisdictional choice, particularly if courts enforce contractual choice of forum.<sup>382</sup> Firms may contractually designate the forum in order to litigate in courts that are most likely to enforce their contracts. Courts, in turn, may be more willing to enforce choice-of-forum than choice-of-law clauses because the former do not force them to deal with the potentially contentious issues of whether to apply a foreign law that conflicts with local values. With enforcement of choice-of-forum provisions, lawyers seeking to attract litigation to their states gain by making local adjudication attractive to contracting parties. An important element of this attractiveness may be the state's willingness to enforce contractual choice-of-law clauses. Both litigators and business lawyers specializing in drafting and planning might want their states to enforce contractual choice of law. Lawyers might favor even enforcement of a contract that does not choose their state as a forum as long as it selects their state's law. Regardless of the forum, experts in Delaware law are more likely to be chosen to represent the parties if the contract applies Delaware law. Consistent with this objective, the Delaware Supreme Court held in *Elf Atochem North America, Inc v Jaffari*<sup>383</sup> that Delaware courts lacked jurisdiction over a dispute between the parties to an LLC agreement formed in Delaware that provided for arbitration and a California forum.<sup>384</sup> The court cited the strong Delaware policy favoring freedom of contract and alternative dispute resolution, including arbitration.<sup>385</sup> The court

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<sup>380</sup> See *id.*

<sup>381</sup> See *id.*

<sup>382</sup> Such enforcement is likely to increase if the Hague Conference on Private International Law adopts the proposed jurisdiction convention on contractual choices of forum. See Hague Conference on Private International Law, *Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters* art 4, available online at <<http://www.lcch.net/ef/conventions/draft36e.html>> (visited September 31, 2000) (adopted by the Special Commission on Oct 30, 1999).

<sup>383</sup> 727 A2d 286 (Del 1999).

<sup>384</sup> The court liberally interpreted Delaware statutes permitting parties to agree to the non-exclusive jurisdiction of the courts of a foreign jurisdiction as allowing contracts for exclusive jurisdiction in a non-Delaware forum. *Id.* at 296.

<sup>385</sup> *Id.* at 292, 295-96.

was influenced by the likelihood that Delaware law generally would be applied even if the case were tried outside Delaware.

Jurisdictional competition is likely to increase, and pro-exit rules to evolve more rapidly, with reductions in the costs of communication and transportation. In particular, the Internet is likely to further increase the viability of exit. Among other things, firms now rely more on networks of relationships than on large capital assets and therefore are less vulnerable to changes in the law in their home office state. Moreover, firms using blocking software to target sales<sup>386</sup> can swiftly avoid states that impose onerous taxes or regulation. Indeed, the Internet ultimately may uncouple choice of law from its territorial roots and lead to a system that is based on individual interests rather than political power.

Jurisdictional competition already has pressured states toward enforcement of contractual choice of law in some contexts. The rising power of contractual choice appears strongest where exit is cheapest, as indicated by the recent treatment of contractual choice in franchise cases. In order to protect local franchisees, several states have passed franchise protection statutes. A few of those states explicitly prohibit franchisors from opting out of the regulations with choice-of-law provisions.<sup>387</sup> Interestingly, each of the legislatures that prohibited the opt-out also limited its franchise protections to in-state franchisees, thereby making it unnecessary for franchisors to move their headquarters or avoid other contacts in order to avoid application of the franchise law to all of the franchisor's outlets.<sup>388</sup> This analysis implies that franchisors that can credibly threaten to eliminate in-state franchises might be able to pressure the state to enforce contractual choice of law.

The efficiency-enhancing forces discussed in this Section relate to but differ from the evolutionary theory discussed in the previous Section. State law may end up evolving toward an efficient equilibrium through *competition* rather than *cooperation*. Under this view, the evolution would occur without any assumptions of altruism by state or federal lawmakers. Nor does this evolutionary theory depend upon monitoring, enforcement, or states' conscious willingness to forgo short-term gain for long-run efficiency. Instead, jurisdictional competition can be seen as an application of Armen Alchian's theory that competitive pressures can produce efficient results over time, even if

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<sup>386</sup> See text accompanying note 320.

<sup>387</sup> See Kobayashi and Ribstein, *Contract and Jurisdictional Competition* at 342-43 (cited in note 12).

<sup>388</sup> *Id.* at 343.

no one consciously attempts to generate these results, by reducing the role of inefficient entities and causing efficient ones to thrive.<sup>389</sup>

One might argue that the effort to show that this Article's theory is non-fanciful has rendered it irrelevant or wrong. It is irrelevant if efficient choice-of-law rules will arise spontaneously. It is wrong if lawmakers' failure to embrace the theory despite the competition dynamic discussed in this Section means that the theory is inefficient. This raises the general question of whether there is any place for choice-of-law theory to operate in the crucible of jurisdictional competition.

Legal proposals can work with jurisdictional and interest group competition to speed the process toward efficient choice-of-law rules.<sup>390</sup> First, competitive forces do not operate perfectly and instantaneously. Second, constraints on decisionmakers' time and information limit their ability to develop new choice-of-law rules on their own. Courts and legislators are unlikely to recoup investments of time and energy in developing new choice-of-law theories. Thus, lawmakers spurred by competition to adopt efficient choice rules may welcome guidance. Legislators look to uniform and model laws,<sup>391</sup> and courts look to academic theories and the American Law Institute's restatements. Courts have almost never promulgated new choice-of-law approaches on their own. Thus, rather than viewing this proposal as a way of achieving conscious cooperation among the states, it should be viewed as way to enhance jurisdictional competition's ability to achieve efficient choice-of-law rules.

#### E. A Note on International Choice of Law

This Article has focused on the particular federal system in effect in the United States. This raises questions concerning the differences between such a federal system and international choice of law. An immediate difference is, of course, the potential in the United States for federal choice-of-law legislation. However, as discussed above,<sup>392</sup> that is an unlikely prospect.

That leaves the prospects for comity among political jurisdictions. Nations are less bound to recognize the laws of other nations than are states within a federal system to enforce the laws of other states. This might mean that there is less hope for enforcement of contractual

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<sup>389</sup> See text accompanying note 46-47.

<sup>390</sup> Accordingly, any third restatement of conflicts should incorporate our approach. For other, more traditional, views on a possible third restatement, see Synposium, *Preparing for the Next Century—A New Restatement of Conflicts?*, 75 Ind L J 399 (2000).

<sup>391</sup> For a general discussion, see Bruce H. Kobayashi and Larry E. Ribstein, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 Colo L Rev 947 (1995).

<sup>392</sup> See Part V.B.

choice in the international than in the U.S. federal context. On the other hand, constitutional constraints cut both ways. In particular, while the Full Faith and Credit Clause of the U.S. Constitution has had little effect in compelling an enforcing State to recognize another State's law,<sup>393</sup> at the same time it prevents the enacting State from punishing the defecting State by refusing to enforce its judgments.<sup>394</sup> Thus, while nations face only slightly less *legal* pressure than sister States to enforce another jurisdiction's law, they have more freedom to use *self-help* to maintain comity. On balance, therefore, the prospects for an international system of choice of law along the lines we suggest may be no worse than those for an interstate system.

### CONCLUSION

Prevailing conflicts theories stress the states' power and interests over those of individuals and firms. These theories implicitly assume that state lawmakers are faithful agents of the governed, so that ensuring that every state has a fair shot at regulating conduct will lead to the "right" results. Conflicts scholars have largely avoided applying the combined tools of economic and public choice analysis to conflicts rules. This Article emphasizes efficiency through enforcing individuals' *ex ante* choice of law over *ex post* court determination of the appropriate allocation of political power. Whether or not one agrees with our specific proposals, our more general recommendation in favor of emphasizing party choice over states' interests can significantly improve conflict-of-laws jurisprudence.

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<sup>393</sup> See note 349 and accompanying text.

<sup>394</sup> See, for example, *Fauntleroy v Lum*, 210 US 230, 237 (1908) (holding that even a mistaken application of Mississippi law by a Missouri court nevertheless was entitled to enforcement in Mississippi); Restatement (Second) of Conflict of Laws § 103 cmt a; Brainerd Currie, *Full Faith and Credit, Chiefly to Judgments: A Role for Congress*, 1964 Sup Ct Rev 89, 89. We thank Michael Whincop for this point. See Michael Whincop and Mary Keyes, *The Recognition Scene: Game Theoretic Issues in the Recognition of Foreign Judgments*, 23 Melb U L Rev 416, 422 (1999).