

## FROM POLITICS TO EFFICIENCY IN CHOICE OF LAW

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### **Abstract**

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. 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.

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Economic analysis has made comparatively 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 economics underpinnings have not been made explicit.<sup>3</sup> Nevertheless, no one has proposed a comprehensive system 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 nothing to economic theory. The First Restatement of Conflict of Laws, published in 1934, reflected the approach to choice of law then prevalent in the United States courts, the "vested rights" rationale offered by its reporter, Joseph Beale. This system is comprised of rules delineating the territorial boundaries of states' lawmaking authority. It is based on the theory that an individual's rights vested at one point and place in time, and only that jurisdiction can determine the extent of the rights created.<sup>4</sup> The vested rights theory accordingly emphasizes the states' *political power*. Most courts eventually replaced their territorial rules with some form of "interest analysis." This system focuses on legislative intent -- i.e., 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 wealth. Rather, political decision-making is infected by the agency costs that inevitably follow delegation of power. Conflict-of-laws rules can deal with political agency costs by letting the governed, by individual action, avoid inefficient mandatory rules.<sup>5</sup>

The starting point of an efficient choice of law system should be enforcement of choice of law contracts. Where the parties cannot contract explicitly, the rules should be

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<sup>1</sup> See Richard A. Posner, *Introduction to Baxter Symposium*, 51 STAN. L. REV. 1007 (1999). 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 (1998) (hereinafter PALGRAVE); INTERNATIONAL ENCYCLOPEDIA OF LAW AND ECONOMICS (forthcoming, 1999) (hereinafter INTERNATIONAL).

<sup>2</sup> See RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 645-46 (5<sup>th</sup> ed., 1998) (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 GEO. L.J. 617 (1992) (public choice analysis of interest analysis); Michael E. Solimine, *An Economic and Empirical Analysis of Choice of Law*, 24 GA. L. REV. 49 (1989) (empirically testing and analyzing differences between First Restatement and modern approaches).

<sup>3</sup> See William F. Baxter, *Choice of Law and the Federal System*, 16 STAN. L. REV. 1 (1963) (arguing that choice of law should maximize the effectuation of the states' interests). See also *infra* Part II.

<sup>4</sup> See generally *infra* Part II(A).

<sup>5</sup> This argument has been made in the securities context. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2395, 2402, 2410 (1998) (arguing that more favorable securities laws can result under "choice of law clause approach" if state regulatory competition replaces federal securities regulation).

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 so as to avoid offensive laws. Moreover, in order to minimize the costs of contracting for or avoiding inefficient laws, in the absence of an explicit contract courts should apply the state law that the parties would have selected had they been able to contract explicitly prior to the development of the legal dispute.<sup>6</sup> Assuming that the parties normally would prefer to be governed by the law that maximizes their joint welfare,<sup>7</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 rests on individual choice has the potential of diluting the effect of *efficient*, as well as *inefficient*, law. The choice of law system therefore must preserve a role for beneficial government regulation as well as for individual choice. But in order to maximize predictability and individual choice, the final determination should be made by state legislatures and not by courts on a case by case basis. Thus, the system of choice-maximizing rules proposed in this article operates as a set of default rules that legislatures can overrule by explicit statutes where necessary to preserve their power to legislate effectively.

The article proceeds as follows. Part I outlines an efficiency approach to choice of law. Part II contrasts our approach with the major existing approaches. Part III articulates general principles that guide our approach, while Part IV develops the framework in detail. Part V discusses some ways our system might be implemented.

## I. AN EFFICIENCY APPROACH TO CHOICE OF LAW

This Part explains how choice of law can affect the efficiency of a state's substantive laws. The perverse effects of inefficient laws can be mitigated to the extent that parties can avoid these laws.<sup>8</sup> On the other hand, if they can evade efficient laws, however, the benefits generated by those laws can be reduced.

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 costs **C**. If those 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 may produce benefits that are reduced by parties' ability to avoid application of the law. **B(E)** represents the benefits that are lost as a result of the choice-of-law rule.

Ideally, choice-of-law rules would strengthen efficient laws while mitigating the inefficient ones. Moreover, they would help ensure that laws general on their face are applied in those contexts in which they produce efficient results but not where they

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<sup>6</sup> See *infra* Part III(B)(1).

<sup>7</sup> See POSNER, *supra* note 2 at 646.

<sup>8</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Competition*, in FALL AND RISE OF FREEDOM OF CONTRACT (F.H. Buckley ed., 1999). 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 the law rather than selecting the law to be applied.

produce inefficiencies. In other words, a choice-of-law rule is efficient if  $B - B(E) > C - C(E)$ . Because reducing the costs of exit may increase both  $B(E)$  and  $C(E)$ , higher exit costs 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.<sup>9</sup>

We measure the efficiency of choice-of-law rules according to the extent to which they increase social wealth by enabling exit from inefficient laws or, conversely, reduce social wealth by enabling exit from efficient laws. Subpart A sets forth the basic problem of inefficient laws, while subpart B discusses exit as a potential solution. Subpart 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  $B$ .

## A. THE PROBLEM OF INEFFICIENT LAWS

A law's efficiency depends on the extent to which it suits parties or transactions that are subject to the law.<sup>10</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 on potential inefficiencies in statutory law, including judicial and administrative application and interpretation of statutes. A statute's costs and benefits depend on the common law or other legal rule that existed prior to its passage. We do not assume either that the common law is efficient<sup>11</sup> or that all statutory law is inefficient. Moreover, 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

Legislators can reap benefits for themselves by, among other things, indulging in leisure. Moreover, legislators can increase their campaign contributions and other perks by brokering wealth transfers that end up favoring the members of some interest groups

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<sup>9</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*, (1999) (draft manuscript on file with authors). For a further discussion of this point, see *infra* subpart V(D).

<sup>10</sup> This refers not only to mandatory rules, but also to default rules because of the costs of drafting around the rule. See R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960). 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>11</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. LEG. STUD. 65 (1977); Paul H. Rubin, *Common Law and Statute Law*, 11 J. LEG. STUD. 205 (1982); Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEG. STUD. 51 (1977). For arguments *contra*, see Robert Cooter & Lewis Kornhauser, *Can Litigation Improve the Law Without the Help of Judges*, 9 J. LEG. STUD. 139 (1980); William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEG. STUD. 235, 280-84 (1979); Martin J. Bailey & Paul H. Rubin, *A Positive Theory of Legal Change*, 14 INT'L REV. L. & ECON. 467 (1994). Part II(E)(2) considers the specific question of the efficiency of common law choice-of-law rules.

at the expense of others.<sup>12</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>13</sup> Successful interest groups tend to be those that are best able to prevent some members from free riding off of expenditures and other political efforts by others. Because relatively small, homogeneous groups can more effectively contain free riding, the winners may be relatively small minorities rather than the public as a whole or even a majority of voters.<sup>14</sup> More importantly from the perspective of social welfare, the proponent interest group's gains from the law may outweigh losses to the rest of society.

Even legislators motivated to enhance social welfare are not perfect agents. Legislators lack perfect knowledge and foresight. Moreover, a law may be inefficient as applied to some people even if it is efficient as applied to others. Legislators cannot always determine what is best for everybody. The more heterogeneous the legislators' constituencies, the more difficult it is for them to tailor laws to suit individual environments. 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 large communities because anonymity allows spendthrifts to take advantage of sellers who have no advance notice that they are dealing with a spendthrift.<sup>15</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>16</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

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<sup>12</sup> See generally Robert E. McCormick & Robert D. Tollison, POLITICIANS, LEGISLATION AND THE ECONOMY; Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339 (1988)

<sup>13</sup> See generally Mancur Olson, *THE LOGIC OF COLLECTIVE ACTION* (1971).

<sup>14</sup> For discussions of the importance of free riding in interest group theory, see the sources cited in *supra* note 12.

<sup>15</sup> This example is suggested by *Lilienthal v. Kaufman*, 239 Or. 1, 395 P.2d 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>16</sup> See Jonathan R. Macey, *Promoting Public Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 228 n.28 (1986); Erin O'Hara & Larry E. Ribstein, *Interest Groups, Contracts, and Interest Analysis*, 48 MERCER L. REV. 765, 766 & n.7 (1997).

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>17</sup>

The difficulty of showing a law's inefficiency suggests preserving a role for individuals and firms to decide for themselves which laws apply to them.

## 2. Courts

Given that some statutes create inefficiencies, one might look to the courts to use some combination of statutory interpretation and choice of law to at least mitigate those inefficiencies. But lawmaking by judges also involves agency costs. Judges may have their own incentives to maximize the value of interest group deals by protecting them from dilution by individuals' choice of law. Judges have some incentive to respond to legislators' interests to the extent that the latter control judges' salary and tenure. If so, judges can be expected to act to increase the durability and value of legislators' interest group deals by enforcing them within the state.<sup>18</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. It is in the interests of at least the trial segment of the bar to attract litigation to the state,<sup>19</sup> whether or not the litigation produces efficient incentives, and to enhance in-state litigation opportunities with forum-biased choice of law.

Judges also may have personal biases that skew the results of cases. Some judges

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<sup>17</sup> Jerry L. Mashaw, *GREED, CHAOS, AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW* 37 (Yale Univ. Press 1997).

<sup>18</sup> See Gary M. Anderson, et al. *On the Incentives of Judges to Enforce Legislative Wealth Transfers*, 32 J. L. & ECON. 215 (1989); W. Mark Crain & Robert D. Tollison, *Constitutional Change in an Interest Group Perspective*, 8 J. LEG. STUD. 165 (1979) and *The Executive Branch in the Interest-Group Theory of Government*, 8 J. LEG. STUD. 555 (1979); William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest Group Perspective*, 18 J. L. & ECON. 875 (1975); see also Richard S. Murphy & Erin A. O'Hara, *Mistake of Federal Criminal Law: A Study of Coalitions and Costly Information*, 5 SUP. CT. ECON. REV. 217, 275-76 (1997); Erin A. O'Hara & William R. Dougan, *Redistribution Through Discriminatory Taxes: A Contractarian Explanation of the Role of the Courts*, 6 GEO. MASON 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).

<sup>19</sup> See, e.g., Ian Ayres, *Supply Side Inefficiencies in Corporate Charter Competition: Lessons From Patents, Yachting and Blue Books*, 43 U. KAN. L. REV. 541, 558 (1995); Jonathan R. Macey, *Judicial Preferences, Public Choice, and the Rules of Procedure*, 23 J. LEGAL STUD. 627, 628 (1994); Jonathan R. Macey & Geoffrey Miller, *Toward an Interest Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 505 (1987); Michelle J. White, *Legal Complexity and Lawyers' Benefit From Litigation*, 12 INT'L REV. OF L. & ECON. 381, 381-82 (1992); Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 WASH. U. L. REV. 984, 1023 (1993); Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEG. STUD. 131, 144 (1996).

have an interest in expanding their power and prestige.<sup>20</sup> Although trial court judges may be disciplined by the appellate courts and by reputational constraints,<sup>21</sup> this rough discipline does not apply in every situation.<sup>22</sup> For example, lower-level judges are tempted to do justice in the individual case without sufficient attention to the effect on future cases.<sup>23</sup> And, some decisions are, *de facto*, insulated from reversal on appeal.<sup>24</sup>

## B. EXIT AS A POTENTIAL SOLUTION TO INEFFICIENT LAWS

There are two potential ways to solve the problem of inefficient law. One is to change the process by which laws are made by increasing the public's say and therefore control over its agents. This can be referred to as the *voice* option. But there are inherent limits to what can be accomplished through greater voice. Individuals must use scarce resources, including time, energy and money to gain information and be heard. They may have inadequate incentives to incur expenses to generate social benefits, especially when most of the benefits will be realized by "free riders."

*Exit* can be an alternative to voice in reducing the costs of inefficient laws.<sup>25</sup> Since no political entity has infinite jurisdiction, people often can escape from laws they do not like. As Charles Tiebout recognized,<sup>26</sup> people can decide on their preferred levels

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<sup>20</sup> See Richard A. Epstein, *The Independence of Judges: The Uses and Limitations of Public Choice Theory*, 1990 B.Y.U. L. REV. 827, 831-38; Bruce H. Kobayashi & John R. Lott, Jr., *Judicial Reputation and the Efficiency of the Common Law* (1996) (unpublished manuscript on file with authors).

<sup>21</sup> See Erin O'Hara, *Social Constraint or Implicit Collusion?: Toward A Game Theoretic Analysis of Stare Decisis*, 24 SETON HALL L. REV. 736 (1993).

<sup>22</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 *infra* text accompanying notes\_\_.

<sup>23</sup> See Stewart E. Sterk, *The Marginal Relevance Of Choice Of Law Theory*, 142 U. PA. L. REV. 949, 993-96 (1994). Sterk notes one judge's comment "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>24</sup> See, e.g., 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 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 (1994) ("substantial evidence" standard of review insulates trial court findings); Rochelle Cooper Dreyfuss, *The Federal Circuit: A Case Study in Specialized Courts*, 64 N.Y.U.L. Rev. 1, 48-49 (1989) (concluding that indeterminacy of fact/law distinctions allows district courts to insulate their findings from appellate review).

<sup>25</sup> See generally Albert O. Hirschman, *EXIT, VOICE AND LOYALTY* (1970).

<sup>26</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). See also Bruno S. Frey & Reiner Eichenberger, *Competition among Jurisdictions: The Idea of FOCJ*, in

of taxes and expenditures if they can effectively vote with their feet. 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>27</sup> and politicians are motivated to compete.<sup>28</sup> An important potential advantage of exit over voice as a disciplinary mechanism is that those who choose to move, while indirectly exerting discipline on lawmakers, capture the direct benefits of the move. 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 simply stay in a state with inefficient laws but somehow elect to be governed by another, more efficient, set of laws. As the cost of exit falls to zero, the problem of inefficient law disappears.

Jurisdictional competition was first observed with regard to corporations. In the United States, the law of a corporation's the state of incorporation almost always governs its management and control arrangements.<sup>29</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 is a "race to the bottom" in which the

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COMPETITION AMONG INSTITUTIONS, (L. Gerken, ed.) 209 (1995); Luder Gerken, *Institutional Competition: An Orientative Framework*, in Gerken, *supra*, at 1; Wolfgang Kerber & Viktor Vanberg, *Competition among Institutions: Evolution within Constraints*, in Gerken, *supra* at 33.

<sup>27</sup> See Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23 (1983); Daniel R. Fischel, *From MITE to CTS: State Anti-Takeover Statutes, the Williams Act, the Commerce Clause, and Insider Trading*, 1987 SUP. CT. REV. 47; Tiebout, *supra* note 26.

<sup>28</sup> Some commentators are skeptical about politicians' motivation to compete. See, e.g., Jeff Macintosh, *The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law: A Second Look*, University of Toronto Law & Economics Working Paper Series, WPS-18 (1993). 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. Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?* 9 J. LEG. STUD. 593 (1980). At the same time, legislators incur costs in competing to provide state law in foregoing rent-seeking opportunities from mandatory rules. 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*, 73 WASH. U. L.Q. 369 (1995) ("*Statutory Forms*"); Larry E. Ribstein, *Delaware Lawyers and the Choice of Law*, 19 DEL. J. CORP. L. 999 (1994). Lawyers are a cohesive interest group and have incentives to make their states standards for commercial contracts in order to attract more litigation business to the state's courts and increase the value of advice on and expertise in the state's law. Lawyers' price, however, may be rules that increase the demand for legal services up to the point that this causes parties to move their legal business to other states, federal courts, and arbitrators.

<sup>29</sup> See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §302(2) (1971) (stating general rule).

states attract incorporation business by exploiting principal-agent problems resulting from the separation of ownership and control<sup>30</sup> or a “race to the top” that is disciplined by efficient capital markets.<sup>31</sup> Evidence supports the latter proposition.<sup>32</sup> Even closely held limited liability companies that are not traded in efficient capital markets have been shown to move toward efficient provisions,<sup>33</sup> and toward an efficient level of uniformity.<sup>34</sup> Given the contractual nature of firms,<sup>35</sup> it may be possible to obtain similar results for contractual choice of law in non-firm contracts.

Even if legislators lack knowledge, motivation and foresight to supply efficient laws, evolutionary theories suggest that efficient laws may nevertheless emerge.<sup>36</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>37</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 the spendthrift law example noted above in which an Oregon court protected an Oregon spendthrift at the expense of a California creditor.<sup>38</sup> If a California court reaches the opposite result, then a creditor could

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<sup>30</sup> See William Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

<sup>31</sup> See Ralph Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

<sup>32</sup> For empirical evidence favoring the race to the top hypothesis, see Peter Dodd, Peter and Richard Leftwich, *The Market for Corporate Charters: Unhealthy Competition versus Federal Regulation*, 53 J. BUS. 259 (1980); Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985).

<sup>33</sup> See Ribstein, *supra* note 28.

<sup>34</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Uniformity*, 34 ECON. INQUIRY 464 (July, 1996).

<sup>35</sup> See generally, Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

<sup>36</sup> See Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950) (observing that a study of the “adaptive mechanism” of the market may be more fruitful than that of “individual motivation and foresight”).

<sup>37</sup> There is also evidence of such evolution with respect to the demand for statutory forms (see the Ribstein articles cited in *supra* note 28) and the demand for uniform statutory provisions. See Kobayashi & Ribstein, *supra* note 19.

<sup>38</sup> See *supra* note 15 and accompanying text.

circumvent the policy underlying a spendthrift law simply by loaning in a state that does not provide spendthrift protections.

In designing a system that reduces the effect of inefficient laws while preserving government's ability to regulate efficiently, courts could try to determine either which laws are efficient or when affected parties are in the best position to make that determination themselves. This article emphasizes the latter alternative. Although the parties sometimes may not make the right choice because, for example, of information asymmetries, judgment biases or bargaining imbalance, judicially-imposed restrictions on exit are not necessarily the answer.<sup>39</sup>

In some cases enforcing individuals' choice of the applicable law will permit evasion of efficient regulation. Even in these cases, the courts should apply a strong rule facilitating party choice whenever feasible, and rely on legislators to specify situations in which party choice should not be enforced. Traditional choice-of-law rules rely on judges to determine, for example, the public policies of the implicated states. This emphasis on ad hoc, case-by-case determination has the effect of eliminating any role for individual choice because parties cannot easily determine in advance what law will regulate their conduct. The purported tradeoff is the greatest possible accuracy in the public policy determination. However, even this is not clear given judicial self-interest.

Relying on explicit legislation regulating choice of law has the advantage not only of effectuating individual choice, but also of promoting more efficient law through interest group competition. This reflects Gary Becker's intuition that, when the burdens of special interest legislation become high enough, the burdened may overcome coordination costs and organize in opposition to the law.<sup>40</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>41</sup> a choice of law rule that forces the legislature to specify prohibitions on contractual choice of law to avoid mandatory rules increases the likelihood of opposition by the disadvantaged group. Thus, an enacted law that includes such a prohibition is likely not to be significantly against the public interest.

In general, a choice-of-law perspective adds new dimensions to the debate on the relative advantages of government regulation and private ordering. This debate is usually viewed in terms of explicit contractual waivers of statutes. However, it is important to recognize the potential for opt-out through choice of law in analyzing the nature and efficiency of regulation.<sup>42</sup> 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. Although this might seem to present the same issues as direct waiver, there are, in fact, significant differences between the two.<sup>43</sup> Among other things, the parties' ability to

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<sup>39</sup> For the reasons discussed in *infra* §V(D), we would prefer to rely on legislatures.

<sup>40</sup> See Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983).

<sup>41</sup> See *infra* Part IV(A)(2).

<sup>42</sup> See Kobayashi & Ribstein, *supra* note 8.

<sup>43</sup> See *infra* §IV(A)(2).

evade laws is limited in the choice-of-law context to the choice of another state's laws. States internalize at least some of the effects of their laws, and therefore have an incentive not to deregulate inefficiently merely to attract out-of-state transactions.

In sum, choice-of-law rules should be designed with a view to the effect of these rules on the efficiency of substantive laws. To maximize efficiency, choice-of-law rules should, in general, facilitate individual exit. This involves enforcing contracts where feasible unless the legislature explicitly regulates against choice of law. The rest of the article develops these general principles in more detail.

## II. PROBLEMS WITH EXISTING THEORIES

Before further specifying our system we place it in context by describing modes of conflict-of-laws analysis that have, until now, occupied most of the 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.

The discussion is organized as follows. Section A considers the vested rights approach reflected in the First Restatement, which focuses solely on where a given event critical to the cause of action occurred. This approach seems to have nothing to do with the question of which governing law seems most efficient for the parties. Section 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. Section C briefly discusses choice-of-law proposals that focus on the merits of the competing substantive laws. Section D describes and begins to incorporate Posner's "comparative regulatory advantage" insights. Section E discusses proposals that attempt to include the factors that judges actually consider in making their choice-of-law decisions. Finally, section F summarizes the differences between our proposal and predominant alternatives.

### A. VESTED RIGHTS

Early conflicts decisions in the United States focussed on territoriality. Laws represented the exercise of state powers, and choice of law was viewed as the mechanism by which state powers were allocated 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>44</sup> Territoriality alone was insufficient to determine the applicable law when a dispute involves people, acts and events spanning multiple jurisdictions. Some secondary principle was necessary to choose the governing jurisdiction among the territorial possibilities.

One approach to resolving the dilemma was the "vested rights" theory<sup>45</sup> advanced

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<sup>44</sup> Joseph H. Beale, A TREATISE ON THE CONFLICT OF LAWS §§ 2.1, 5.2 (1935).

<sup>45</sup> For a summary of the vested rights theory, see Lea Brilmayer, CONFLICT OF LAWS 16-17 (2d ed. 1995). The vested rights approach was also advocated in England. See A.V. Dicey, A DIGEST OF THE

in the United States by Joseph Beale, the Reporter of the First Restatement.<sup>46</sup> This theory was 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 First Restatement, 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 was generally supplied by the place of injury for tort rights,<sup>47</sup> the place of contract formation for contract validity,<sup>48</sup> and by the situs of real property for property rights.<sup>49</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 of the necessary elements 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 was no reliable way to tell where a given right might be said to have vested when the First Restatement or precedent is ambiguous or silent. Thus, as pointed out by Walter Wheeler Cook,<sup>50</sup> courts made decisions about whether to enforce rights in cases connected with other jurisdictions under their own conflicts law.<sup>51</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>52</sup> "guided by considerations of social and economic policy or ethics."<sup>53</sup> These "considerations" hid in the misty fog of vested rights analysis, creating an opportunity for both confusion and self-interested manipulation by judges.

While the criticisms of the First Restatement were largely valid, its critics nevertheless tended to commit the Nirvana fallacy.<sup>54</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

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LAW OF ENGLAND WITH REFERENCE TO THE CONFLICT OF LAWS xliii (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>46</sup> See generally Beale, *supra* note 44.

<sup>47</sup> See RESTATEMENT (FIRST) OF CONFLICTS, §378 (1934) [hereinafter FIRST RESTATEMENT].

<sup>48</sup> *Id.* at § 332.

<sup>49</sup> *Id.* at §§ 211, 214, 216-23.

<sup>50</sup> Walter Wheeler Cook, *The Logical and Legal Bases of the Conflict of Laws*, 33 YALE L.J. 457 (1924).

<sup>51</sup> *Id.* at 462, 466-67.

<sup>52</sup> *Id.* at 475.

<sup>53</sup> *Id.* at 487.

<sup>54</sup> For early identifications of the "Nirvana" problem see Coase, *supra* note 10 at 43 (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).

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 relevant conduct occurs,<sup>55</sup> and therefore to gear their conduct to that law.

But the First Restatement is not entirely conducive to party autonomy. In part this is because of its focus on allocating sovereign powers. Significantly, the First Restatement has no provision enabling contracting parties to choose their governing law by contract, which Beale condemned as impermissible private legislation.<sup>56</sup> Moreover, the First Restatement rules have several "escape devices" courts can manipulate, thereby nullifying the parties' *ex ante* choice. Most importantly, states could ignore the law indicated in the rules if application of that state's law would violate a strong public policy of the forum.<sup>57</sup> This device is almost infinitely malleable. For example, one court rejected an appeal to public policy and applied the racist laws of Nazi Germany to a contract dispute,<sup>58</sup> while another used the public policy exception to avoid applying a foreign state guest statute.<sup>59</sup>

Perhaps the strongest impediment to individual choice under the First Restatement is the problem of characterization.<sup>60</sup> Because the application of First Restatement rules depend 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 the 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 arise regarding common types of disputes such as contracts involving the transfer of property.<sup>61</sup> They also arise concerning whether a

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<sup>55</sup> See Solimine, *supra* note 2 at 61.

<sup>56</sup> See Beale, *supra* note 44 at 1079.

<sup>57</sup> See FIRST RESTATEMENT, *supra* note 47, §612.

<sup>58</sup> *Holzer v. Deutsche Reichsbahn-Gesellschaft*, 277 N.Y. 474, 14 N.E. 2d 798 (1938).

<sup>59</sup> *Paul v. National Life*, 352 S.E. 2d 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 or wanton misconduct." *Id.* at 550.

<sup>60</sup> See Lea Brilmayer, *CONFLICT OF LAWS: CASES AND MATERIALS* 124-25 (4<sup>th</sup> ed. 1995).

<sup>61</sup> See, e.g., *Burr v. Beckler*, 264 Ill. 230, 106 N.E. 206, 209 (1914) (holding that although the

specific issue is one of substance or of procedure, since the forum law normally controls the latter but possibly not the former. Courts distinguished rules creating rights as substantive and rules describing how to obtain a remedy as procedural.<sup>62</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 refusal to enforce choice of law contracts and its inherent ambiguity make it unsatisfactory as an efficiency-based test.

## 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>63</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. Subsection 1 discusses the most famous version of this theory put forth by Brainerd Currie. Subsections 2 and 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* interest.

### 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>64</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 multi-state facts.<sup>65</sup> Currie criticized territorial rules on the ground that they often operated to further the legislative policy of no interested state.<sup>66</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 First

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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>62</sup> See, e.g., *Levy v. Steiger*, 124 N.E.2d 477 (Mass. 1919); *Grant v. McAuliffe*, 264 P.2d 944, 949-49 (Cal 1953).

<sup>63</sup> See generally Brilmayer, *supra* note 45 at 25-31.

<sup>64</sup> See *id.* at 50-53.

<sup>65</sup> *Id.* at 53.

<sup>66</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 (1963) [hereinafter *SELECTED ESSAYS*] (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 *Selected Essays*, *supra*, Ch. 3 (discussing place of accident rule).

Restatement 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>67</sup> (2) the place of the accident rule to determine tort immunity;<sup>68</sup> and (3) the place of contract rule to determine an out-of-state married woman's capacity to contract.<sup>69</sup>

Currie's fundamental reliance on government interest is suspect in light of the analysis in Part I. Interest analysis appears categorically to emphasize the political process or the interplay of interest groups over the individuals' right to exit inefficient laws. But how well Currie's approach meshes with an efficiency-based approach depends on how courts are to determine government interests and legislative intent. Even if a statute is approved by a majority of the legislators, it is infeasible to determine *the* legislative intent underlying the statute. Legislators bring a variety of interests, motivations, and intentions to the lawmaking table.<sup>70</sup> Some may be voting for private interests,<sup>71</sup> some concerned with the public interest, and some may be opposed to the statute but logrolling for a favorable vote on another statute, perhaps even hoping that the executive will veto the statute or a court strike it down. The statute may be silent or ambiguous because its drafters sidestepped important issues to achieve a consensus on the bill.

Currie's inquiry compounds these familiar 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, an exploration of constructive intent proves no more fruitful than that for actual intent because it is not clear what principles should guide the construction.<sup>72</sup> One could plausibly argue that reference to the First Restatement rules is most appropriate since these rules prevailed when much legislation was enacted and is often the basis of much

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<sup>67</sup> Brainerd Currie, *Conflict, Crisis and Confusion*, 1963 DUKE L.J. 1, reprinted in SELECTED ESSAYS, ch. 14 at 720.

<sup>68</sup> *Id.* at 721.

<sup>69</sup> See Currie, *Married Women's Contracts*, *supra* note 66 at 119.

<sup>70</sup> We set aside the social choice difficulties of assuming that a statute reflects some majority consensus given the lessons from Arrow's Theorem. Kenneth J. Arrow, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1963). Arrow's Theorem holds, in very simple terms, that a collective decision-making 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 decision-making, and decided according to fair collective decision-making processes. See generally MAXWELL L. STEARNS, CONSTITUTIONAL PROCESS: A SOCIAL CHOICE ANALYSIS OF SUPREME COURT DECISION MAKING ch 2 (forthcoming University of Michigan Press).

<sup>71</sup> See *Kaczmarek v. Allied Chemical Corp.*, 836 F.2d 1055, 1059 (7<sup>th</sup> 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>72</sup> See Lea Brilmayer, *Interest Analysis and the Myth of Legislative Intent*, 78 MICH. L. REV. 392, 430 (1980)

actual legislation on choice of law.<sup>73</sup> Alternatively, legislators might want courts to defer to other legislatures by reading at least some domestic statutes narrowly in order to foster reciprocal relationships with other states that can maximize the forum state's long-run interests.<sup>74</sup> In short, a constructive intent analysis lends itself to whatever approach the construing court might wish to use to resolve conflicts of law.

The real problems of Currie's approach from an efficiency standpoint begin with Currie's determinations about what policies *ought* to matter for purposes of determining constructive intent. Currie assumes that governments have parochial interests in protecting their own domiciliaries.<sup>75</sup> This discriminatory application of state law could exacerbate the problem of inefficient legislation discussed above in Section I(A).<sup>76</sup> One potential source of inefficiency is that state legislators may tend to benefit locals while imposing costs on residents of other states. This reflects the non-residents' inherent lobbying disadvantages.<sup>77</sup> 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 laws that benefit local plaintiffs' lawyers at the expense of remote manufacturers.

Interest analysis further exacerbates this inefficiency by facilitating choice of law by one of the affected parties at the time of litigation, when it can take into account the wealth effects of the choice. 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>78</sup> The plaintiff can choose a forum

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<sup>73</sup> *Id.*

<sup>74</sup> *See infra* note 103 and accompanying text.

<sup>75</sup> *See* Brilmayer, *supra* note 72 at 408 (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>76</sup> 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 First Restatement 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, *supra* note 2. However, while interest analysis may beat the territorial place-of-injury rule, as discussed in *infra* Part IV(D)(1) the point-of-sale rule is preferable to both interest analysis and the First Restatement in increasing the efficiency of state products liability law.

<sup>77</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 *NEW DIRECTIONS IN LIABILITY LAW* 90 (Walter Olson ed., 1988).

<sup>78</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

from among all of those with which the defendant has had enough contact to create a predicate for jurisdiction.<sup>79</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. These more recent versions of interest analysis share the central problem of Currie's original proposal that they facilitate rather than discourage the application of inefficient laws. This subsection considers Baxter's comparative impairment theory, while the next subsection discusses attempts, particularly by Larry Kramer, to more realistically ascertain legislative intent.

Soon after Currie published his series of essays on choice of law, William Baxter published an article building on Currie's interest analysis.<sup>80</sup> While Baxter thought that Currie properly focussed 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>81</sup> Currie had proposed the application of forum 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 between the states. Baxter's intuition was that states would be willing to cede authority over those cases in which they were relatively less interested in return for gaining authority over those cases in which they were relatively more interested.<sup>82</sup> Thus, courts should apply the law of the state that would suffer the greatest "comparative impairment" if its law were not applied.<sup>83</sup>

Comparative impairment arguably represents the approach most consistent with economic theory because it attempts to maximize the joint utility of the polity within each

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parties share a domicile elsewhere. *See* Brilmayer, *supra* note 77 at 1315.

<sup>79</sup> Interest analysis has been attacked on the ground that it simply allows choice of the applicable law based on jurisdiction rather than resolving conflicts among potentially applicable laws. *See* Kermit Roosevelt, *The Myth of Choice of Law: Rethinking Conflicts*, 97 Mich. L. Rev. 2448 (1999). 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* at 168. But this is not a significant constraint today given the increasingly national and international scope of enterprise.

<sup>80</sup> *See* Baxter, *supra* note 3.

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

<sup>82</sup> *See* Baxter, *supra* note 3 at 10.

<sup>83</sup> *See id.* at 18 (stating that "the 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.").

state.<sup>84</sup> However, a significant problem with Baxter's approach from the standpoint of efficiency analysis is that comparative impairment focuses on maximizing *government* rather than *individuals'* interests. Lawmakers may not be faithful agents of the public.<sup>85</sup> 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>86</sup> But this assumes that the parties choose the law *ex post*, after winners and losers have been identified, and ignores the possibility of designing rules to emphasize *ex ante* choice of law.

This brings up another problem with Baxter's theory from an efficiency perspective: Parties cannot easily choose the law by altering their conduct because it is hard to predict the results courts will reach under this approach.<sup>87</sup> *Bernhard v. Harrah's Club*,<sup>88</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 drunk 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 facts. If this were the only case of a California patron served in a Nevada tavern and thereafter causing injury on California highways it would matter little to the states' policies which law is applied. But if all drunk drivers who injure California residents were served alcohol in a Nevada tavern, or if all accidents caused by drunk patrons of Nevada taverns occurred in California, each state's policy would be thwarted by application of the other state's law. The actual situation will probably be somewhere between these extremes. Thus, it will be very hard to determine which state is more impaired. Moreover, comparative impairment forces courts to make the difficult empirical determination of

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<sup>84</sup> See Posner, *supra* note 3, at 645-46.

<sup>85</sup> See *supra* subpart I(A). Baxter himself, no stranger to public choice, recognized that the states could not be trusted to objectively perform a comparative impairment analysis. See Baxter, *supra* note 3 at 23. An essential, but largely ignored, component of his proposal was the overruling of *Klaxon v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941) to enable the federal courts, sitting in diversity, to develop a common law incorporating comparative impairment. *Id.* at 41-42. 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.

<sup>86</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." *Id.* at 5. The court could choose among these competing laws only by superimposing his own "super-value judgment" onto the merits of the case. *Id.* Posner, *supra* note 3 at 645-46, 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").

<sup>87</sup> The following argument is drawn from William H. Allen & 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 (1999).

<sup>88</sup> 16 Cal. 3d 313, 546 P.2d 719, 128 Cal. Rptr. 215 (1976),.

how the relevant conduct -- serving alcohol in Nevada and DUI accidents in California -- varies with changes in legal rules. Nor is it clear how to compare the alternative regulatory goals of deterrence and distribution, or account for differences in how important policies are to lawmakers.<sup>89</sup>

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

Larry Kramer modifies Currie's approach by proposing a more sophisticated look at legislative intent.<sup>90</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. 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>91</sup>

Kramer operationalizes 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>92</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>93</sup> (3) "True 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>94</sup> (4) "Where one of two conflicting laws is obsolete (i.e. inconsistent with prevailing legal and social norms in the enacting state), the other law should be applied."<sup>95</sup> (5) "Where two laws conflict, but the parties actually and reasonably relied on one of them, that law should be applied."<sup>96</sup>

These canons improve on Currie's approach from the standpoint of an efficiency analysis by emphasizing private ordering while de-emphasizing forum law, thereby

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<sup>89</sup> See Larry Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277, 317 (1990) (noting that "[t]he 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 the comparison").

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* at 303; Larry Kramer, *Return of the Renvoi*, 66 N.Y.U.L. REV. 979, 1011 (1991) (noting that "[a] state's approach to choice of law by definition establishes the state's rules of interpretation for questions of territorial scope"). Like Baxter, Kramer proposed resolving true conflicts by reference to a hypothetical bargain among the states. Kramer, *supra* note 89 at 316.

<sup>92</sup> *Id.* at 323.

<sup>93</sup> *Id.* at 324.

<sup>94</sup> *Id.* at 329.

<sup>95</sup> *Id.* at 334.

<sup>96</sup> *Id.* at 336.

avoiding some of the more wealth-reducing implications of Currie's theory.<sup>97</sup> Moreover, Kramer's third, or contractual, canon is clearly consistent with our approach.<sup>98</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>99</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>100</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>101</sup>

The central problem with Kramer's theory is that interest analysis remains at its core. Kramer's pursuit of a more realistic determination of legislative intent than Currie's may lead in the wrong direction from an efficiency standpoint. Legislators might have incentives to restrict exit from inefficient laws in order to maximize the value of an interest group bargain. Accordingly, 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 subsection 2, comparative impairment emphasizes the effectuation of legislative policy, which may reflect the defects of the underlying political process.

Another problem with Kramer's theory is its emphasis on state reciprocity. Kramer criticized Currie for ignoring the possibility that states would want to defer to other states' interests in order to foster comity<sup>102</sup> and reciprocity,<sup>103</sup> preventing forum-

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<sup>97</sup> It has also drawn criticism, precisely for its attribute that we most favor -- that is, facilitating exit from inefficient laws. See Louise Weinberg, *Against Comity*, 80 GEO. L.J. 53, 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>98</sup> However, as explained more fully below in section 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 who 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>99</sup> See Kramer, *supra* note 89 at 330-31.

<sup>100</sup> See *id.* at 330 (noting that "while 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>101</sup> *Id.* at 333-34.

<sup>102</sup> See Kramer, *supra* note 89 at 313 (noting that "states share what are usually called "multistate policies" that may point toward the application of another state's law, including comity, facilitating multistate activity and providing a uniform and predictable legal regime).

shopping,<sup>104</sup> and promoting 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>105</sup> particularly in light of the courts' incentives to defect from the long-term cooperative solution in order to entice plaintiffs or favor local litigants.<sup>106</sup> State courts cannot easily monitor, let alone discipline, uncooperative state courts. But more importantly from the standpoint of our theory, even if the states do cooperate, there is no reason to assume that the goal of this cooperation would be to enhance efficiency or individual autonomy.

### C. JUDICIAL POLICY MAKING

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 Bealian artificiality, nevertheless committed what Cavers thought to be the same sin of being *jurisdiction* rather than *law*-selecting.<sup>107</sup> Cavers believed that courts should weigh the policies behind the conflicting substantive laws.<sup>108</sup> Willis Reese similarly emphasized the need to formulate policy-based rules, which requires an explicit choice between the conflicting states' laws.<sup>109</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>110</sup> Leflar advocated that courts should use five "choice-influencing considerations" in choosing governing law,<sup>111</sup>

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<sup>103</sup> *Id.* at 314 (observing that "[f]rom 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>104</sup> *Id.* at 313, 340.

<sup>105</sup> *See infra* Part V(B).

<sup>106</sup> *See* Hay, *supra* note 2.

<sup>107</sup> David F. Cavers, *A Critique of the Choice of Law Problem*, 47 HARV. L. REV. 173, 178 (1933).

<sup>108</sup> *Id.* at 190.

<sup>109</sup> Willis Reese, *Choice of Law: Rules or Approach*: 57 CORNELL L. REV. 315, 329-30 (1972). *See also* Joseph Singer, *Real Conflicts*, 69 B.U.L. REV. 1, 79 (1989) (concluding that courts initially should focus on substantive justice and the substantive policy that underlies the particular legal field).

<sup>110</sup> Symeon C. Symeonides, *Choice of Law in the American Courts in 1997*, 46 AM. J. COMP. L. 233, 258 & n. 107 (1998) (stating that, in 1997, Arkansas, Minnesota, New Hampshire, Rhode Island, and Wisconsin followed the "Better Law" approach).

<sup>111</sup> *See* Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267, 282-304 (1966).

the most important of which was the "better rule of law."<sup>112</sup> Leflar justified his conclusion on the ground that choosing more favorable law is inherent in what courts have actually done and in the way lawyers actually argue cases, even if both camouflage actual practice by instead 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>113</sup> Stewart Sterk has similarly minimized the importance of choice of law theory.<sup>114</sup>

The problem with letting courts choose the "better" substantive law is that, because of agency costs of judicial decision making,<sup>115</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>116</sup> Thus, it may be better to improve the incentives of judges as well as legislators by increasing the opportunity for affected parties to choose among competing legal regimes.<sup>117</sup>

#### D. COMPARATIVE REGULATORY ADVANTAGE

Judge Richard Posner has defended the First Restatement *lex loci delicti* rule 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>118</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. The place of the accident likely has the "comparative regulatory advantage" with regard to creating optimal incentives to take care in that jurisdiction, as well as to determine the optimal rules regarding nuisance, trespass, and other issues affecting land use or alienability.

Posner's comparative regulatory advantage insight fits comfortably into an efficiency approach to choice of law. However, the theory's principal defect from this perspective is that it may not work well as a general default rule outside the area of

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<sup>112</sup> See Brilmayer, *supra* note 72 at 71.

<sup>113</sup> Robert Leflar, *Choice of Law: A Well-Watered Plateau*, 41 LAW & CONTEMP. PROBS. 10, 11 (Spring 1977).

<sup>114</sup> See Sterk, *supra* note 23 at 952 (1994) (noting that "in many cases reaching the 'correct' choice of law result is and should be less important to judges than other substantive law considerations.").

<sup>115</sup> See *supra* text accompanying notes 18-22.

<sup>116</sup> See Leflar, *supra* note 111, at 298-99.

<sup>117</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.

<sup>118</sup> *Kaczmarek v. Allied Chemical Corp.*, 836 F.2d 1055, 1058 (7<sup>th</sup> Cir. 1988). See also POSNER, *supra* note 2 at 646; Solimine, *supra* note 2, at 59-64.

accident law in which Posner applied it. Even where the parties do not explicitly choose the applicable law *ex ante*, applicable default rules should help the parties make this choice where feasible, as by deciding where to live, travel or transact business. Thus, the courts should temper comparative regulatory advantage with choice-maximizing rules.

An important aspect of facilitating choice is avoiding case-by-case determinations that promote *ad hoc* judicial decision-making and minimize the parties' ability to engage in *ex ante* planning.<sup>119</sup> Making a general 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>120</sup> Some rules such as negligence seem to deter harmful conduct, while others, such as guest statutes and other immunities, seem to allocate losses.<sup>121</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 pool of funds available to compensate the families of children who die from vaccination profoundly affected drug companies' willingness to produce the vaccines.

Rigid application of a comparative regulatory advantage approach also presents problems from the standpoint of the optimal bundling of legal rules.<sup>122</sup> Because some loss-allocating rules do affect primary conduct, an issue-by-issue analysis threatens to break up state laws that work together. For example, state A might provide broad recovery for injuries but adopts immunities to prevent fraudulent and collusive claims. Assume that state A lets an injured plaintiff recover by proving the defendant failed to comply with a simple negligence standard and generously applies the negligence *per se* and *res ipsa loquitur* doctrines. The state might also have a direct action statute that enables the plaintiff to sue the defendant's insurer directly. To protect against fraudulent claims or excessive litigation, however, state A law does not allow suits between husbands and their wives, children and their parents, beneficiaries and their charities, or automobile passengers and their drivers. In contrast, state B lets all injured plaintiffs to sue for compensation, but to discourage abuses it forbids direct actions, caps damages, disallows negligence *per se*, and utilizes a narrow *res ipsa loquitur* doctrine. 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, and may undermine deterrent effects of tort law for state B accidents involving state A residents.

In order to avoid these problems of applying the comparative regulatory advantage approach, this article suggests rules for specific categories of cases that mesh

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<sup>119</sup> See *infra* Part III(B).

<sup>120</sup> Baxter, *supra* note 3 at \_\_\_.

<sup>121</sup> CITE. This assumes that a driver is unlikely to take any more or less care driving on the basis of whether or not his guest passenger could sue him for injuries in the event of an accident because he is much more concerned with his own personal safety and any damage that might result to his car.

<sup>122</sup> See *infra* Part III(D).

comparative regulatory advantage and choice-maximizing considerations.<sup>123</sup>

## E. DESCRIPTIVE VS. 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 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>124</sup> Currie criticized the First Restatement rules by pointing out the many places where state courts used the escape devices to reach more intuitively satisfying results.<sup>125</sup> Others, such as Leflar,<sup>126</sup> advocated their own proposals on descriptive grounds.

Descriptive choice-of-law theories are potentially useful in helping predict future results from past cases. Normatively, a descriptive theory might stand for the modest principle that choice-of-law rules should clearly reflect what courts actually are doing, and as a criticism of courts that do not clearly state their reasoning. Clear statement facilitates *ex ante* choice of law, consistent with our efficiency approach.<sup>127</sup> But a descriptive theory has normative value in this sense only in comparison to a regime in which courts say one thing and do another. It says nothing about any particular clearly expressed rule. The question for present purposes is whether descriptive theories have a normative function and, more specifically, how they relate to an efficiency approach.

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>128</sup> For now the claim should be treated skeptically because it appears inconsistent with the discussion above of how judges may serve their own, plaintiffs' or legislators' interests rather than those of litigants as a whole.<sup>129</sup> First, judges may favor particular interest groups such as local lawyers who would want to attract litigation,<sup>130</sup> and in-state litigants who have the most influence on judicial selection. Second, judges may favor forum law, partly to serve the legislators that determine judges' pay and perquisites, and partly because this simplifies judges' task. Indeed, studies of case law show that the dominant modern interest analysis has pro-plaintiff, pro-resident and pro-

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<sup>123</sup> See *infra* Part IV.

<sup>124</sup> See *supra* text accompanying notes 50-53.

<sup>125</sup> See SELECTED ESSAYS, *supra* note 66.

<sup>126</sup> See Leflar, *supra* note 111.

<sup>127</sup> See *infra* §III(B).

<sup>128</sup> See *infra* subpart V(D).

<sup>129</sup> See *supra* subpart I(A)(2).

<sup>130</sup> See Solimine, *supra* note 2 at 73 (noting that judges may favor the bar through decisions that will generate litigation, and the bar may fund judicial election campaigns).

forum biases.<sup>131</sup>

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 facilitated more self-indulgent judicial decision making. This evolution may be attributed to a kind of Prisoner's Dilemma game among the states. That is, even if the First Restatement is socially optimal, individual states and their courts gain by abandoning this approach. Courts in the larger states such as New York<sup>132</sup> and California<sup>133</sup> could compete for litigation business and otherwise serve their self-interest by rejecting the constraints of the First Restatement. The large states' more attractive markets made it hard for parties to avoid sufficient contacts to create a basis for exerting jurisdiction.<sup>134</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 foregoing using the modern approach. In short, it no longer paid for most of the states or their courts to retain the First Restatement.<sup>135</sup> To be sure, a dynamic might develop through jurisdictional and interest group competition that overcomes these barriers to efficiency.<sup>136</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,

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<sup>131</sup> See Patrick Borchers, *The Choice of Law Revolution: An Empirical Study*, 49 WASH. & LEE L. REV. 357, 377 (1992) (finding choice-of-law decisions under the First Restatement to be more evenhanded than each of the modern approaches); Solimine, *supra* note 2, at 81-89. Stuart Thiel, *Choice of Law and the Home Court Advantage: Evidence* (unpublished manuscript 1996) found that while the modern approach states clearly use forum law more often than states using the First Restatement, 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 appears inconsistent with George Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEG. 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. Choice of law questions might be sufficiently inexpensive and preliminary in the litigation process that results may vary at the margin across jurisdictions. However, Thiel, *supra*, is consistent with what would be expected based on Priest & Klein.

<sup>132</sup> This is evidenced by the evolution of an interest-type analysis in guest statute cases such as *Babcock v. Jackson*, 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963); *Tooker v. Lopez*, 24 N.Y.2d 569, 249 N.E.2d 394, 301 N.Y.S.2d 519 (1969); *Neumeier v. Kuehner*, 31 N.Y.2d 121, 286 N.E.2d 454, 335 N.Y.S.2d 64 (1972).

<sup>133</sup> For example, see Justice Traynor's opinion embracing interest analysis in *Reich v. Purcell*, 67 Cal. 2d 551, 63 Cal. Rptr. 31, 432 P. 2d 727 (1967), as well as his earlier opinion in *Bernkrant v. Fowler*, 55 Cal. 2d 588, 360 P.2d 906, 12 Cal. Rptr. 266 (1961).

<sup>134</sup> For a discussion of markets, operating in conjunction with jurisdiction rules, as a mechanism for disciplining choice of law, see *infra* §V(D).

<sup>135</sup> See PALGRAVE, *supra* note 1; INTERNATIONAL, *supra* note 1. Interestingly, most of the states that have retained the First Restatement are contiguous to one another and located in the Southeastern United States. CITE. Mobility and market transactions for residents of these states seem to be relatively more confined to other First Restatement states than would be the case for those state that have abandoned the rules.

<sup>136</sup> See *infra* subpart V(D).

however, there is room to doubt the efficiency of at least some of the rules courts have developed.

Are normative choice of law theories such as those discussed above in this Part 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>137</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>138</sup>

At the same time, there is something to be said for normative theories. Indeed, the fact that this article proposes a normative theory of choice of law necessarily entails endorsement of the potential usefulness of such theories. As discussed below,<sup>139</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, as illustrated by looking at a system that lacks a clear theory. The Second Restatement has been characterized as a kind of grand description, accommodating all of the various judicial approaches to choice of law.<sup>140</sup> The Second Restatement's choice-of-law "rules" are only as baseline presumptions that courts can ignore if a multi-factored, contact-based analysis indicates that another state's law most appropriately applies.<sup>141</sup> This ends up sanctioning whatever the courts want to do, thereby contributing to the judicial agency costs discussed above. Moreover, it frustrates parties who seek to determine the law applicable to conduct before they engage in it.

## F. SUMMARY

None of the approaches surveyed above relies squarely on efficiency or attempts to use efficiency as a comprehensive guidepost for developing a choice-of-law approach. Modern choice of law centers on state interests rather than party interests, and ignores the costs of uncertainty and forum shopping. Moreover, all choice-of-law proposals to date

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<sup>137</sup> See Ribstein, *supra* note 19 (discussing legal academics' role in ALI's corporate governance project).

<sup>138</sup> *Id.*

<sup>139</sup> See *infra* subpart V(D).

<sup>140</sup> See William A. Reppy, *Eclecticism in Choice of Law: Hybrid Method or Mishmash?* 34 MERCER L. REV. 645, 655-66 (1983) (arguing that part of the Second Restatement's "eclecticism" arises from courts who graft Currie-style interest analysis or some other independent method to the most-significant-relationship standard).

<sup>141</sup> Cf. Jason E. Pepe, *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 Second Restatement, some jurisdictions essentially ignore the presumptive rule in favor of the most significant relationship test, and citing several case examples).

ignore the important implications of public choice theory. Perhaps ironically, as indicated above and discussed below, the First Restatement, which in form pays the least attention to anything resembling policy considerations, actually is most likely to lead to efficient results because of the effect of clear rules in promoting predictability and enabling 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 work to 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 help affected parties choose the law at the time of the relevant conduct rather than later through plaintiff's 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 and winners and losers have been identified.

Although this article emphasizes the general importance of party choice, 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. The strong interest group support that would be necessary for such an expression itself suggests the efficiency of that the underlying law.<sup>142</sup>

The main difference between the system proposed here and those that have dominated so far is the important one of emphasis. The choice of law rules to date, while providing some scope for exit by contract or domicile (under interest analysis) or by physical movement (the First Restatement), take *government* interests as starting points. The proposed theory, on the other hand, takes individual exit as its starting point. Subject to legislative veto noted immediately above, courts should choose economic or 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>143</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 which courts and legislators are rapidly applying to many areas, including such non-traditional areas as prenuptial agreements,<sup>144</sup> securities fraud<sup>145</sup> and

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<sup>142</sup> See *infra* Part III(E).

<sup>143</sup> See *supra* Part II(E).

<sup>144</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. Several courts have gone further, enabling the parties to use choice of law to ensure the validity of their agreement. See, e.g., Carr v. Kupfer, 296 S.E.2d 560, 562 (Ga. 1982); In re Estate of Massello, 1997 WL 89091, at \*3 (Del. Ch.); Elgar v. Elgar, 679 A.2d 937, 944 (Conn. 1996).

RICO<sup>146</sup> liability. Although the proposed theory's departure from current law is most pronounced in non-contractual situations, even here the theory may not reach results strikingly different from those under current law. The difference lies mostly in greater *ex ante* predictability rather than in *ex post* results.

## A. ENFORCEMENT OF CONTRACTUAL CHOICE

The proposed approach begins with the enforcement of contractual choice of law. The strongest advantage of contractual choice from the standpoint of our general theory is that it promotes competition among legal regimes that helps to discipline interest group bargains in the competing states. At the same time, however, choice-of-law clauses could thwart arguably efficient regulation of contract aimed at asymmetric bargaining problems that enable one contracting party to impose costs on the other. Some prohibited contract terms, such as fiduciary duty waivers, usurious interest rates, employment termination at-will, and non-competition provisions, may involve concerns about asymmetric information or bargaining power.

In resolving this tension, however, it is important to keep in mind that contractual choice of law does not necessarily nullify regulation of contracts.<sup>147</sup> The parties avoid a mandatory rule only by opting into a different regulatory regime. Consequently, they can only opt out of regulation 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 addressed in a way that better suits the parties rather than being simply ignored or disregarded. The danger of inefficiently lax regulation in the chosen state cannot be assumed to be greater than that of inefficiently strict laws in the regulating state.

The costs the parties jointly incur in contracting for the governing law will vary depending on the net costs imposed by the regulation that otherwise would apply. It follows that the higher the parties' costs of exiting from inefficient laws, the more costs of those laws the parties must tolerate, and the less exit can constrain inefficient laws. Exit costs may range from simply designating the preferred law in the contract to having to establish a substantial connection with the chosen state. One important determinant of the cost of exit is whether the parties can pick the individual laws of different states or must

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<sup>145</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 anti-waiver provisions in the Securities Act of 1933 and the Securities Exchange Act of 1934 (15 U.S.C. § 77n; 15 U.S.C. § 78cc(a)). *See* *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, 1366 (2d Cir. 1993); *Allen v. Lloyd's of London*, 94 F.3d 923, 930-32 (4<sup>th</sup> Cir. 1996); *Haynsworth v. The Corporation*, 121 F.3d 956, 969-70 (5<sup>th</sup> Cir. 1997); *Bonny v. Society of Lloyd's*, 3 F.3d 156, 162 (7<sup>th</sup> Cir. 1993); *Richards v. Lloyd's of London*, 135 F.3d 1289, 1296-97 (9<sup>th</sup> Cir. 1998); *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953, 957-58 (10<sup>th</sup> Cir. 1992); *Lipcon v. Underwriters at Lloyd's, London*, 148 F.3d 1285, 1297-99 (11<sup>th</sup> Cir. 1998). *See also* *Shell v. R.W. Sturge, Ltd.*, 55 F.3d 1227, 1231-32 (6<sup>th</sup> Cir. 1995) (forum-selection clause enforceable despite public policy behind Ohio's security statutes).

<sup>146</sup> *See Roby, supra*, 996 F.2d at 1366; *Richards, supra*, 135 F.3d at 1296; *Lipcon, supra*, 148 F.3d at 1299, n.20. No circuits have held to the contrary.

<sup>147</sup> *See Kramer, supra* note 89 at \_\_\_; Michael J. Whincop & Mary Keyes, POLICY AND PRAGMATISM IN THE CONFLICT OF LAWS (unpublished manuscript 1998) ("*Policy & Pragmatism*"); Michael J. Whincop & Mary Keyes, *Statutes' Domains in Private International Law: An Economic Theory of the Limits of Mandatory Rules*, 20 SYDNEY L. REV. 435 (1998) ("*Statutes' Domains*").

accept the entire bundle of a jurisdiction's laws.<sup>148</sup>

A principal limitation on the efficiency of enforcing contractual choice, and a possible justification for constraining contractual choice, is that the contracting process may be flawed. A choice of law clause may be a Trojan horse concealing a term of the chosen law that is onerous to the non-drafting party. Also, the choice-of-law clause may be included in an "adhesion" contract imposed by one party on another.<sup>149</sup> But concerns about the contracting process, even if well grounded, do not necessarily justify an outright prohibition of choice-of-law clauses. A state might appropriately require highlighting of choice-of-law provisions. If the state is concerned that a choice-of-law clause represents 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 is choosing a state's law in order to take advantage of caps on damages 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 disclosure of any otherwise applicable mandatory rules that the choice-of-law provision is attempting to circumvent.

Thus, even if courts should not always enforce contractual choice of law, there should at least be a clear presumption favoring such enforcement, and regulation generally should be confined to procedural measures short of outright prohibition.<sup>150</sup> The remainder of this Part discusses principles that should underlie legislative jurisdiction in the absence of contractually chosen law.

## B. EXIT-FACILITATING RULES

Courts often must choose law in situations that, for one reason or another, do not lend themselves to explicit party choice. These include accident cases where choice of law is not feasible, or contract cases in which the parties do not negotiate for a choice-of-law clause.

Under modern choice-of-law approaches people know the applicable law only after they have acted, and therefore cannot select the law that governs their conduct. The approaches are biased toward applying the law where the plaintiff chooses to sue, after the conduct has occurred.<sup>151</sup> At the extreme, the *lex fori* rule in a couple of states necessarily applies forum law.<sup>152</sup> Thus, a defendant might be hauled into court in any of several jurisdictions with which it had contact. When the courts do not apply forum law, the unpredictability of interest analysis or the Second Restatement makes it hard for the parties to predict which other law will apply. For example, a seller who (1) negotiates with a buyer in the buyer's domicile state A, (2) accepts the contract at its branch office in

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<sup>148</sup> See *infra* Part III(D).

<sup>149</sup> See Romano, *supra* note 5 at 2406-07 (1999) (discussing court reluctance to enforce choice-of-law clauses in some adhesion contracts).

<sup>150</sup> See *infra* Part IV(A)(2).

<sup>151</sup> See Borchers, *supra* note 131; Solimine, *supra* note 2 at \_\_\_\_; Thiel, *supra* note 131 \_\_\_\_.

<sup>152</sup> For a treatment of the *lex fori* approach, see Brilmayer, *supra* note 45 at 361-66 (noting that two U.S. states, Kentucky and Michigan, have experimented with the approach).

state B, and (3) is headquartered in state C, might be subject to the law of all three states. The court chooses the relevant law at trial, as if from a hat, from one of the likely candidates.

This article advocates instead rules that maximize the parties' ability to choose the applicable law by arranging their conduct. These rules would select a particular factor for determining the applicable law, such as the place of contract offer or acceptance, or the place of the accident or negligent conduct. Thus, one aspect of the proposed system is reliance on clear rules. 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>153</sup> This article emphasizes a rule-based system's advantage of facilitating parties' choice of the laws that govern their conduct.

More importantly, the proposed system relies on factors the parties can identify *ex ante*, before engaging in the relevant conduct. Thus, a clear rule such as *lex fori* may be even worse than a muddy rule if both operate *ex post*. By ensuring 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. By contrast, a choice of law rule that operates randomly would not do as good a job attracting plaintiffs and would therefore give the state less of an incentive to shape its law to suit plaintiffs.

The choice-facilitating principle meshes well with other fundamental choice-of-law concerns. Due process, which demands that a party not be unfairly surprised,<sup>154</sup> has been characterized as focusing on the parties' expectations when they acted.<sup>155</sup> The exit-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 sought its benefits by acting locally.<sup>156</sup> Finally, insisting that parties know what law applies at the time of the relevant conduct encourages the parties tailor their conduct in light of existing laws, thereby bolstering law's deterrence objective. Although *ex ante* predictability concerning the governing law may have little value in some situations where people do not pay attention to differing legal standards,<sup>157</sup> repeat players such as manufacturers and insurance companies pay careful attention to differing laws, so that governing tort standards may affect aggregate

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<sup>153</sup> See Michael H. Gottesman, *Draining the Dismal Swamp: The Case for Federal Choice of Law Statutes*, 80 GEO. L.J. 1 (1991); Reese, *supra* note 109 at 322-23 (condoning abandonment of a search for the state with the greatest interest where "the court finds the task disproportionately time consuming"); Maurice Rosenberg, *The Comeback of Choice-of-Law Rules*, 81 COLUM. L. REV. 946, 948 (1981) (praising Reese for rejecting a "no-rules" approach, yet noting Cavers' critique that the traditional system encouraged forum shopping). See also Cavers, *supra* note 107, at 173 (advocating use of rules as long as they grow out of policy considerations).

<sup>154</sup> See *Home Ins. Co. v. Dick*, 281 U.S. 397, 410 (1930); *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 327 (1981) (Stevens, J., concurring); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 837-38 (1985) (Stevens, J., dissenting).

<sup>155</sup> Brillmayer, *supra* note 45, at 143.

<sup>156</sup> See *Home Ins. Co. v. Dick*, 281 U.S. at \_\_\_\_.

<sup>157</sup> See Sterk, *supra* note 23 at 983, 1013 (discussing example of accidents); 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.).

behavior.<sup>158</sup>

Any rule-based system tailored to particular situations raises characterization problems. As discussed above in the context of the First Restatement,<sup>159</sup> ambiguity in the characterization of a claim or issue creates opportunities for manipulation by the courts. This, in turn, makes it harder for actors to determine at the time of their conduct which law will apply to any resulting dispute. One way to avoid this problem is to make the applicable choice of law rule turn on facts rather than legal theories, which courts can more easily manipulate. For example, instead of asking whether an issue involves a "contract" or "tort," we would focus on whether the parties have bargained with each other.<sup>160</sup>

The emphasis on clear rules that enable *ex ante* choice implies that the 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 First Restatement.<sup>161</sup> But Cavers himself objected only to choice-of-law rules that lacked a policy foundation.<sup>162</sup> 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.

It is important to distinguish this article's approach from one relying on party "expectations." Such a test would be circular because expectations are shaped by the courts' approach to choice of law.<sup>163</sup> In any event, given the ambiguous nature of modern choice-of-law rules, the parties may not have any meaningful expectations about the applicable law. Rather, they may legitimately expect the application of the law of any of several states that have contact with the controversy. The effect of an expectations test, therefore, is to leave the final choice to an *ex post* judicial selection from among the relevant states rather than the parties' *ex ante* choice of a particular jurisdiction.<sup>164</sup>

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<sup>158</sup> See William M. Landes & Richard A. Posner, *THE ECONOMIC STRUCTURE OF TORT LAW* 14-19 (1987); Bruce, Christopher, *The Deterrent Effects of Automobile Insurance and Tort Law: A Survey of the Empirical Literature*, 6 *LAW & POL'Y* 67 (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, 64-65 (1982).

<sup>159</sup> See *supra* Part II(A).

<sup>160</sup> See *infra* Part IV(D) (discussing product liability and malpractice claims).

<sup>161</sup> See Cavers, *supra* note 107 at 177.

<sup>162</sup> See *generally* Cavers, *supra* note 107 at 190.

<sup>163</sup> See Richard Michael Fischl, *Some Realism About Critical Legal Studies*, 41 *U. MIAMI L. REV.* 505, 532 n.73 (1987) (noting circularity of entitlement arguments based on expectation).

<sup>164</sup> If courts widely 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 unfairly surprised the parties. See *New York Life Ins. Co. v. Dodge*, 246 U.S. 357 (1918) (using

### C. A FALLBACK: COMPARATIVE REGULATORY ADVANTAGE

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 unplanned events that can significantly alter their well-being.<sup>165</sup> Moreover, it may be unclear in these contexts what rule maximizes the parties' mutual ability to choose their governing law. For example, a plaintiff-domicile rule enables the plaintiff to live in the state that provides the protections against injury that she prefers. At the same time, however, the defendant has greater ability to choose if the rule instead applies the law of the place of the accident-triggering conduct. Accordingly, this article proposes a rule for cases where the exit-facilitating approach proves unfruitful: apply the law of the law of the state with the comparative regulatory advantage.<sup>166</sup> In contrast with approaches based on interest analysis,<sup>167</sup> comparative regulatory advantage can reflect *individuals'* rather than solely *states'* interests.

The comparative regulatory advantage approach is based on a hypothetical bargain that anticipates the law that the parties would bargain for if they had that opportunity.<sup>168</sup> Prior to a dispute's arising, the parties normally can be expected to select the law that maximizes their joint interests. In other words, the parties would want to select the jurisdiction whose law is best adapted to the particular case. With respect to torts, for example, *lex loci delicti* is "the law most closely attuned to conditions in the state affecting safety, such as climate, terrain, and attitudes toward safety."<sup>169</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, all things equal

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substantive due process).

<sup>165</sup> Although accident law is arguably part of the bundle of laws the parties select by choosing their domicile, it is too small a part for the choice of domicile to be meaningful in this respect. The courts might enhance choice by "unbundling" choice of law, as by applying the guest statutes and other no-duty rules of the defendant's domicile and the conduct rules of the place of the accident. This might enable insurers to choose insureds and set their rates according to where they live. However, unbundling entails potential costs. *See infra* Part III(D).

<sup>166</sup> *See supra* Part II(D). Our approach contrasts with Posner's in examining regulatory advantage at a general level rather than with respect to each issue in the case. *See infra* Part III(D). While this sacrifices some precision, as we discuss below there are advantages to bundling, including enabling a simpler set of rules than is possible under depechage and preserving complementarity among a state's laws.

<sup>167</sup> *See supra* Part II(B).

<sup>168</sup> The hypothetical bargain approach has come under attack in the contracts setting on the ground that it ignores information asymmetries that can affect the bargain in inefficient ways. *Compare* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J.87 (1989); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992); Ian Ayres & Robert Gertner, *Majoritarian v. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999) with Barry E. Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 STAN. L. REV. 1547 (1999). This debate is not particularly important in the present context because we focus on situations where it is usually impractical for the parties to contract around the default rule. Rather, individual parties will be able to avoid the rule, if at all, only by altering their conduct.

<sup>169</sup> *See supra* note 118 and accompanying text.

it is better that they be informed. Accordingly, it can be assumed that, if the affected parties were in a position to contract on the issue and were concerned for their mutual advantage, they would choose the law of the place with the comparative regulatory advantage. Although the state with the comparative regulatory advantage may not always have the most efficient law with respect to the parties' claim, no other state is *more likely* to have legislated more efficiently.

It is important to keep in mind that comparative regulatory advantage is proposed only as an adjunct to maximizing individual choice. Accordingly, a rule that facilitates individual choice may be preferable to one that selects the state with the comparative regulatory advantage, particularly where the result under the comparative regulatory advantage approach is unclear.

The comparative regulatory advantage approach is useful as a general principle that guides the formulation of specific rules rather than as a basis for results in individual cases. For example, although the rules of *lex loci* for accidents and *situs* for land regulation might generally tend to result in regulation by states with the comparative regulatory advantage, that is not always the case. But clear rules that decide most cases correctly have advantages that offset the potential loss of accuracy. They not only economize on litigation costs, but provide predictability for parties who can make some *ex ante* choice, such as one of where to live.<sup>170</sup> More importantly, clear rules tend to discipline judges, who as discussed above may have incentives to choose law that is poorly suited to the parties but well-suited to the judges' preferences.<sup>171</sup> Judges can more easily shade a standard to apply forum law or achieve the results they favor than they can stretch or ignore a rule.

#### D. BUNDLING

The more modern approaches to choice of law typically resolve conflicts on an issue-by-issue basis. Thus, one state's law might determine whether defendant acted "negligently," while another's might determine whether plaintiff's cause of action is barred by defendant's immunity to suit. The term "depechage" refers to a court's practice of applying different states' laws to a single legal claim.<sup>172</sup> Some depechage inevitably occurs whenever foreign substantive law applies, if only because courts are entitled to apply their own procedural rules.<sup>173</sup> This section addresses the extent to which a single legal claim should be subject to differing substantive law.

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" their choices reduces their ability to choose or avoid particular rules since they must take the good with the bad, just as a seller's bundling reduces consumer choice. However, a

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<sup>170</sup> Although, as discussed in *supra* note 165, the parties generally will not choose where to live based on the applicable law, they might do so if the law were idiosyncratic or important enough.

<sup>171</sup> See *supra* § I(A)(2).

<sup>172</sup> See Symeon C. Symeonides, Wendy Collins Purdue, & Arthur T. von Mehren, *CONFLICT OF LAWS: AMERICAN, COMPARATIVE, INTERNATIONAL* 128 (1998).

<sup>173</sup> See Eugene F. Scoles & Peter Hay, *CONFLICT OF LAWS*, 57 (2d ed. 1992) (noting that substance/procedure distinction has medieval origins).

concern for clarity and public choice considerations ultimately cut against bundling.

Bundling serves several important purposes. First, forcing contracting parties to choose an entire body of law may help to prevent bargaining or information disparities from influencing the choice.<sup>174</sup> If designating parties must accept both favorable and unfavorable legal rules, it is harder for them to use contractual choice as a way of inserting one-sided terms in contracts.<sup>175</sup> This type of constraint might reasonably substitute for more burdensome restrictions on choice of law. To be sure, even with bundling contracting parties might still use choice of law opportunistically where a particular state law's advantages outweigh any possible disadvantages from other laws. An example might be the lack of an interest rate ceiling in a loan contract. But this may mean that bundling focuses the use of contractual choice of law on avoidance of the most burdensome, and therefore possibly most inefficient, regulations.

Second, as a default choice-of-law rule to be applied in the absence of explicit choice, bundling may reflect the parties' hypothetical bargain for reasons similar to those underlying the comparative regulatory advantage rule discussed above. 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 cap on damages because the cap may have been an important prerequisite to the adoption of the wrongful death statute. Unbundling can cause analogous but less obvious problems in many other situations. One state might combine a low speed limit with relatively lax enforcement and no negligence-per se rule while another might combine a high speed limit with relatively strict enforcement and a negligent-per-se rule.<sup>176</sup> These bundles reflect different decisions about the appropriate combination of legal standard, administrative enforcement, criminal penalties and civil liability. It follows that the same state's laws should apply to the standard of conduct, the fine and the negligence per se rule.<sup>177</sup> Unbundling may result in application of a combination of state laws that effectuates no state's policy concerns.

Third, bundling reflects a realistic view of interest group objectives. An interest group's investment in supporting or opposing a law depends in part on the law's actual effect on the members of the group. This, in turn, depends on how the law interacts with other laws. For example, truckers would not invest heavily in opposing a low speed limit if the speed limit were not enforced and did not trigger civil liability.

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<sup>174</sup> It might be said conversely that bundling inefficiently reduces freedom of contract. However, since the parties retain the ability to write default terms into their contracts, bundling merely restricts parties from evading *mandatory* rules of several states by choosing other states' permissive rules. The efficiency of this constraint on exiting mandatory rules depends on weighing the benefits of unrestricted exit against the benefits discussed in the Text of imposing bundling constraints on exit.

<sup>175</sup> Conversely, selection of an entire state 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 supra* subpart III(C).

<sup>176</sup> *See* Allen & O'Hara, *supra* note 87 at 1035-36.

<sup>177</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. *See* Allen & O'Hara, *supra* note 87 at 1035-36. For the contrary view, *see* Baxter, *supra* note 3 at 13.

Fourth, bundling reduces the parties' uncertainty about the law that governs their conduct. Without bundling, parties would have to predict which law a court will apply to each issue in the case. With bundling, the parties need only make a single prediction.

The foregoing analysis suggests that a single state's law should govern both procedural and substantive issues. In particular, 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 comparative regulatory advantage regarding procedural rules in that it knows best how to fashion the best procedures to suit 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.

Given the general advantages of bundling, and the specific reason for distinguishing procedural rules, the latter probably 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 raised by those cases. 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 parole evidence rule. For difficult characterization issues, courts could look to the forum's procedure code for guidance.<sup>178</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.

## E. RENVOI

Choice-of-law confronts courts with the difficult problem of renvoi -- that is, whether the state law that applies to a particular set of facts also provides the choice of law rule. Under vested rights analysis, the forum should apply the law of the state where it decides rights vested, arguably including the vesting state's choice of law rule. Yet that rule may point to a different state. The vesting state may use a different characterization rule than that applied by the forum, or even reject vested rights theory altogether. The forum therefore might end up applying the law of a state *other than* where it has decided rights vest. Moreover, the issue can cycle endlessly if the choice of law rule points to yet another state or back to the original state. Territorial analysis provides no principled way to resolve this dilemma.

Currie argued that renvoi is not a problem under his approach because interest analysis decides definitively which state's substantive policies should control the outcome.<sup>179</sup> But interest analysis runs into a problem similar to that under territorial rules. A state's choice-of-law rules arguably indicate whether the state is, indeed, interested in determining the outcome.<sup>180</sup> This brings back the uncertainty under vested rights analysis about whether the applicable law includes the law of conflicts.

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<sup>178</sup> See *Sampson v. Channell*, 110 F.2d 754 (1<sup>st</sup> Cir. 1940) (suggesting that since Federal Code of Civil Procedure did not address issue, federal interest in uniformity questionable).

<sup>179</sup> CITE.

<sup>180</sup> See *Kramer*, *supra* note 91.

This article's approach cuts through the renvoi problem by ignoring legislative power and intent. Under an approach that maximizes party choice, contractual designation of the applicable law should be interpreted as referring only to the state's substantive law. This reasonably assumes that it is unlikely the parties would mutually agree to deliberately obfuscate their meaning by incorporating a renvoi analysis. Rather, they would prefer a default interpretation rule that encourages clarity, at least in the absence of explicit contractual adoption of renvoi.

Where there is no contract or contracting is not feasible, the law should provide transparent default rules that facilitate contracting or other form of party choice. Here again, renvoi is inappropriate because it hides the applicable law, thereby complicating exit from or contracting around that law. Moreover, renvoi is not suitable as a term of a hypothetical bargain. The parties can be assumed to want to be governed by the law of the state with a comparative regulatory advantage<sup>181</sup> only because that state is best able to regulate the underlying conduct. This implies no advantage in determining the law that applies to that conduct.

#### IV. DEVELOPING THE FRAMEWORK

This Part elaborates the general principles set forth in Part III by deriving choice-of-law rules for particular types of legal disputes. In general, as discussed in Part III, we would maximize parties' ability to choose the applicable law or, where party choice is impracticable, we rely on the law of the state with the comparative regulatory advantage. The proposed rules reach results similar to those under the First Restatement 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. Courts should enforce contractual choice-of-law and choice-of-forum clauses irrespective of whether the parties have any contact with the chosen jurisdiction.<sup>182</sup> Legislatures can, however, qualify enforcement of choice-of-law clauses in order to effectuate efficient mandatory rules. We also propose a default rule for those contracts that do not include a choice-of-law clause.

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

Our approach to enforcing choice-of-law clauses differs from the more restrictive approach in the Second Restatement.<sup>183</sup> Under *Restatement* §187(2), the parties cannot choose their own governing law for mandatory rules such as validity, where choice of law matters most, if:

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<sup>181</sup> See *supra* subpart II(D).

<sup>182</sup> For a fuller analysis of this issue see generally 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>183</sup> RESTATEMENT (SECOND) OF CONFLICTS, § 187 (1971).

(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.

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 helps ensure that chosen states internalize some effects of inefficiently lax laws by regulating only those who have a connection with the state. However, whether or not the *contracting* parties are subject to the law, the state will presumably be constrained by other residents who are affected.<sup>184</sup>

The second limitation seems intended to protect against evasion of efficient state regulation. However, other methods can protect the parties while intruding less 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 contravened a "fundamental policy of a state which has a materially greater interest than the chosen state." 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>185</sup>

In practice, courts applying the *Restatement (Second)* rule have quite generally enforced contractual choice of law.<sup>186</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>187</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, Illinois, Delaware, New York and Texas, have promulgated statutes that, to varying degrees, clarify the enforcement of contractual choice of law clauses.<sup>188</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 should be default rules that courts apply only in the absence of explicit legislative statement to the contrary. It is important, however, that the legislative restriction on contractual choice be explicit. For example, a statutory rule that prohibits

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<sup>184</sup> See *supra* text accompanying note 43.

<sup>185</sup> See *supra* subpart III(A).

<sup>186</sup> See Symeonides, *supra* note 110 at 273.

<sup>187</sup> 1939 A.C. 277.

<sup>188</sup> See Larry E. Ribstein, *Delaware, Lawyers and Choice of Law*, 19 DEL. J. CORP. L. 999 (1994).

waiver of the statutory protections should not apply to choice of law unless it explicitly so provides.<sup>189</sup> As long as the legislature must specify the effect of contractual choice, interest group competition will help constrain any resulting inefficiency.<sup>190</sup> Opposing and proponent groups will be able to 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>191</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 on the mistaken assumption that courts will let them avoid the restriction through a choice of law clause. Conversely, interest groups favoring the restriction may not mobilize in favor of a restriction on contractual choice because they assumed the courts would interpret an anti-waiver provision to extend to choice of law.<sup>192</sup>

Although legislatures would have the main role in deciding the scope of opt out through choice of law, courts would retain their role as interpreters of choice-of-law clauses. Consistent with the need for explicit rules, courts should enforce choice-of-law clauses only if explicit rather than looking for evidence of implied choice. In the absence of an explicit clause, the default rules discussed in the next section would apply. Enforcing unarticulated expectations would emphasize *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. The unconscionability doctrine helps guard against the most egregiously one-sided contracts, while bad faith rules help protect against unfair surprise from overly literal interpretation of contract provisions. These procedural protections, along with those that might apply to choice-of-law provisions such as disclosure requirements,<sup>193</sup> provide more balanced protections than the vague and potentially sweeping rules in the Second Restatement.

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<sup>189</sup> This is supported by federal decisions regarding application of U.S. securities and anti-racketeering laws to international transactions. *See supra* notes 145-146. This 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, supra* note 66. *See also* Lilienthal v. Kaufman, 239 Or. 1, 395 P.2d 543 (1964) (holding in favor of extraterritorial application of spendthrift law despite lack of explicit legislative requirement).

<sup>190</sup> *See supra* text accompanying note 40.

<sup>191</sup> For example, courts might hold that contractual choice would violate a state's "public policy." RESTATEMENT (SECOND) OF CONFLICTS § 187(2).

<sup>192</sup> Legislative restriction of choice of law in specific cases is a kind of "tailoring" of choice of law. *See generally* 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 to choice of law, *see* Whincop & Keyes, *Policy & Pragmatism, supra* note 147 at \_\_\_. *See also* Michael Whincop & 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 (1997). We suggest tailoring concerning the intent underlying a specific law rather than concerning the application of the law to the facts of the particular case. This kind of tailoring is better done by the legislature, which knows what it intends, than by the courts, which specialize in factual assessment.

<sup>193</sup> *See supra* subpart III(A).

### 3. Default rules

What law should apply to contracts when the parties have not explicitly selected a particular state's law? The First Restatement 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>194</sup> This bifurcated rule makes some sense. 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. 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 general rule is better in this situation than one that courts "tailor" to specific facts.<sup>195</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 clearly known to both offeror and offeree. Similarly, in the Internet case the default rule should be the *buyer's* location. Although this might subject sellers to multiple state regulation, 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 website.<sup>196</sup> A default rule that favors buyers gives sellers an incentive to clarify the applicable law by contract rather than capitalizing on buyers' confusion.

## B. BUSINESS ASSOCIATIONS

The same considerations that justify enforcing choice-of-law clauses in ordinary contracts apply at least as strongly to corporations and other business associations.<sup>197</sup> However, this category deserves separate discussion given the difference in the choice-of-law rules that courts traditionally have applied.

### 1. The corporate internal affairs rule

As already discussed, theory and available data suggest that competition for public corporation law is efficient.<sup>198</sup> There is also theory and data supporting similar conclusions regarding competition for the law governing informal firms despite the lack

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<sup>194</sup> Restatement of Contracts §§332, 358.

<sup>195</sup> See *supra* text accompanying note 192.

<sup>196</sup> See Jack L. Goldsmith, *Against Cyberanarchy*, 65 U. CHI. L. REV. 1199, 1214 (1998); *infra* subpart IV(E).

<sup>197</sup> See Ribstein, *supra* note 182.

<sup>198</sup> See note 31 and accompanying text.

of an efficient market and the motivating factor of franchise taxes.<sup>199</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 some aspects of corporate governance, particularly in a publicly held firm. Accordingly, this article advocates a strong version of the "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>200</sup> Institutional economists have shown the fundamental economic similarity between business associations and other contracts as mechanisms for economizing on transaction costs.<sup>201</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>202</sup> Firms might resolve conflicts between mandatory and non-mandatory rules by complying with the former,<sup>203</sup> and between multiple mandatory rules through litigation and *stare decisis* or collateral estoppel.<sup>204</sup> On the other hand, business firms are mobile, and can punish states that do not recognize foreign incorporation by withdrawing assets and other contacts. Moreover, states may have recognized that refusal to grant foreign corporation privileges would invite retaliation in

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<sup>199</sup> See *supra* note 28.

<sup>200</sup> The two sets of rules are compared in Ribstein, *supra* note 182. For a discussion of the rules for non-corporate contracts, see *supra* §IV(A).

<sup>201</sup> For some important theoretical contributions, see Oliver E. Williamson, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (1985); Armen Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777 (1972); Steven Cheung, *The Contractual Nature of the Firm*, 26 *J. LAW & ECON.* 1 (1983); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 *J. POL. ECON.* 288 (1980); Eugene Fama & Michael Jensen, *Separation of Ownership and Control*, 26 *J. LAW & ECON.* 301 (1983); Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 *J. POL. ECON.* 691 (1988); Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure*, 3 *J. FIN. ECON.* 305 (1976); Michael Jensen & William Meckling, *Transaction Costs Economics: The Governance of Contractual Relations*, *J. LAW & ECON.* 233 (1979); Klein, Crawford & Alchian, *supra* note; Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 *AM. ECON. REV.* 519 (1983); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 *J. L. & ECON.* 233 (1979). Some economists have maintained that there is no important difference between firms and non-firms, only less important differences among many types of contracts. See Armen A. Alchian and Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777 (1972); Steven N.S. Cheung, *The Contractual Nature of the Firm*, 26 *J. L. & ECON.* 1 (1983). See also Ribstein, *Limited Liability Unlimited*.

<sup>202</sup> See Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 *CAL. L.REV.* 29 (1987); Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 *YALE L.J.* 137 (1955); Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 *WASH. U. L.Q.* 445 (1991)

<sup>203</sup> See Latty, *supra* note 202 at 141 (making a similar point about choice-of-law clauses generally).

<sup>204</sup> See Buxbaum, *supra* note 202 at 51.

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 certain attributes by the chartering state.<sup>205</sup> This "entity" theory has more recently spread to unincorporated firms.<sup>206</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 are rapidly breaking down. The Second Restatement 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 grounds that the parties to a partnership may have no real expectation concerning the applicable law,<sup>207</sup> that is plainly not true for some non-corporate firms whose owners clearly select the applicable law by filing a certificate in a particular state.<sup>208</sup> 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>209</sup>

Contractual choice of law is also expanding to informal firms, particularly including 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>210</sup> that is explicitly

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<sup>205</sup> See Willis L.M. Reese & Edward M. Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith & Credit*, 58 COLUM. L. REV. 1118, 1121 (1958); Larry E. Ribstein, *The Constitutional Conception of the Corporation*, 4 S. CT. ECON. REV. 95 (1995).

<sup>206</sup> See, e.g., Revised Uniform Partnership Act § 201 (1996).

<sup>207</sup> See RESTATEMENT (SECOND) OF CONFLICTS, § 294, Comment b.

<sup>208</sup> If the parties to partnerships have no expectations concerning the applicable law, that is probably only because there has long been a high degree of uniformity in state partnership law. The Uniform Partnership Act has been adopted in substantial part by 49 states. Note, however, that the recent promulgation of the Revised Uniform Partnership Act (1996) may cause substantial disuniformity in partnership law, thereby increasing the importance of the conflicts issues. Section 106 of the Uniform Act provides that the law of the firm's chief executive office controls but, interestingly enough, that provision is subject to contrary agreement. This may signal a movement of partnership law toward a corporate-type internal affairs rule.

<sup>209</sup> See Larry E. Ribstein & Robert Keatinge, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES, ch. 13 (1991 & Supp.).

<sup>210</sup> RUPA § 106(a).

subject to contrary agreement.<sup>211</sup> This replaces the complex Second Restatement contract rules with a simple default rule.<sup>212</sup>

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. 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 borderline "firms" such as franchise relationships can escape vicarious liability by making a public filing analogous to a certificate of incorporation.<sup>213</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 state of formation 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 matters that are subject to the formation state's law -- i.e., agents' management power and limited liability. It therefore arguably follows that formation state law should apply even if the matters might also be viewed as localized 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. Although these laws are troublesome on policy grounds because they threaten the security of contractual choice, and may even be unconstitutional,<sup>214</sup> they arguably make sense. 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. It is not surprising, therefore, that the pseudo-foreign restrictions are limited to California and New York, the small minority of states that have enough market power to avoid being punished by exit of the affected firms.

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<sup>211</sup> RUPA limits opt out by limited liability partnerships. *See infra* text accompanying notes\_\_\_.

<sup>212</sup> For criticism of this rule, *see* Jennifer J. Johnson, *Risky Business: Choice of Law and the Unincorporated Entity*, 1 J. OF SM. AND EM. BUS. L. 249 (1997).

<sup>213</sup> *See* Larry E. Ribstein, *Limited Liability Unlimited*, 24 DEL. J. CORP. L. \_\_\_ (1999).

<sup>214</sup> For discussions of the constitutional issue, *see* Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29 (1987); Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955); Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 WASH. U. L.Q. 445 (1991).

Third, there is an argument that the formal filing of incorporation should be mandatory for contractual choice. This question is raised by state choice-of-law statutes that ensure application of the state's law to certain large transactions.<sup>215</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 the firm under the Delaware choice of law statute?<sup>216</sup> This would create a sort of "platypus" that is both mammal (a Delaware contract) and reptile (a contract organized in the state of X). In the converse situation, a Delaware court applied Delaware law to a shareholders' agreement of a Delaware corporation that selected New Jersey law.<sup>217</sup> Analogously, the Revised Uniform Partnership Act applies a limited liability partnership's formation state rather than a different law chosen in the partnership agreement.<sup>218</sup>

There are arguments for prohibiting alternative choice in this situation. One is that permitting contracts to override application of formation state law may create confusion because of the collision of two choice-of-law rules. However, a rule of interpretation requiring that the intent to opt out of the default choice-of-law rule be made clear would reduce or eliminate the confusion. Another 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>219</sup> On the other hand, for closely held firms, franchise fees may be a less important motivator than lawyers' gains in litigation and planning business from use of their local law. Lawyers might want to give their state law away free for the same reason that Internet browsers are given away -- in order to generate secondary business. In a sense the property right in the law may be viewed as having been allocated to the lawyers rather than to the state.

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>220</sup> and on contractual choice of law generally.<sup>221</sup> The default rule should provide for enforcement of the contract even where it negates the formation-state default rule. However, the legislature can override this rule by providing for application of the formation state rule irrespective of contract. As with other restrictions on contractual choice of law, this would help ensure the efficiency of mandatory rules by forcing the proponents of the restriction to incur the extra political costs of obtaining interstate application.

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<sup>215</sup> Ribstein, *Delaware, Lawyers*, *supra* note 28.

<sup>216</sup> *See id.* at 1022-25.

<sup>217</sup> *Rosenmiller v. Borden*, 607 A.2d 465 (Del. Ch. 1991).

<sup>218</sup> *See* Revised Uniform Partnership Act, § 103(b).

<sup>219</sup> For a discussion of the importance of these incentives, *see* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225 (1985).

<sup>220</sup> *See supra* text accompanying notes\_\_.

<sup>221</sup> *See supra* § IV(A)(2).

## C. MARRIAGE

Marriages, like business associations and commercial contracts, are an appropriate context for enforcement of contractual choice. 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>222</sup>

Marriages differ from more conventional contracts and business associations mainly in external effects of marriage in the spouses' domicile. Because of the family's central role in society, marital status is fraught with the weight of 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 for violation of fornication and sodomy laws.<sup>223</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, and the absence of efficient markets to discipline choice of marriage partners.

Despite this difference, traditional choice-of-law rules concerning marriage are closely analogous to the strong contractual choice that applies to business associations.<sup>224</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 decide to marry generally determines validity in the absence of the strong countervailing public policy of some other state closely connected with the marriage.<sup>225</sup> The marriage rule, like the one for corporations, has been rationalized on the basis that marriage is a privileged status that is created by the state whose laws sanction the marriage,<sup>226</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>227</sup> Consistent with these policies, courts usually uphold marriages that are valid where made even if barred by domicile law.<sup>228</sup> Also, many state statutes specifically provide that a marriage valid where entered into is valid everywhere.<sup>229</sup>

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<sup>222</sup> See Scoles & Hay, *supra* note 173 at 173 at \_\_\_.

<sup>223</sup> See F.H. Buckley & Larry E. Ribstein, *A Choice-of-Law Solution to the Marriage Debates* (1999).

<sup>224</sup> See Note, *In Sickness and in Health, in Hawaii and Where Else?: Conflict of Laws*, 109 HARV. L. REV. 2038, 2053 (1996).

<sup>225</sup> See RESTATEMENT (SECOND) OF CONFLICTS, § 284; RESTATEMENT OF CONFLICTS § 132 (1934); SCOLES & HAY, *supra* note 173 at 438.

<sup>226</sup> See *Maynard v. Hill*, 125 U.S. 190, 210-11 (1888); SCOLES & HAY, *supra* note 173 at 430.

<sup>227</sup> See Scoles & Hay, *supra* note 173 at 445.

<sup>228</sup> *Id.* at 444-45.

<sup>229</sup> *Id.* at 439.

The increasing attention being paid to same sex marriage challenges the contractual approach to marriage and may signal a wider role for the public policy exception and other restrictions on contractual choice.<sup>230</sup> The recent development of so-called covenant marriage, in which couples attempt to opt out of no fault divorce, also may test the limits of contractual choice in this context. Accordingly it is more important than ever to consider how far courts should go in enforcing contractual choice of the state of celebration.

One way to deal with these problems in the context of same sex marriage is by taking potential externalities and paternalism problems into account in the context of the public policy exception.<sup>231</sup> Another approach is to simply sweep these problems under the rug and Constitutionally require states to recognize foreign same sex marriage under the full faith and credit clause.<sup>232</sup> The former approach leaves much latitude to courts and therefore compromises the security of marriage. The latter approach not only ignores these problems, but raises serious questions concerning the treatment of other marriage issues, including covenant marriage.

The key to a solution to choice of law in marriage is to unbundle marriage into its contractual and non-contractual elements, rather than adhering to a rule that marriage is valid either for all purposes or none.<sup>233</sup> To the extent that marriage entails contractual elements, there is no reason why it should be treated differently from any other contract. Thus, consistent with our general approach in this article, marriages should be valid everywhere if they are valid in the state of celebration.<sup>234</sup> Non-contractual elements such as local subsidies, tax breaks and privileges should depend on the law of the domicile.<sup>235</sup> As with business associations and other contracts,<sup>236</sup> state legislatures would be free to impose explicit restrictions on the local recognition of marriage.<sup>237</sup>

Contractual choice of law also presents problems for covenant marriages. Under

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<sup>230</sup> See Buckley & Ribstein, *supra* note 223.

<sup>231</sup> See Michael E. Solimine, *Competitive Federalism and Interstate Recognition of Marriage*, 32 CREIGHTON L. REV. 83 (1998).

<sup>232</sup> See Larry Kramer, *Same-Sex Marriage, Conflict of Laws, and the Unconstitutional Public Policy Exception*, 106 YALE L.J. 1965 (1997).

<sup>233</sup> See Scoles & Hay, *supra* note 173 at 433.

<sup>234</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 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 Buckley & Ribstein, *supra* note 223 at \_\_\_\_.

<sup>235</sup> The precise distinction between contractual and non-contractual elements of marriage is discussed *id.* at \_\_\_\_.

<sup>236</sup> See *supra* § IV(A)(2).

<sup>237</sup> See Buckley & Ribstein, *supra* note 223, at [Part V].

current law, a divorce valid where entered is entitled to recognition everywhere.<sup>238</sup> Thus, a Nevada divorce might end a covenant marriage even if the divorce is contrary to the celebration state marriage law. This may stop the covenant marriage movement in its tracks, short of a new federal law or constitutional amendment. A possible solution is for covenant marriage states to enact standard form *contracts* that increase the durability of marriage, among other things by clarifying the validity of contractual divorce penalties. Such agreements might get the same interstate recognition as other contracts.

#### 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. Courts tend not to enforce choice-of-law provisions in contract disputes as to tort actions arising out of the contractual relationship.<sup>239</sup> This might reflect a concern that victims of tort-type injuries cannot bargain effectively over the applicable law. However, Paul Rubin convincingly argues that tort waivers should be enforced because potential tort victims, who ultimately bear the costs of their choices, are likely to be better at assessing the appropriate legal standard of care than would a judge or jury.<sup>240</sup> Even if judgment biases infect contracting parties' assessment of potential tort risks,<sup>241</sup> and therefore their decisions on waiver, that is not necessarily true concerning the parties' choice of the state law that governs assessment of liability. Thus, courts should be particularly willing to enforce choice-of-law clauses even if they have the effect of waiving tort liability. Disclosure rules can deal with potential concerns that the contracting parties may not be aware of the waiver embedded in the choice of law.<sup>242</sup>

When contracting parties have not designated the law to govern their relationship, the same law that governs their contract disputes should also govern their tort disputes. Among other things, this would minimize characterization difficulties that bedevil borderline causes of action such as breach of fiduciary duty, bad faith dealing, and inducing breach.<sup>243</sup> Applying contract rules to all causes of action arising out of the contract therefore would enhance *ex ante* predictability, and therefore the parties' ability

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<sup>238</sup> See *Williams v. North Carolina*, 317 U.S. 287 (1942) (upholding Nevada's power to divorce a North Carolina couple though it lacked jurisdiction over one of the members).

<sup>239</sup> See, e.g., *Wagoner v. Leach Co.*, 1999 WL 961166 at 15 (Ohio App. 2d); *Klock v. Lehman Bros. Kuhn Loeb, Inc.*, 584 F. Supp. 210, 215 (S.D.N.Y. 1984).

<sup>240</sup> Paul H. Rubin, *Courts and the Tort-Contract Boundary in Product Liability*, in *THE FALL AND RISE OF FREEDOM OF CONTRACT* \_\_\_\_ (Frank Buckley, ed. 1999).

<sup>241</sup> For discussions of cognitive errors and their effects on private judgments, see generally Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998); Christine Jolls, Cass R. Sunstein, and Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Cass R. Sunstein, *Cognition and Cost-Benefit Analysis*, 9-19 (Chicago Working Paper in Law and Economics, 1999).

<sup>242</sup> See *supra* subpart III(A).

<sup>243</sup> See, e.g., *Nedlloyd Lines BV v. Superior Court of San Mateo County Seawinds, Ltd.*, 834 P.2d 1148, 3 Cal. 4<sup>th</sup> 459, 11 Cal. Rptr. 2d 330 (1992).

to choose the applicable law. Moreover, if the parties know what law applies, they are better able to internalize the incentives that the law hopes to create.

The following subsections discuss two of the most important categories of market torts, product liability and medical malpractice.

### 1. Products 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, and specifically the default rules of the Uniform Commercial Code, govern 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 torts or contract, for the reasons discussed above, the parties should be able to contractually 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>244</sup> Most importantly for our purposes, the rule permits both manufacturers and consumers to avoid oppressive laws. 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. Depending on manufacturers' ability to price discriminate based on location,<sup>245</sup> a point of sale rule enables manufacturers to set prices based on the applicable liability rule and consumers to determine their preferred tradeoff between price and safety level.

By contrast, the tort place-of-injury rule exposes manufacturers to the potential application of any law where the product happened to cause injury.<sup>246</sup> Manufacturers that could not easily avoid a state's expansive liability laws even by refusing to sell in that state. Moreover, plaintiffs might be able to sue a multi-state manufacturer in one of several states. Under interest analysis, the forum is likely to be able to find some basis for applying its law.<sup>247</sup> This gives states incentives to adopt stringent product liability rules that simply transfer wealth from manufacturers to injured plaintiffs and their lawyers in order to attract litigation and benefit the local trial bar.<sup>248</sup>

It might be said that a place-of-sale rule facilitates a race to the bottom because of

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<sup>244</sup> See, e.g. McConnell, *supra* note 77 at 98-99; Solimine, *supra* note 2; O'Hara & Ribstein, *supra* note 16; Allen & O'Hara, *supra* note 87.

<sup>245</sup> [Discuss price discrimination.]

<sup>246</sup> See McConnell, *supra* note 77.

<sup>247</sup> See Solimine, *supra* note 2 at 71. To be sure, interest analysis may be preferable in this respect to territorial rules. See *infra* note 250.

<sup>248</sup> Cf. Lea Brilmayer, Jennifer Haverkamp & Buck Logan, *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).

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 is not a persuasive argument for several reasons. First, because a place of sale rule lets manufacturers avoid states only by refusing to sell there, it is mainly useful as a way to avoid particularly harsh laws rather than to embrace particularly favorable ones. Second, choice of law is most important in the context of national products markets, in which information intermediaries and sophisticated consumers help set prices and thereby ameliorate information asymmetries.<sup>249</sup> Third, it is important to keep in mind that the alternative place-of-injury rule is not necessarily better for *consumers* as a general class since it transfers the effective choice to *lawyers* and *plaintiffs*.

Manufacturers might prefer a rule choosing the place of manufacture or the manufacturer's domicile rather than the place of sale. This would enable the manufacturer to rely on a single tort standard for all of its product sales. It might also provide them with the most favorable rule, since states would have an incentive to compete for tax revenues by offering liberal products laws.<sup>250</sup> But a place of manufacture rule would not facilitate the parties' *mutual* choice of law because consumers could not easily determine what law applies under this alternative rule. That is particularly true where the seller owns or buys from factories all over the world, or where the injured consumer is not the original purchaser. Indeed, this suggests that even manufacturers might prefer a place of sale rule since they will bear some of consumers' information costs in a competitive market.

Contracting parties would be able to contract for a law other than that of the place of sale, including the place of manufacture or the manufacturer's home office.<sup>251</sup> Under current doctrine, a court might characterize a contract on a product package designating the applicable law as an adhesion contract or, more specifically, a contract that is contrary to the "fundamental policy" of an involved state under Second Restatement §187(2)(b).<sup>252</sup> However, this is far from clear. The Supreme Court has led the way under federal law in enforcing closely related choice of forum<sup>253</sup> and choice of adjudicator<sup>254</sup> clauses in contract settings that lacked explicit bargaining over the contract term.

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<sup>249</sup> See Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979).

<sup>250</sup> . Indeed, because of the potential for such competition, interest analysis has been said to lead to more defendant-oriented product laws than the First Restatement place of injury rule. See Hay, *supra* note 2.

<sup>251</sup> The chosen law might have no connection with either party. However, manufacturers would be likely to choose the law of a place where they have some political leverage. In this way, This is how Indeed, this this opportunity to choothis is a potentially important this is unlikely in practice because the main force driving liberalization in product law would be competition for headquarters or manufacturing facilities. States probably would not compete for litigation by attracting defendants, since in this situation plaintiff is uniquely in control of the forum.

<sup>252</sup> See *supra* text accompanying notes \_\_\_\_.

<sup>253</sup> See *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991).

<sup>254</sup> See *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477 (1989).

From a policy standpoint, as noted above,<sup>255</sup> choice of law clauses would be subject to potential discipline in national product markets. Moreover, indirect waiver of product liability through choice of law differs significantly from direct waiver because, in the former setting, the manufacturer must find some state that is willing to impose a liberal liability law on its own residents.<sup>256</sup> As with contracts generally, contractual choice of law in products cases could be policed by interpretation rules, including a rule that forces manufacturers to select an entire body of state law rather than picking only favorable terms.<sup>257</sup> Finally, states can always pass statutes requiring application of local product liability law. Since manufacturers are fairly well coordinated on a national basis, the fact that consumers or lawyers nevertheless were able to bear the costs of lobbying to prohibit contractual choice says something about the benefits, and therefore the overall efficiency, of local law.

## 2. Professional malpractice

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 default choice of law rule for professional malpractice is unlikely to hinge on whether malpractice is treated as contract or tort since the malpractice is likely to occur where the parties entered into their professional relationship. The main consequence of characterization concerns enforcement of contractual choice of law. Contracts are especially useful in this context in ensuring that parties can make an effective *ex ante* choice of law. Without the ability to contract for the applicable law, national law or accounting firms would be potentially subject to different and inconsistent state laws. As for product liability, tort characterization is justified by the supposed need for tort treatment to protect clients. However, as noted above, choice of law differs significantly in this respect from direct waiver of the underlying legal standards. Moreover, informational asymmetries between the client and the professional are addressed in this context by professional ethics rules. And, as in products liability cases, contracts can be further disciplined by interpretation rules and ultimately subject to potential legislative constraint or prohibition.

Similar considerations apply to professional firms' ability to choose the ethical rules of a single state. Both liability and disciplinary sanctions simultaneously govern professionals' conduct. Moreover, because ethical rules, such as those on liability and multidisciplinary practice, can affect the firm's structure,<sup>258</sup> they should be determined at the level of the firm as a whole rather than that of each of the firm's transactions. The American Bar Association recognized the virtues of clarity for choice of law in disciplinary proceedings when it amended the Model Rules of Professional Conduct.<sup>259</sup>

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<sup>255</sup> See *supra* text accompanying note 249.

<sup>256</sup> See *supra* subpart III(A). Indeed, a point-of-sale default rule tends to discipline explicit contracts by ensuring that a state's law does affect the state's residents generally rather than merely the relatively small subsets of seriously injured plaintiffs and lawyers.

<sup>257</sup> See *supra* subpart III(D).

<sup>258</sup> See generally, Larry E. Ribstein, *Ethical Rules, Agency Costs and Law Firm Structure*, 84 VA. L. REV. 1707 (1998).

<sup>259</sup> See MODEL RULES OF PROFESSIONAL CONDUCT Rule 8.5(b) (1993). Amended Rule 8.5

Eschewing the typical standard-based choice of law decision making, the Model Rule drafters saw a need for “relatively simple, bright-line rules” governing lawyers.<sup>260</sup> Lawyers cannot be unique in their fear of exposure to conflicting professional standards. Treating these issues as contractual helps reduce characterization uncertainty, and allowing party choice serves to enable both further clarification and uniform standards of conduct.

## E. NON-MARKET TORTS

Injuries that occur without a contractual interface between the parties present difficulties for our approach. Because the parties are much less likely to plan for accidents and potential liability, commentators and courts have asserted that predictability is irrelevant for torts.<sup>261</sup> But while individuals involved in an accident usually do not consider the possibility of harm, third parties such as insurance companies and employers are often the real parties in interest. They often know the governing laws and attempt to influence law-relevant conduct through their contracts. Clear choice of law rules therefore enable some planning *ex ante*, and they facilitate early dispute settlement *ex post*.

As discussed earlier,<sup>262</sup> default choice of law rules where contracts are not feasible should attempt to find the state with the comparative regulatory advantage. 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 victim's domicile; and (4) the tortfeasor's domicile. Under our approach the place of wrongful conduct usually controls for non-market torts, even where this differs from the place of injury.

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provides that if the breach of a disciplinary rule is related to litigation in the forum, then forum rules apply so long as the lawyer is admitted to practice in the forum state. In all other cases, whether the lawyer's conduct is litigation or to negotiation or counseling, the law of the state in which the lawyer is admitted to practice governs. If the lawyer is admitted to practice in two or more states, then the law of the state in which the lawyer “principally practices” governs unless “particular conduct clearly has its predominant effect in another jurisdiction in which the lawyer is licensed.” *Id.* The last portion of the rule has been criticized for creating unnecessary uncertainty. *See, e.g.* 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); Jeffrey L. Rensberger, *Jurisdiction, Choice of Law, and the Multistate Attorney*, 36 S. Tex. L. Rev. 799, 833-37 (1995).

<sup>260</sup> *See* ABA Comm. On Ethics and professional Responsibility, Recommendation and Report to the House of Delegates 4 (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.”). Moreover, the *Restatement (Third) of the Law Governing Lawyers*, recently approved by the membership of the American Law Institute, proposes a multi-factored approach similar to the Second Restatement. *Id.* sec. 5, cmt. h (Proposed Final Draft 1998).

<sup>261</sup> *See, e.g.*, *Nesladek v. Ford Motor Co.*, 46 F.3d 734, 738 (8<sup>th</sup> Cir. 1995); *Mitchell v. Craft*, 211 So.2d 509, 514 (Miss. 1968); *Heath v. Zellmer*, 35 Wisc.2d 578, 595, 151 N.W.2d 664, 672 (1967); Robert Leflar, *Choice-Influencing Considerations in Conflicts of Law*, 41 N.Y.U.L. REV. 267, 310 (1966).

<sup>262</sup> *See supra* subpart III(C).

The need to choose among the competing locales<sup>263</sup> raises issues concerning tort rules' competing functions of regulating conduct and distributing losses.<sup>264</sup> The place of defendant's conduct arguably has the comparative regulatory advantage in generating conduct rules, while the parties' domiciles might be better situated to decide issues that allocate the loss, such as those pertaining to survival of actions, immunities and damages.

Despite theoretical differences among types of tort rules and the theory's potential role in determining comparative regulatory advantage, the law of the place of injury should apply with respect to both types of rules. This partly follows from comparative regulatory advantage itself taking into account the need to view a state's law as a whole rather than to engage in depeçage. As discussed above,<sup>265</sup> a state's regulation of conduct may take into account other elements of the cause of action and remedy.

To some extent, however, it is necessary to supplement comparative regulatory advantage by taking into account the more fundamental principle of choice-maximization. This approach recognizes that the presence or absence of party choice is relative rather than absolute, and that the bargain may not be completely hypothetical.<sup>266</sup> The tortfeasor and plaintiff generally are both aware of and can exercise some control over the place of injury, while plaintiffs may not be aware of the place where the wrongful conduct occurred. To be sure, there may be a concern that a place of injury rule would create problems for insurers. This explains laws such as guest statutes and charitable immunity designed to minimize insurance premia. But as long as the rule is clear, insurers can set rates reasonably accurately according to insureds' domicile, especially since most accidents occur near home.<sup>267</sup> Finally, where a place of injury rule does not precisely mesh with comparative regulatory advantage, choice maximization requires a clear rule that does not involve fine case-by-case characterizations of the nature and function of the tort rule involved.<sup>268</sup>

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>269</sup> At first blush such a rule seems objectionable. It is arguably unfair to subject the defendant to litigation in remote places

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<sup>263</sup> In many cases involving direct harm all four will be the same. Where the harm is indirect, the case may not be in this general category at all. For example, in product liability cases the manufacturer is often remote from the consumer, but the law of the place of sale should control. *See supra* subpart III(D)(1).

<sup>264</sup> *See supra* note 120 and accompanying text.

<sup>265</sup> *See supra* subpart III(D).

<sup>266</sup> Indeed, the application of a hypothetical bargain approach itself is based on the need to maximize choice, since it is designed to minimize bargaining costs where bargaining does occur.

<sup>267</sup> Regina Austin, *The Insurance Classification Controversy*, 131 U.P.A. L. REV. 517, 547 (1983).

<sup>268</sup> *See id.*

<sup>269</sup> *See* Goldsmith, *supra* note 196. *But see* David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367 (1996) (concluding that that general conflicts analysis cannot adequately treat Internet problems).

and under regulation that defendant could not have anticipated.<sup>270</sup> Statements posted on defendant's web page might be legal where they are posted but defamatory or otherwise wrongful in other states where the page can be accessed.<sup>271</sup> If defendant cannot control where its messages reach, permitting the law of the place of injury to control would give that state effective power to regulate conduct everywhere.

But these objections fade on closer analysis. In the first place, it is necessary to take the plaintiff's plight into account. Plaintiff cannot easily determine from where the message originated, and therefore cannot easily decide not to receive messages based on their state of origin. Thus, permitting defendant to rely on lax regulation in its own state might permit that state to impose costs on other states by thwarting their regulatory efforts. Moreover, defendant's plight is not as serious as it might first appear. States have no jurisdiction based merely on a receiver's downloading if the defendant remains passive with respect to the receiver's state.<sup>272</sup> And emerging technologies such as blocking software can help enable a broadcaster to control the access to its broadcasts.<sup>273</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>274</sup>

The law of the place of conduct should apply in the special case where latent injuries manifest themselves outside the place of injury.<sup>275</sup> In this situation, tort law's deterrence and compensatory objectives<sup>276</sup> arguably conflict for purposes of determining which state has the comparative regulatory advantage. The victim's domicile, where the injury is normally manifested, arguably has the advantage in determining the appropriate extent of compensation, while the place where the conduct occurs has the advantage in regulating the conduct. But the efficiency implications of influencing local conduct outweigh those of determining compensation to local victims. Potential tortfeasors react directly to liability rules and may be either discouraged from dangerous conduct or, in the case of defendant-oriented liability rules, encouraged to engage in socially useful

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<sup>270</sup> See Johnson & Post, *supra* note 196 at 1374-75 (noting absence of physical borders in cyberspace that typically notify individuals that they may be assuming new legal obligations).

<sup>271</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>272</sup> See Goldsmith, *supra* note 196 at 1216-21.

<sup>273</sup> *Id.* at 1224-30 (describing technological advances that enable information flow to be directed and controlled). Recipients may be able to screen messages, but they cannot effectively anticipate harmful messages. Moreover, recipient blocking is ineffective where the harm is to third parties, as in the case of defamation.

<sup>274</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>275</sup> We focus here on civil liability. Criminal liability is a special case because states typically do not enforce each other's criminal laws. See Scoles & Hay, *supra* note 173 at 74-77; *The Antelope*, 23 U.S. (10 Wheat.) 66, 123 (1825) (stating that “the courts of no country execute the penal laws of another”).

<sup>276</sup> See William L. Prosser, *HANDBOOK OF THE LAW OF TORTS* § 5, at 23 (4<sup>th</sup> ed. 1971).

conduct. Compensation rules are unlikely to have significant local welfare effects since tort plaintiffs generally do not comprise a significant portion of the general population. Choosing the law of the place of conduct instead of that of injury manifestation also meshes with the fundamental principle of choice-maximization. Both injurer and victim were on notice that the state where the injury occurred might determine their rights and liabilities. However, the injurer may have had little knowledge of the potential application of the law of another state to which the victim traveled before the injury manifested itself.

## F. REAL PROPERTY

Disputes over property, such as those about land use,<sup>277</sup> title,<sup>278</sup> ownership interest,<sup>279</sup> testamentary disposition,<sup>280</sup> or intestate succession,<sup>281</sup> are governed by the law of the state where the land was located.<sup>282</sup> The situs rule has undergone relatively little change in recent years.<sup>283</sup> However, modern interest analysts criticize its broad application.<sup>284</sup> For example, William Baxter stated that he thought it “obvious that the situs rule is defective on its face because the relationships relevant for choice criteria are those between sovereigns and people, not those between sovereigns and property.”<sup>285</sup>

The situs rule is not, however, as arbitrary as the critics suggest. Regarding land use, zoning and nuisance laws for example, the situs state is similar to the place of injury rule for torts in that it is most likely to be the state having the comparative regulatory advantage over these issues.<sup>286</sup> The situs rule can also be justified for title issues,<sup>287</sup> since

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<sup>277</sup> See Scoles & Hay, at 744, n.4 (citing several sources)

<sup>278</sup> See Scoles & Hay, at 746, n.3 (citing several sources for proposition that situs law governs validity and effect of inter vivos conveyance of land).

<sup>279</sup> *Id.*

<sup>280</sup> *Id.* at 804-09.

<sup>281</sup> See *id.* at 796-97, nn. 1-4 (citing several sources).

<sup>282</sup> See 2 Beale, CONFLICT OF LAWS § 214.1, at 939 (1935) (“[e]very question arising with regard to land is to be governed by the law of the situs”); Scoles & Hay, *supra* note 173, at 743, n.2 (citing several sources); RESTATEMENT (FIRST), *supra* note \_\_\_, at § \_\_\_\_.

<sup>283</sup> *Id.* at 743.

<sup>284</sup> See, e.g. Note, *Modernizing the Situs Rule*, 65 Tex. L. Rev. 585 (1987) (arguing that situs rule is anachronistic and sometimes unconstitutional); Baxter, *supra* note 3, at 15-17.

<sup>285</sup> See Baxter, *supra* note 3 at 16.

<sup>286</sup> Baxter thought the situs rule appropriate for land use rules also. See *id.* (noting that “[p]ersons 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 property and hence of those people often should control the applicability of those laws”). See also Scoles & Hay, *supra* note 173 at 744 (stating that “[l]and use control is an important and pervading interest of the situs and its laws seem an appropriate standard for that use”).

clarity of title affects the price and availability of title insurance and therefore the transferability of land to its most highly valued uses.<sup>288</sup>

An additional consideration supporting the situs rule on comparative regulatory advantage grounds is that a state's law regarding local property reflects that state's judgment regarding the optimal fragmentation of property. Divisible ownership interests enable optimal property use only in the absence of excessive fragmentation. Michael Heller has shown how state property law regarding such diverse issues as the nature and extent of title, zoning and sub-division rules, property taxes and registration fees, and the Rule Against Perpetuities, all reflect concerns about the optimal division of property.<sup>289</sup> These concerns vary from state to state depending on the local economic environment.

Application of situs law also reflects choice-maximization principles, consistent with the discussion in the previous subpart of the pervasive relevance of choice. Clarity of title depends on whether a single state's law controls the issue of who possesses an interest in land. The situs is the single state of which most parties connected to the property are likely to be aware. By contrast, if place of contract sometimes controlled, defects in title might be very difficult to trace. Significant conduct such as title recording and property maintenance occurs in the situs, and the situs is the one place associated with the real property that does not change over time.

The need for clear rules that effectuate parties' *ex ante* choice also supports minimization of characterization issues. For example, is a dispute involving a contract for the sale or use of land one of contract or of property?<sup>290</sup> Should the validity of the disposition of property in a will 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>291</sup> in order to maximize parties' ability to make *ex ante* jurisdictional choices, characterization should be based on facts rather than legal theories. For the reasons given above, the relevant facts support application of situs law regardless of theory.

Consistent with this article's approach to contractual choice,<sup>292</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 helps enable parties to contract according to a uniform set of rules regarding validity and construction.<sup>293</sup> At the

<sup>287</sup> *But see id.* (“as to competing claims of ownership, situs is not a reliable choice criterion”).

<sup>288</sup> *Cf.* Scoles & Hay, *supra* note 173 at 744 (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”).

<sup>289</sup> Michael A. Heller, *The Boundaries of Private Property*, 108 *YALE L.J.* 1163 (1999).

<sup>290</sup> *See* Scoles & Hay, *supra* note 173 at 747-51 (discussing the characterization issue).

<sup>291</sup> *See supra* text accompanying note 160.

<sup>292</sup> *See supra* subpart III(A).

<sup>293</sup> *Cf.* Scoles & Hay, *supra* note 173 at 804-05 (noting “difficulty in making a will devising land

same time, a state that seeks to assert an interest in local property, for example to prevent excessive fragmentation of property interests, retains the ability explicitly to invalidate contractual choice.<sup>294</sup>

## V. IMPLEMENTING THE FRAMEWORK

Public choice theory concerning the defects of courts and legislatures explains the problems that modern conflicts law creates and the need for a solution through a new approach to choice of law. It seems to follow that our choice-of-law proposal is wishful thinking. 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 the positive question of whether efficient choice of law is possible and the normative question of which government institutions, if any, should take the lead in assisting in the production of efficient choice of law. Subpart A shows the problems of relying solely on state law, including application of that law in federal courts. Subpart B shows that adoption of our proposal at the federal level, although superficially promising, also is not likely to solve these problems. Subparts C and D then discuss alternative long-run methods of overcoming impediments to state adoption -- cooperation and competition. Evolutionary competition offers the most likely solution. Our theory can be combined with competitive forces to produce evolution toward efficient choice of law.

### A. IMPEDIMENTS TO STATE ADOPTION

It seems unlikely that state courts suddenly will turn from politics to efficiency in choice of law. First, state judges may have private interests in helping their residents and in applying forum law.<sup>295</sup> Second, state judges, who may not have strong incentives to work hard, might prefer to adhere closely to the local case law, statutes and jury instructions they know than to spend the time learning foreign law. Third, to the extent that the courts respond to local bar pressures,<sup>296</sup> forum law increases the demand for the expertise of forum lawyers. Fourth, judges arguably serve the public interest by adding to the stock of precedent available for future litigation in the forum rather than spending time applying foreign law, which does not create binding precedent.<sup>297</sup> When the court creates precedents using forum law, it is more likely to affect local behavior, which is presumably a state court's primary concern. In light of these considerations, it is not surprising that judges have favored modern interest analysis, with its bias in favor of forum law.

Even if some judges can see past these narrow concerns and focus on the social

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in several states conform to the varying requirements in each").

<sup>294</sup> See *supra* subpart IV(A)(2).

<sup>295</sup> See *supra* I(A)(2).

<sup>296</sup> See *supra* subpart I(A)(2).

<sup>297</sup> The use of forum law generates a public good in the form of a precedent for future litigants. See Erin O'Hara & Larry E. Ribstein, *Law and Economics of Choice of Law*, forthcoming, International Encyclopedia of Law and Economics; Stuart Thiel, *supra* note 131. Although this suggests that judges are acting in the public interest, more precedents are not necessarily better, particularly if they come at the cost of efficient choice of law rules.

value of simple rules that facilitate party choice of law,<sup>298</sup> producing an efficient body of choice of law rules requires consistent application of these principles across the bulk of state courts. Spontaneous coordination on this scale seems unlikely to happen soon.

Because federal courts are less likely to be biased in favor of local interests and forum state law, they could, in theory, help promote efficient choice of law through their diversity jurisdiction. There is some empirical support for the proposition that federal courts are less biased toward application of forum law even if they purport to apply state conflicts rules.<sup>299</sup> However, because each federal court sitting in diversity must apply the choice-of-law principles followed in the state in which it is located,<sup>300</sup> federal courts are as unlikely as the state courts to coordinate around general principles of party choice. Moreover, state courts could always trump federal diversity precedents. The most that can be said for federal judicial resolution is that federal courts provide an alternative, competing forum that may marginally discipline state choice of law. However, federal judges hold diversity jurisdiction in low regard.<sup>301</sup> This suggests that proposals for greater federal court involvement,<sup>302</sup> or overruling *Klaxon*,<sup>303</sup> have little chance of success. Constitutional implementation of our general proposal also seems infeasible, particularly in light of the wide-open constitutional principles that courts would have to apply.<sup>304</sup> In short, we are not sanguine that, in the short run, the states will coordinate to produce

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<sup>298</sup> A prominent example is *Paul v. National Life*, 352 S.E.2d 550, \_\_\_ (W. Va. 1986) (Neely, J.) (noting that “[t]he 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.”).

<sup>299</sup> See Ribstein, *supra* note 182 at 284-85 (1993) (finding that federal courts, sitting in diversity, are more likely to enforce choice-of-law clauses than state courts).

<sup>300</sup> *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941).

<sup>301</sup> See, e.g., *Federalization of Crimes: Chief Justice Rehnquist on Federalization of Crimes*, 33-APR PROSECUTOR 9, 15 (1999) (Justice Rehnquist states that federal diversity jurisdiction should be repealed); Henry J. Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483 (1928); Judith Resnick, *The Federal Courts and Congress: Additional Sources, Alternative Texts, and Altered Aspirations*, 86 GEO. L.J. 2589, 2616 (1998) (noting that federal court judges have campaigned against diversity jurisdiction for nearly a century).

<sup>302</sup> See Baxter, *supra* note 3 at \_\_\_; 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 (1993); Scott Fruehwald, *Choice of Law in Federal Courts: A Reevaluation*, 37 BRANDEIS L.J. 21 (1998-99); Harold L. Korn, *Big Cases and Little Cases: Babcock in Perspective*, 56 ALB. L. REV. 933, 939 (1993); Linda S. Mullenix, *Federalizing Choice of Law for Mass Tort Litigation*, 71 TEX. L. REV. 1623, 1631 (1992). See also Roosevelt, *supra* note 79 at 2538, n.264 (advocating that the federal courts impose constitutional restrictions on state choice of law rather than using diversity jurisdiction to help).

<sup>303</sup> See, e.g., Baxter, *supra* note 3 at \_\_\_; Borchers, *supra* note 302 at \_\_\_; Fruehwald, *supra* note 302 at \_\_\_.

<sup>304</sup> The most promising Constitutional rules would help ensure enforcement of contracts. See Ribstein, *supra* note 182 at \_\_\_. Kermit Roosevelt has proposed a general Constitutional approach to choice of law based on states' applying their choice of law rules evenhandedly. See Roosevelt, *supra* note 79. As discussed *infra* text accompanying notes \_\_\_, this may mesh with our approach since choice-maximizing rules are also non-discriminatory rules.

efficient choice of law, with or without federal court involvement.

## B. FEDERAL LEGISLATION

Given the impediments to state coordination, a federal choice of law statute is arguably the best way to implement our proposal. 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 a specific issue, such as products liability. Congress could adopt a federal statute ensuring enforcement of choice-of-forum or choice-of-law clauses in contracts. Enforcement of contractual choice-of-forum alone might lead to enforcement of choice-of-law clauses, partly because of lawyers' incentives to attract litigation to their jurisdictions.<sup>305</sup> In each of these cases, Congress could act under its general commerce clause power<sup>306</sup> or its specific power under the full faith and credit clause.<sup>307</sup>

Regardless of the form it takes, a federal choice of law statute would have the important potential benefit of enhancing international trade. When the applicable state law is unclear, foreign companies concerned about exposure to liability in several states might avoid trading with the United States. This consideration has influenced the Court in civil procedure cases.<sup>308</sup> The prospect of increased foreign trade might generate interest group support for federal law on choice of law.

A federal choice-of-law statute might generate political support despite its usurpation of traditional state lawmaking authority. This sort of federal law avoids the difficulties of federalizing substantive areas of state law since the federal government would simply serve as a referee among the states rather than imposing its own substantive policy. This comports with Jonathan Macey's theory of federalism.<sup>309</sup> Macey pointed out that the federal government will refrain from exercising its near plenary power to federalize substantive law whenever the political support for federal deference is greater than the support that it might receive for regulation. Macey identifies three circumstances under which the federal government will refrain from regulating when (1) federal regulation would dissipate a substantial state capital investment in regulation;<sup>310</sup> (2) the political-support-maximizing outcome varies markedly across states due to varying

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<sup>305</sup> See *infra* text accompanying notes \_\_\_. As discussed below, enforcement of choice-of-forum clauses might arise from state competition without federal help.

<sup>306</sup> U.S. CONST., Art I, § 8.

<sup>307</sup> U.S. CONST., Art IV, § 1.

<sup>308</sup> See, e.g., *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) (forum-selection clause); *Helicopteros Nacionales de Columbia, S.A. v. Hall*, 466 U.S. 408 (1983) (general jurisdiction).

<sup>309</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>310</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.

economic, social or political environments;<sup>311</sup> and (3) controversial issues threaten damaging political opposition from special interest groups.<sup>312</sup> None of these impediments to federal action 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, enforcing party choice enables each state to exercise its comparative regulatory advantage. And, as long as the federal allows states to opt out of the law with a specific statute preventing party choice of law in particular settings, states could retain some control over politically contentious issues.

Despite these arguments in favor of federal law, a federal choice of law statute is probably not a viable solution since Congress will not necessarily act whenever, and only when, it should. For example, one of the few instances in which Congress has acted is in the area of marriage law, with the Defense of Marriage Act.<sup>313</sup> DOMA illustrates the difficulty of relying on Congress to fix defects in state choice-of-law rules. DOMA ended up favoring a specific, powerful, interest group, namely the religious right, and it did so by cutting off only a very small piece of the choice-of-law uncertainties regarding marriage validity. Interest group pressures likely will lead Congress to act on specific issues,<sup>314</sup> and then not 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.<sup>315</sup> More precisely, each state's long-run gains from cooperation will exceed 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 even when it is not obviously in their interests to do so. Because more efficient choice of law could produce substantial aggregate welfare, cooperation can dominate defection in the iterated prisoner's dilemma.

Of course, cooperation among state courts depends critically on their ability to monitor and discipline defections. The classic tit-for-tat enforcement strategies<sup>316</sup> would be difficult to implement, especially because monitoring of other states' choice of law

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<sup>311</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>312</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.

<sup>313</sup> 28 U.S.C.A. § 1738c (West Supp. 1998).

<sup>314</sup> One possible such issue would be internet transactions; legislators already have shown that they want to be active on this issue.

<sup>315</sup> Kramer, *supra* note 89 at 342-44; Brilmayer, *supra* note 45 at 181-218.

<sup>316</sup> *See generally* Robert Axelrod, THE EVOLUTION OF COOPERATION (1984).

decisions is costly.<sup>317</sup> Moreover, it might be years before an interstate dispute arises in the disadvantaged state enabling retaliation against the state that originally defected.<sup>318</sup> Larger plaintiff-favoring states, which were the first to abandon the First Restatement, have more opportunity to defect than smaller states because they handle a larger volume of interstate litigation.

A larger problem is that it is not clear that this situation can be modeled as a game among the "states," as distinguished from courts and legislators who have private incentives that might run counter to the interests of the state as a whole.<sup>319</sup> Although "states" may win in the long run from reciprocity, powerful interest groups or self-interested lawmakers may win both in the short and long run by rejecting an efficiency-maximizing approach. This is not clear, however, since statutes may be more valuable to interest groups if they are enforced in other states and enforcement might be enhanced by reciprocation. 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>320</sup> provides reason to suspect the feasibility of a cooperative solution.<sup>321</sup> Perhaps most revealing, uniform statutes of limitations have failed. This is unsurprising, since statutes of limitations are a means for lawyers, an important interest group, to maximize use of their local forum.<sup>322</sup> Cooperation is not worthwhile to lawyers in the face of their personal stakes. Uniformity appears to succeed only in the unusual case.<sup>323</sup> An example is the Uniform Child Custody Jurisdiction Act, where potential injuries from non-uniformity were felt equally across all states, and were significant relative to the minor effect on state litigation. The paucity of evidence supporting state cooperation suggests that other mechanisms for achieving uniformity are similarly unlikely to succeed. Lea Brilmayer has suggested that the American Law Institute foster state cooperation with the adoption of a third restatement.<sup>324</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>325</sup>

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<sup>317</sup> See Kramer, *supra* note 89 at 345, n.228 (noting that monitoring and punishing defections will be the most likely impediments to cooperation).

<sup>318</sup> This and other enforcement problems are discussed in Sterk, *supra* note 23 at 1008-1011.

<sup>319</sup> Sterk, *supra* note 23 at 1009 notes the difficulty of treating the judges as a single player. We add the increased difficulty generated by adding the other state decisionmakers into the analysis.

<sup>320</sup> See Brilmayer, *supra* note 45 at 213-18; Kramer, *supra* note 89 at 339-44.

<sup>321</sup> [Kramer on the need for a uniform choice of law code, 89 Mich 2134]

<sup>322</sup> The uniform rule that has been widely adopted -- the one in the UCC -- is so vague as to be useless for our purposes. [cite]

<sup>323</sup> See Kobayashi & Ribstein, *supra* note 19 (presenting data on state adoption of uniform laws).

<sup>324</sup> Brilmayer, *supra* note 45 at 213-18.

<sup>325</sup> See Ribstein, *supra* note 19; Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1994); Robert E. Scott, *The Politics of Article 9*, 80 VA. L.

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>326</sup> Accordingly, its predictions are not very convincing.

#### **D. EXIT, COMPETITION AND INTEREST GROUPS**

The discussion so far in this Part might well 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 choice-of-law reforms. This subpart shows that there may be a way out of this conundrum: Jurisdictional competition could create sufficient pressure on the states over time to force them toward efficient reforms.

Jurisdictional competition might operate in several ways. First, interest groups other than lawyers can coordinate in litigation as well as around legislative action to foster the gradual evolution of efficient choice-of-law rules.<sup>327</sup>

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 flee by allowing them to contract out of application of the state's law.<sup>328</sup> The credibility of an exit threat turns on the advantages of the jurisdiction to the exiting group, including its aesthetic resources and the size of its market. 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>329</sup>

Third, even interest groups that favor a particular state regulation might accede to exit-favoring rules, including enforcement of contractual choice of law, if this appeases opponents of the law sufficiently to enable passage or to significantly reduce the costs of lobbying for the law.<sup>330</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. To minimize its lobbying costs and ensure passage, the proponent

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REV. 1783 (1994).

<sup>326</sup> [see Picker]

<sup>327</sup> See Rubin & Bailey, *supra* note 11.

<sup>328</sup> See Kobayashi & Ribstein, *supra* note 8.

<sup>329</sup> See *supra* text accompanying notes\_\_.

<sup>330</sup> See O'Hara, *supra* note 9.

groups may agree to permit contractual choice.<sup>331</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. The question is whether the proponent interest group gains more from substantively weakening the statute or from allowing exit. It may prefer the latter alternative because of the transaction costs of exit or the statute's application to existing contracts.<sup>332</sup>

Fourth, lawyers may play a role in pushing the law toward enforcement of jurisdictional choice, particularly if courts enforce contractual choice of forum. 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 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 benefits by making their jurisdiction's law attractive to contracting parties. An important element of this attractiveness may be the state's willingness to enforce contractual choice-of-law clauses. Thus, both litigators and business lawyers specializing in drafting and planning might want their states to enforce contractual choice of both forum and law. Moreover, lawyers might favor enforcement of choice of forum provisions even if their own state is not the chosen forum as long as the contract chooses their own state's law. Regardless of the forum, experts in Delaware law are more likely to be chosen to represent the parties. For example, the Delaware Supreme Court held in *Elf Atochem North America, Inc. v. Jaffari*<sup>333</sup> that Delaware courts lacked jurisdiction over a dispute between the parties to an LLC agreement that provided for arbitration and a California forum.<sup>334</sup> The court cited the strong Delaware policy favoring freedom of contract and alternative dispute resolution, including arbitration.<sup>335</sup>

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 do not need to maintain 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>336</sup> can swiftly avoid states that impose onerous taxes or regulation.

Jurisdictional competition already has pressured states toward more efficient choice of law in some contexts. Courts have increasingly enforced contractual choice of law, especially relative to the non-recognition of contractual choice under the First

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<sup>331</sup> See O'Hara, *supra* note 9 at \_\_\_\_.

<sup>332</sup> See *id.*

<sup>333</sup> 727 A. 2d 286 (Del. 1999).

<sup>334</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>335</sup> *Id.* at 292, 295-96.

<sup>336</sup> See *supra* text accompanying note 273.

Restatement.<sup>337</sup> The rising power of contractual choice appears strongest where exit is feasible, 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 prohibited franchisors from opting out of the regulations with choice-of-law provisions.<sup>338</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>339</sup> This analysis implies that franchisors than 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 subpart relate to but differ from the evolutionary theory discussed in the previous subpart. We posit here that the states 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 general theory that self-interested people can reach efficient results over time by interacting in a competitive environment even without obvious incentives to generate socially efficient outcomes.<sup>340</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 subpart means that the theory is inefficient. This raises the general question of whether there any place for choice-of-law theory to operate in the crucible of jurisdictional competition.

The answer is that legal proposals can work with jurisdictional and interest group competition to speed the process toward efficient choice-of-law rules. First, competitive forces do not operate perfectly and instantaneously. Second, constraints on decision-makers' 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>341</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. Accordingly, there is room for a proposal that guides state action despite the

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<sup>337</sup> See *supra* subpart III(A).

<sup>338</sup> See Kobayashi & Ribstein, *supra* note 8.

<sup>339</sup> *Id.*

<sup>340</sup> See Alchian, *supra* note 36. See also Martti Vihanto, *Competition between Local Governments as a Discovery Procedure*, 148 J. INSTITUTIONAL & THEORETICAL. ECON. 411 (1992).

<sup>341</sup> See Bruce H. Kobayashi & Larry E. Ribstein, *Uniform Laws, Model Laws and ULLCA*, 66 COLO. L. REV. 947 (1995).

powerful forces of jurisdictional competition.

## VI. CONCLUDING REMARKS

Prevailing theories of conflict of laws stress the states' power and legislative interests over the interests 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 tools of economic 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 this article's specific proposals represent optimal choice of law rules, the more general recommendation in favor of emphasizing party choice over states' interests has the potential of significantly improving conflict-of-laws jurisprudence.