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Rules and Institutions in Developing a Law
Market: Views from the U.S. and Europe

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Developments in European choice of law seem to offer the US a tantalizing opportunity for escape from the chaos of state-by-state choice-of-law rules. Specifically, the Rome Regulations provide the sort of uniform choice-of-law rules that have eluded the US. Also, decisions of the European Court of Justice that permit firms to adopt home-country rules in some situations seem to facilitate jurisdictional choice by private parties. This top-down ordering of choice-of-law rules contrasts with the seemingly chaotic and decentralized system that prevails in the US. However, decentralized US-style federalism might have something to offer Europe because choice of law in the U.S. has sparked a type of law market that helps constrain inefficient State regulatory efforts. Viewed from the perspective of which system best fosters a market for law, both the US and Europe have advantages that each could learn from the other.

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Erin O'Hara & Larry E. Ribstein, draft of February 27, 2008*

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RULES AND INSTITUTIONS IN DEVELOPING A LAW MARKET: VIEWS FROM THE US AND EUROPE	1
I. OBJECTIVES OF CHOICE OF LAW	4
A. VOICE: POLITICAL CHOICE WITH COSTLY EXIT	5
B. EXIT: JURISDICTIONAL CHOICE	6
C. COSTS OF EXIT	7
D. ACHIEVING AN EFFICIENT BALANCE	8
1. Enforcing contractual choice	8
2. Choice-facilitating rules	9
3. Default rules	9
4. Mandatory override	10
5. The federal backstop	11
II. A BRIEF GLIMPSE OF US CONFLICTS LAW	11
III. THE NEW EUROPEAN UNION APPROACH	13
A. ROME I	14
B. ROME II	15
1. Products liability	16
2. Party autonomy	17
C. CONSTITUTIONAL RULES: MUTUAL RECOGNITION	18
IV. EUROPE AND US LAW MARKET INSTITUTIONS	23
V. CONCLUSION	26

Several important developments in Europe promise to bring order and rationality to what traditionally has been the chaos of private international law. European rules on choice of law for contracts (referred to here as “Rome I”) and non-contractual obligations (referred to here as “Rome II”) provide general answers for a wide range of conflict of laws questions. The European Court of Justice has been imposing what are in effect constitutional constraints on private international law under the aegis of the four freedoms of the Treaty of Rome. Through these rulings, firms and individuals are protected to some extent by the application of multiple laws where this could impede trade and travel in the European Community.

Meanwhile, the US continues to muddle through, as people and firms face disparate choice-of-law regimes across the states that force them to be subject to

unsuitable rules and uncertainty about what rules apply to their transactions. While federal law theoretically plays a role through the Due Process¹ and Full Faith and Credit² clauses of the U.S. Constitution, these rules impose virtually no limit on State court choice-of-law decisions.³

Though Europe seems to be moving toward greater predictability than the US in choice of law, its lessons for the US are not as clear as they might seem. In order properly to evaluate US and European choice of law, it is necessary to see the rules through the prism of two choice-of-law revolutions. The first, which has occurred over the last fifty years, replaced a poorly functioning rule-based standard for choice of law with a variety of vague, standard-based approaches.⁴ Defenders of this shift tout its greater realism and focus on relevant policies.⁵ They weigh these values more heavily than the greater predictability that the rule-based approach promised but often failed to deliver.

The second choice-of-law revolution now appears to be underway. Fueled by easy, worldwide party and asset mobility, private parties are increasingly able to choose their own governing laws. The second revolution replaces state interests with those of individual parties and firms by empowering them to choose the laws that suit their needs. Party choice induces nations and states to enforce parties' contracts to apply a particular law or to have the case adjudicated in a particular forum, because parties can more readily both avoid jurisdictions that do not enforce the contracts and center their operations in jurisdictions that do. Moreover, the rise of globalization, with products increasingly designed and sold in international markets, gives firms a strong incentive to seek federal or global standards when states refuse to enforce contractual choice. In short, states must either get on the jurisdictional choice bandwagon or lose their power to regulate altogether. Individual governments' power to regulate, especially in a protectionist manner, is breaking down.

This emerging law market produces important global efficiency advantages. Consider, for example, what happens today when a state or nation attempts to regulate contract terms in ways that tend to give advantages to particular local contracting parties. Those burdened by these protections can, if the costs imposed are large enough, move their jobs, assets and transactions to other states. Interest groups that benefit from businesses locating and conducting business in the regulating state can lobby the local legislature to repeal these laws or for the enforcement of choice-of-law provisions that enable firms to choose the laws of other states. In short, mobility constrains the efficiency losses associated with bad laws.

¹ See U.S. CONST. amend. XIV, § 1 ("No state shall . . . deprive any person of life, liberty, or property, without due process of law . . .")

² U.S. CONST. art. IV, § 1.

³ See *infra* text accompanying notes___.

⁴ See, e.g., EUGENE F. SCOLES & PETER HAY, CONFLICT OF LAWS (2d ed. 1992) (referring to shift in American Conflicts law as a « revolution »); SYMEON C. SYMEONIDES, THE AMERICAN CHOICE-OF-LAW REVOLUTION : PAST, PRESENT AND FUTURE (2006).

⁵ Advocates of making choice-of-law decisions that turn on the underlying substantive policies of the laws at issue include Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. REV. 267 (1966); Willis L.M. Reese, *Choice of Law: Rules or Approach*, 57 CORNELL L. REV. 315 (1972); Joseph William Singer, *Real Conflicts*, 69 B.U. L. REV. 1 (1989).

To be sure, a law market threatens to impose social costs. When a state attempts to protect its residents from harmful products or predatory business practices, for example, easy evasion of these regulations can prove problematic. Choice-of-law rules need to strike a balance between enhancing jurisdictions' power to regulate and promoting the freedom of the law market.

This paper evaluates European and US responses to the challenge of promoting state interests while accommodating party choice. Europe's relatively clear and uniform choice-of-law principles may seem to be an appropriate response to the chaos resulting from the first choice-of-law revolution. Moreover, the European Court of Justice's decisions applying the four freedoms under the Treaty of Rome⁶ show some promise in constraining the costs of fragmented regulation. However, no general rules, including those in Europe, can fully address the situations in which states' or nations' mandatory rules should trump parties' power to specify the applicable law in their contracts. Moreover, European default rules on choice of law lack any central theory, including one designed to accommodate the development of a market for law. Thus, despite the EU's substantial investment in developing uniform choice-of-law rules, member nations cannot fully either reap the efficiency gains of the law market or to constrain its efficiency losses.

On the other hand, despite its failure to squarely address the challenges of conflicting jurisdictions in a global trade environment, the US's dynamic lawmaking institutions, including significant party mobility among the states and ongoing interaction between federal and state lawmakers, better prepare it to reap the benefits of the law market. Thus, even with its chaos, the US experience offers lessons for Europe.

In general, our analysis contrasts two approaches to conflicts of laws – a European-type system based on centralized substantive *rules* that determine the applicable law, and a US-type system offering *institutions* that facilitate mobility and other pressure on jurisdictions to recognize party autonomy. Additionally, the institutional approach is necessarily a *dynamic* analysis which focuses on the process by which choice-of-law rules develop. A rule-based approach, on the other hand, is more *static* in the sense that it focuses on the rules that either do or hopefully will exist at a given point in time.

Part I below describes the most important objectives of choice of law in a law market. Part II provides a brief glimpse of US conflicts rules, primarily to set up the comparison with the European approach. Part III discusses the emerging European rules under Rome I and II and from the ECJ's interpretation of the EC Treaty. Part IV revisits Europe and American law from the standpoint of the law market. Law markets depend not only on specific choice-of-law rules, but also on institutions that favor mobility and jurisdictional choice by individual parties and firms. Europe may have clearer choice-of-law rules, but the US ultimately has an edge in its ability to provide a dynamic framework in which an effective law market can operate.

I. OBJECTIVES OF CHOICE OF LAW

This Part provides a basis for analyzing choice-of-law rules that we will use to assess US and European rules in the remainder of the article. In general, we proceed from the assumption that choice-of-law systems should resolve conflicts among potentially

⁶ See *infra* text accompanying note 57.

applicable laws so as to maximize efficiency. As with other legal problems, the basic tradeoff in designing choice-of-law rules involves an attempt to minimize defects in political markets on the one hand and in commercial markets on the other.⁷ We see two basic mechanisms for maximizing social welfare – the political process, or voice, and jurisdictional competition, or exit.⁸ Individual interests are sometimes best served by exit, and sometimes through the political system. Law ideally should help produce mechanisms that generate efficient results both by incentivizing governments to pass efficient laws and by enabling parties to choose the laws that best serve their often diverse needs.

To see the applicable tradeoffs, imagine two sharply contrasting systems. In System I there is one jurisdiction, where parties have no ability to choose the jurisdictional rules that apply to them either by moving or by contracting. In System II, parties can choose unilaterally or by contract the laws that will apply to their acts. In System I, the regulatory decisions of government are final, and parties have no way to avoid bad laws other than trying to enact better ones. Even with laws that best suit the average company and citizen, those with differing concerns or needs face individually suboptimal legal rules. In System II, by contrast, government decisions are irrelevant, and the parties must hope they are adequately protected by markets. In System I, “voice,” or political action, rules; in System II the plenary power to “exit” rules. Neither system is desirable. Of course in reality there are multiple jurisdictions, each of which asserts some degree of sovereignty designed to limit party choice. Thus, designing choice-of-law rules is a matter of finding the optimal compromise between these two Systems. The following subsections consider specific factors that underlie the relevant tradeoffs.

A. VOICE: POLITICAL CHOICE WITH COSTLY EXIT

Decision rules should minimize the total costs, both administrative and political, of decision-making. The latter political costs include the winners’ ability to use the governing political system to impose costs on the losers.⁹ A significant determinant of political costs is the interest group dynamics created by the political system and its surrounding environment. Politicians can be viewed as acting as brokers among interest groups, where politicians provide these groups with political favors and the interest groups return those favors with enhanced reelection prospects, in the form of campaign contributions and votes.

An interest group’s influence depends significantly on how well it can overcome free-riding by individual members.¹⁰ If people think they can enjoy the benefits of others’

⁷ In other words, we do not see fundamental differences in goals between maximizing individual interests, maximizing state policies and incentivizing states to pass efficient laws. See Ralf Michaels, *Two Economists, Three Opinions? Economic Models for Private International Law—Cross-Border Torts as Example*, in *An Economic Analysis of Private International Law* 143-184 (Jürgen Basedow & Toshiyuki Kono eds., Mohr Siebeck 2006).

⁸ Our use of the concepts of voice and exit are very similar, but not quite identical to, the concepts famously invoked by ALBERT O. HIRSCHMAN, *EXIT, VOICE AND LOYALTY* (1970).

⁹ See JAMES BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962).

¹⁰ MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965).

lobbying efforts, they may choose not to contribute to the cause. Thus, a group can increase its relative influence by inducing more beneficiaries to contribute to the common cause. Lawyer interest groups can be politically powerful because their members' interests are often fairly homogeneous and their organizing costs are offset to some extent by the non-political benefits of bar associations. Lawyers therefore may be able to gain political benefits at the expense of many other much larger but also much more unwieldy group of voters.

Traditional public choice theory holds that interest groups may be weak when they attempt to influence lawmaking in jurisdictions other than where their members vote.¹¹ For example, a state may impose stringent regulation on behalf of a well-organized local interest group of small business people such as local professionals or franchisees at the expense of professionals or franchisors based outside the state. These out-of-state interests may have the ability to organize nationally but they may be outgunned in particular states. This "spillover" problem may affect firms that are trying to sell their products or services in a national or global market but face regulatory burdens in individual jurisdictions.

Although interest groups may cause wealth transfers, competition between interest groups can defeat inefficient laws.¹² If the stakes are large for both local winners and losers, interest groups will fight hard on both sides of a proposed law, and lawmakers will likely avoid making enemies by preserving the status quo. As we will see, this competitive dynamic is important not only in analyzing voice, but also in evaluating the political effects of exit.

Even efficiency-minded legislators who try to balance costs and benefits among all affected groups find it difficult to fashion efficient laws. After all, they suffer from a lack of information about the costs, benefits, and effects of the law in complex global markets amid rapidly evolving technology and markets, and often what little information they do have comes from the very interest groups whose influence they seek to avoid. The information deficit is particularly a problem for state and local jurisdictions whose legislatures lack staff and other resources. However, some states and countries may be willing to invest in a lawmaking infrastructure designed to benefit particular segments of the economy, and those states can generate laws that are superior to those of states that lack such incentives.

B. EXIT: JURISDICTIONAL CHOICE

Analysis of jurisdictional choice begins with Charles Tiebout's model of many local jurisdictions enabling people to "vote with their feet" for their preferred mix of public goods and taxes.¹³ With costless mobility, people do not need political power in order to obtain the bundle of government services (and taxes) that they prefer. In turn, jurisdictions that seek more residents to help pay for public services have an incentive to minimize taxes and expand public amenities to attract and retain residents.

¹¹ The problem is particularly acute at the local government level. See LYNN A. BAKER & CLAYTON P. GILLETTE, *LOCAL GOVERNMENT LAW: CASES AND MATERIALS* 43 (3d ed. 2004).

¹² See Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983).

¹³ Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

The viability and efficiency of this market for public goods depends on the availability of alternative packages of public goods, on parties' costs of moving from one jurisdiction to another, and on the extent to which jurisdictions impose costs outside their borders. If people are bound to a particular set of laws by the need to stay with a family or job, the availability of alternative packages does them little good. Without enough mobility to fuel a competitive market, governments may have little incentive to offer efficient packages of public goods. Moreover, if governments can impose costs on their neighbors, then their taxes will not reflect the full cost of their public goods, and this deficit will lead to a misallocation of resources.

One way to reduce parties' exit costs and thereby enhance the market for public goods is to, in effect, unbundle laws from the governments that enact them – that is, to let parties shop for the laws of jurisdictions outside their places of residence. Of course, allowing full unilateral choice would eliminate governments' power to regulate local activities and permit small law-selling jurisdictions to impose costs on jurisdictions where the law-shoppers live or work. Shopping for law produces the greatest net benefits where the choice is contracted for jointly by the affected parties, so that external effects are constrained. In these contexts, choice-of-law clauses can subject even mandatory laws to Coasian bargaining.

Allowing the parties to shop for law might seem necessarily to subvert laws intended to protect local residents. We acknowledge some of those costs in subsection C below. But it is important to keep in mind that choosing law requires the parties to opt into a set of government laws rather than letting them evade all law. As long as the parties choose a jurisdiction with a political process in which various interest groups contend, there is no a priori reason to conclude that the chosen jurisdiction's law is somehow inferior to the avoided law, particularly if the parties must accept all of the chosen jurisdiction's laws rather than cherry-picking the provisions that suit them.

Just as political decision-making may be self-correcting to some extent because of competition among interest groups, so might commercial market forces constrain a market for laws. As long as merchants can gain by choosing lax laws, consumers or groups or informational intermediaries have an incentive to learn about these and avoid contracts that are governed by them. Merchants that trick their customers or that impose costs on society by contracting for lax laws might find their reputations suffer when the strategy is discovered.

Finally, voice and exit intersect. When a jurisdiction loses or fails to attract people and firms because of its laws, those who forgo or lose business have an incentive to lobby to improve the law. Put differently, voice and exit are not always and everywhere substitutes. Exit by some can add voice to others who benefit by the presence of those who have exited. These "exit-affected" groups are then added to the mix of pro- and anti-regulatory groups competing to enact their preferred laws. In a world of enhanced mobility, outside interests are often powerful despite their lack of physical proximity to local lawmakers.

C. COSTS OF EXIT

Allowing parties to exit unfavorable laws sometimes can involve a "race to the bottom" where jurisdictional competition leads to socially inefficient laws. This can happen in two general situations. First, if a regulated party can by its own act determine the applicable law, this may have the effect of denying other parties the protection even of efficient regulation. An obvious example is where a child pornographer selling online

could escape US laws by going offshore, thereby maintaining a market that leaves American children vulnerable. When parties adversely affected by a unilateral choice cannot protect themselves, through market choice, contract, or otherwise, the law market produces harmful costs. If, however, a party can protect herself from the harmful consequences of another's unilateral choice of law, then law markets can produce efficient results. For example, even if a corporation's shareholders choose to form under a corporation law that does not protect creditors, the firm's voluntary creditors may be able to negotiate with the firm for protection or higher interest rates. Involuntary creditors are admittedly less protected, although sometimes they can at least benefit from the managerial incentives that contracts with voluntary creditors create. In any event, the law market can potentially impose costs on third parties who cannot be protected without regulation.

Second, a contracting party may agree to a choice of governing law with little leverage or expertise regarding a choice-of-law clause. In consumer contracts, for example, the seller's ability to choose the applicable law arguably stacks the deck against the consumer, since sellers or producers may have an advantage in researching or influencing the laws they choose. Some argue that choice-of-law clauses in consumer contracts are particularly pernicious because consumers are often unaware of the true implications of these clauses.¹⁴ On the other hand, firms want to protect their reputations from being perceived as offering one-sided terms. Consumer groups and publications stand ready to publicize incidents of abuse, including use of a choice-of-law clause to hide contract risks.¹⁵ We do not attempt to resolve this debate, but rather highlight the opposing sides by way of considering how choice-of-law rules can take them into account.

D. ACHIEVING AN EFFICIENT BALANCE

The goal of designing efficient choice-of-law rules depends on facilitating party choice of law while taking care to minimize the costs of exit discussed in subpart C – that is, achieving the optimal mix of exit and voice. We propose a procedural approach to obtaining that mix. Achieving this balance through procedural mechanisms involves the following five components.

1. Enforcing contractual choice

Choice-of-law clauses in contracts should have the presumption of enforceability that is accorded contract provisions generally in a market economy, even if lawmakers conclude that some regulation of these clauses is appropriate.¹⁶ This is the general principle for contractual choice of law in the US, as summarized by Restatement (Second) §187.

¹⁴ William J. Woodward, Jr., *Constraining Opt-Outs: Shielding Local Law and Those it Protects From Adhesive Choice of Law Clauses*, 40 LOY. L.A. L. REV. 9, 13-14 (2006).

¹⁵ Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363 (2003).

¹⁶ Others have also come to this conclusion. See Larry Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277, 329 (1990); Michael J. Whincop & Mary Keyes, *Putting the "Private" Back Into Private International Law: Default Rules and the Proper Law of the Contract*, 21 MELBOURNE U. L. REV. 515 (1997).

2. Choice-facilitating rules

Even outside the context of contracts, choice-of-law rules should facilitate party choice of governing law. As a positive matter, states have an incentive to adopt rules facilitating party choice because of parties' ability to direct their conduct toward jurisdictions that accommodate choice and away from jurisdictions that do not do so. From a normative standpoint, the rules should facilitate choice by enabling parties to know and to choose the applicable law at the time they plan their conduct and their contracts.

Choice-of-law rules should facilitate *mutual* rather than unilateral choice. For example, in products liability and other tort cases arising out of market transactions, a rule that directs courts to apply the law of the place where goods are manufactured allows the seller to make a single informed choice of law by choosing where to locate its plant. If all companies chose to locate their plants in states with minimal liability laws, and if one or more states were willing to compete for these plants by providing little or no consumer tort protections, then the place of manufacture rule would lead to too little liability.¹⁷ That is because applying the law of the state of manufacture may not facilitate choice by the buyer, who would have to learn about the law of all the jurisdictions where sellers are located.

On the other hand, a place of sale rule would enable the seller to both decide where it wants to sell products and to price products according to the liability rules imposed on its sales. Each state could choose the optimal bundle of price and consumer protection. At the same time, the buyer or plaintiff may be best able to learn about and act with reference to the law where he buys the product, which typically will be where he lives or some other jurisdiction he has deliberately chosen. Even if this is not true for all consumers, at least some, particularly those buying large volume or large ticket items, could shop for their preferred bundle of protections. Thus, a place of sale rule would be mutually choice-facilitating in this type of case.

3. Default rules

In some cases, where the parties are not acting with reference to the applicable legal rules, legal rules cannot realistically be said to be choice-facilitating. In those situations the law could supply a rule that replicates the result that contract would produce – that is, supply a “hypothetical bargain” as to which law governs the parties' relationship. This term may be misleading because the intent is not to imagine what actual parties would do,¹⁸ but rather to produce the sort of efficient results expected in a well-ordered market – that is, selection of the jurisdiction that has the best information and incentives to act, or “comparative regulatory advantage.”¹⁹ Like actual bargains, the

¹⁷ For a treatment of the various incentives created in products liability as a result of the applicable choice-of-law rules, see Michael W. McConnell, *A Choice of Law Approach to Products Liability Reform*, in *NEW DIRECTIONS IN LIABILITY LAW* 90 (Walter Olson, ed. 1988).

¹⁸ Some have objected to the term on this ground. See Jurgen Basedow, *Lex Mercatoria and the Private International Law of Contracts in Economic Perspective*, 69 [need source book].

¹⁹ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 633-34 (7th ed. 2007); Erin A. O'Hara & Larry E. Ribstein, *From Politics To Efficiency In Choice Of Law*, 67 U. CHI. L. REV. 1151, 1179-80 (2000); Michaels, *supra* note 7, at 167 (recommending comparative regulatory advantage for efficiency-

hypothetical bargain would be subject to override by mandatory rules based on state policy as discussed in the next subsection.

4. Mandatory override

We not only use an efficiency criterion, but also assume that markets usually reach efficient results, at least in the absence of a demonstrated market failure. It follows that a choice-of-law system should strive to support the market for law, and therefore facilitate mutual party choice in the absence of bargaining defects or harmful externalities. But while party exit from regulation is an important antidote to the defects of the political process, there is still an important role for the political process to make social policy. In those circumstances, choice-facilitating rules should be subject to override by the mandatory laws of a state whose constituents suffer the negative consequences of an unfettered law market.

It is important to emphasize that under our analysis the relevant choice is not between efficiency and other values, but between political and contractual mechanisms for achieving efficiency. Reinforcing regulation of contracts through restrictions on jurisdictional choice can produce efficient results because of potential defects in the contracting process. But potential defects in the political process can produce inefficient regulation. Accordingly, we turn to a branch of law and economics – that is, public choice analysis – to promote political processes that are most likely to produce efficient results.

The problem of permitting mandatory laws to trump choice-facilitating rules is deciding which states can impose overriding mandatory laws and under what circumstances. Choice-of-law regimes generally punt on this critical issue by providing for override of default choice of law rules, including those that effectuate party choice, when they contravene the vaguely defined important public policies of vaguely selected interested states or countries.²⁰ Obviously a mandatory override must avoid the danger of being so open-ended that it can undermine the predictability of the choice-of-law system.

Choice-of-law rules therefore need to accommodate political decision-making while preserving to the extent possible the efficiency-enhancing benefits of jurisdictional competition. As discussed below, we propose a particular mechanism for accomplishing this: the decision of any state to impose a mandatory override should be made by its legislature rather than by a court. Under this approach, interest groups would have to compete directly in order to secure super-mandatory rules – that is, rules that trump party choice. The interest group that prevails on the super-mandatory issue would have to

based approach).

²⁰ For example, the Restatement (Second) of Conflict of Laws provides that the choice-of-law clause will not be given effect if either:

- (a) The chosen state has no substantial relation 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 the fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, . . . [according to a separate very vague standard] . . . , would be the state of the applicable law in the absence of an effective choice of law by the parties.

Restatement (Second) of Conflict of Laws § 187(2) (1971)

overcome not only groups that oppose the regulation, but also “exit-affected interest groups” – that is, groups that are harmed when firms avoid contacts with states that will not enforce choice-of-law contracts. The approach thus helps provide an opportunity for all voices to inform the debate over whether to circumvent the law market. Relying on explicit legislative determinations has the additional benefit of providing clear and predictable rules. Clear rules enable parties to predict which state's law will apply both at the time they engage in the regulated conduct and at the time of suit. In addition, rules enable courts in all jurisdictions readily to determine whether to give laws supermandatory effect.

5. The federal backstop

For a choice-of-law approach to work effectively, it is important to have a federal or equivalent government to intervene in particular cases where state choice-of-law rules work poorly. This intervention can occur (1) where competitive pressures force the states to succumb to a race to the bottom; or (2) where state burdens on interstate commerce are not constrained by the threat of party exit. The federal backstop can prevent a race to the bottom in situations where the pro-regulatory groups are ineffective at the state level but not at the federal level. As to the second situation, the threat of physical exit may not be constraining in situations where defendants can be sued in states with mandatory laws regardless of their lack of business contacts with the state. Of course, federal government involvement should be used sparingly because it can have the effect of eliminating the very state competition that produces the beneficial effects of the law market.

II. A BRIEF GLIMPSE OF US CONFLICTS LAW

This Part provides a quick look at US law, primarily as a backdrop for the discussion of the European developments in Part III.

As we have detailed elsewhere,²¹ modern US choice of law essentially begins with Joseph Beale's "vested rights" theory, which anchors choice of law in the notion that states should control rights that vested within their borders. This system promised clarity, but actually delivered confusion, as courts found many ways, such as by manipulating the characterization of a claim, to escape the constraints of vested rights rules.

The vested rights approach largely has been replaced in the US by what has been referred to as the choice-of-law revolution – that is, the recognition of the importance of state interests.²² In an influential series of articles in the 1960's, Brainerd Currie sought to avoid the artificiality of vested rights analysis by explicitly recognizing the role of state interests.²³ Although Currie sought to marry state policy with clear rules, his main contribution ended up being to provide support for courts' tendency to favor residents, forum law, and plaintiffs. Currie explicitly assumed that states would want to protect their residents. The forum bias was inherent in Currie's mechanism for resolving "true" conflicts between two "interested" states – that is, apply forum law. This helped plaintiffs, who usually choose the forum, and abetted an increasing judicial preference for protecting plaintiffs.

²⁴ See *infra* text accompanying notes ____.

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By the time the Restatement (Second) of Conflict of Laws was promulgated in 1971, its drafters faced a chaotic legal scene in which various courts applied not only vested rights, but also many versions of Currie's interest analysis. The American Law Institute attempted to accommodate all of these systems by combining a set of rules with an multifactor analysis that simply lists all of the considerations the courts were applying in deciding on the applicable law. The Second Restatement thus left the courts free to reach just about any result they wanted. Moreover, even the Restatement's compromise did not bring unity, as states apply many different approaches. And, as discussed below,²⁴ the U.S. Constitution brings only a minimal amount of order to this chaos.

However, the most important recent influences on the law governing private parties in the US have not been the formal state law or constitutional rules, but the institutions that determine the dynamics of competition. These include federal constitutional protection from government interference with property and other rights; common language and culture; and firms' ability, enforced by the negative commerce clause, to do business throughout the country without having to worry about discrimination in favor of local firms. These factors provide the basic mobility that enables firms and people to escape oppressive laws, even if they have to move physically.

Firms' mobility is backed by the availability of the federal government to alleviate significant pathologies in state competition. First, as noted above, the federal government can take over a state law area at the instance of an interest group that claims harm from a "race to the bottom," or where state regulation or litigation unconstitutionally impedes interstate commerce.²⁵ Second, the federal courts, through federal diversity jurisdiction, can give interstate firms a refuge from possibly parochial state courts.²⁶ Third, firms have been able to gain enforcement of contractual choice-of-forum and arbitration clauses. Enforcement of the former has been boosted by U.S. Supreme Court decisions,²⁷ while the latter is enforced pursuant to the Federal Arbitration Act.²⁸

This mobility, in turn, has given them significant leverage to insist on enforcement of choice-of-law clauses. The current rule, embodied in the Restatement (Second) of Conflicts, §187, begins the analysis of contractual choice of law with enforcement of the parties' contract. The Restatement calls for application of the open-ended default choice-of-law rule²⁹ for contract only where the parties have not contracted for the applicable law, or where the choice-of-law clause is not enforceable for lack of the requisite connection between the parties or transaction and the chosen law, or in the face of a contrary fundamental policy of a state whose law would be chosen under the default contract rule.³⁰ Although the Restatement's fundamental policy exception seems open-

²⁵ See *infra* text accompanying notes 76-78.

²⁶ See O'Hara & Ribstein, *supra* note 21, ch. 3.

²⁷ See, *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972); O'Hara & Ribstein, *supra* note 21, ch. 3.

²⁸ See 9 U.S.C., Sec. 2; O'Hara & Ribstein, *supra* note 21, ch. 5.

²⁹ See Restatement (Second) §188 (1971).

³⁰ *Id* §187(2).

ended, in fact the courts quite generally enforce contractual choice of law, confining the exception to a few narrow categories of cases.³¹ US courts explicitly recognize enforcement of contractual choice of law only as to contractual issues and sometimes refuse to apply the parties' chosen law to disputed tort issues.³²

Thus, the US has fostered an active law market, not because of the choice-of-law rules themselves, but because of dynamism inherent in the institutional features of the US federal system. The loose nature of U.S. choice-of-law rules leaves much room for improvement, particularly regarding tort law. This gives U.S. lawyers and lawmakers a strong reason to look to recent European efforts to harmonize choice of law. However, as discussed in the next two parts, the U.S. can draw no more than limited guidance from these developments.

III. THE NEW EUROPEAN UNION APPROACH

Europe offers two opportunities for improvement over the current chaotic US conflicts system. First, Europe has approved uniform choice-of-law rules, commonly known as the Rome I Convention, for contractual obligations,³³ and Rome II Regulation, for non-contractual obligations.³⁴ The Rome I Convention is in the process of being replaced by a Regulation.³⁵ These rules, which are discussed below in subpart A, help ensure that the same choice-of-law rules will be applied across the EU, in contrast to the situation in the US in which the applicable rule varies from one State court to another.

Second, as discussed in subpart B, the European Court of Justice and the European Parliament have recognized a constitutional principle of mutual recognition that helps ensure international firms that at least some of their home country regulations will follow their business activities throughout Europe. This contrasts with the minimal constitutional protection that interstate firms get from disparate regulation throughout the US.

Although these developments create somewhat more order in European choice of law than exists in the US, they are not clearly a better approach to the law market than the apparently chaotic US system. The European rules lack a sound theoretical framework that would enable courts to consistently fill in the ambiguities. Moreover, the European rules necessarily fail to answer definitively the extent to which mandatory rules trump party choice. Without a sensible framework that responds to the current emerging

³¹ See Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 380 (2003) (discussing exceptions to applying law chosen in choice of law clauses).

³² See *id.* at 380 (discussing cases refusing to enforce contractual choice of law clauses as to tort claims).

³³ EC Convention on the Law Applicable to Contractual Obligations, Jan. 26, 1998 O.J. (C 27) 34.

³⁴ Regulation of the European Parliament and of the Council on the law applicable to non-contractual obligations, adopted July 11, 2007, effective January 11, 2009. The convention does not cover marriage and family obligations, wills, promissory notes, company law, trustees, privacy and defamation.

³⁵ See *Proposal For A Regulation Of The European Parliament And The Council, On The Law Applicable To Contractual Obligations*, Commission of the European Communities COM(2005) 650 final 2005/0261 (COD) (December 15, 2005).

revolution in global choice of law, the rules threaten to impede the law market's benefits while failing to help protect against its costs. Despite the fact that the American system for choice of law is far from perfect, in this regard, the European approach offers little instruction for U.S. reform.

A. ROME I

The Rome I proposed choice-of-law regulation for contractual obligations generally provides for enforcement of choice-of-law clauses,³⁶ with the main exception that the parties' choice is subject to "overriding mandatory provisions" rendering the performance of the contract "unlawful."³⁷ This contrasts with the Rome I Convention, which provides more broadly that "effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract."³⁸ The Convention defines "mandatory rules" as "provisions which cannot be derogated from by agreement."³⁹ Rome I Regulation states that "'overriding mandatory provisions' should be distinguished from the expression referred to for example in Article 3(3) and should be construed more restrictively."⁴⁰ The use of the word "unlawful" suggests that the contract is unenforceable only when the performance is prohibited by provisions of public law, rather than, for example, merely because of disparity in bargaining position.

The Rome I Regulation apparently gives much greater scope to the parties' contract than do the generally applicable choice-of-law rules for contract in the US, which are embodied in the contractual choice of law provision in Restatement (Second) of Contracts §187.⁴¹ This section qualifies enforcement of contractual choice not only where the chosen rule conflicts with the fundamental policies of a closely related jurisdiction or the forum, a rule similar to that under the Rome I Convention, but also where there is no reasonable relationship between the parties or transaction and the chosen jurisdiction, a limitation not found either in the Convention or the Regulation.⁴²

³⁶ See Rome I, *supra* note 35, Article 3.

³⁷ *Id.* Article 9(1).

³⁸ Rome I Convention, *supra* note 33, Article 7(1).

³⁹ *Id.* Article 3(3). This provision also requires application of the mandatory rules of the place where all the elements of the contract are connected.

⁴⁰ Rome I Regulation, *supra* note 35, Introductory clause 37. Article 3(3), referred to in the text, gives parties the right to change their governing law.

⁴¹ See Ribstein, *supra* note 31.

⁴² For an analysis highlighting similarities between U.S. law and European law under the Rome Convention, see Giesela Ruhl, *Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency*, CLPE Research Paper No. 4/2007, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=921842.

B. ROME II

The Rome II Regulation providing choice-of-law rules for tort cases offers a stronger contrast with US rules than does the Rome I Convention and Regulation.⁴³ The Regulation generally eschews American-style interest analysis, which looks to the content of individual laws, in favor of ostensibly more predictable jurisdiction-selecting rules like those used in the US in the early part of the 20th century. In general, Rome II applies the law of the country in which damage occurs, the traditional *lex loci delicti* rule, and determines that jurisdiction based on the last event giving rise to injury.⁴⁴

Although it provides for a jurisdiction-selecting rule rather than one based primarily on interest analysis, Rome II, like the Second Restatement, combines approaches by also looking to the parties' interests and country's legislative objectives:

A connection with the country where the direct damage occurred (*lex loci damni*) strikes a fair balance between the interests of the person claimed to be liable and the person sustaining the damage, and also reflects the modern approach to civil liability and the development of systems of strict liability.⁴⁵

This “fair balance” may not be obvious in practice. For example, it has been argued that where the law of the place of conduct contains a high conduct standard, applying a lower standard embedded in the law of the place of injury arguably would dilute the deterrence objective of the jurisdiction where the harmful conduct occurs.⁴⁶ Put differently, the justification for the rule does not acknowledge all potential interests.

To some extent, however, the rule does facilitate party choice. Often both victim and tortfeasor know where the place of injury is and therefore are in a position to plan their activities based on the applicable rule.⁴⁷ More importantly, the Convention aligns with choice facilitation in the important respect that it includes a specific rule respecting party autonomy.⁴⁸ However, the Convention makes political compromises that dilute choice-facilitation. The law of the place of injury does not apply where the parties have a common habitual residence,⁴⁹ or where the case is more closely connected to another jurisdiction.⁵⁰ There are also special rules for products liability, unfair competition and

⁴³ For an analysis of Rome II, Symeon C. Symeonides, *Rome II and Tort Conflicts: A Missed Opportunity*, 56 Am J. Comp. L. (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1031803.

⁴⁴ See Rome II, Section 4(1).

⁴⁵ *Id.* Recital 16.

⁴⁶ See Symeonides, *supra* note 43, at 20.

⁴⁷ See O'Hara & Ribstein, *supra* note 19.

⁴⁸ Rome II, Article 14; Article 4(3) (noting the relevance of preexisting relationships, including contract).

⁴⁹ *Id.* Section 4(2).

⁵⁰ *Id.* Section 4(3).

industrial actions.⁵¹ The following analysis focuses on two categories of exceptions: (1) product liability cases; and (2) choice-of-law clauses.

1. Products liability

Article 5 of the Rome II Regulation provides:

1. Without prejudice to Article 4(2), the law applicable to a non-contractual obligation arising out of damage caused by a product shall be:

(a) the law of the country in which the person sustaining the damage had his or her habitual residence when the damage occurred, if the product was marketed in that country; or, failing that,

(b) the law of the country in which the product was acquired, if the product was marketed in that country; or, failing that,

(c) the law of the country in which the damage occurred, if the product was marketed in that country.

However, the law applicable shall be the law of the country in which the person claimed to be liable is habitually resident if he or she could not reasonably foresee the marketing of the product, or a product of the same type, in the country the law of which is applicable under (a), (b) or (c).

2. Where it is clear from all the circumstances of the case that the tort/delict is manifestly more closely connected with a country other than that indicated in paragraph 1, the law of that other country shall apply. A manifestly closer connection with another country might be based in particular on a pre-existing relationship between the parties, such as a contract, that is closely connected with the tort/delict in question.

This rule usually will result in applying the law of the country where the victim habitually resided. Since it may be difficult for the manufacturer to determine where a future victim resides, this rule would seem less suitable from a mutual choice-maximization standpoint than a place-of-injury, or, better yet, a place-of-sale rule. However, this problem is significantly mitigated by the qualification that the state of victim residence applies only if the product was marketed in that country, which ensures that the manufacturer will have some control over the laws to which it finds itself subject. If the product was not marketed in any of the three main designated jurisdictions, the fallback is the place of manufacturer under the proviso, or perhaps the place of contract under subsection 2.

The main question concerning the rule from the perspective of our choice-facilitation theory relates to the drafters' preference for residence over sale or damage (in both cases subject to the marketing exception). As indicated in Part I, the place of sale arguably would be preferable from a choice-maximization standpoint. First, it is generally less costly for the seller to get information about how and where the product is sold than about who buys it. Second, the buyer might prefer the option of shopping in different countries for a mix of safety and price to being stuck with the rules in her

⁵¹ *Id.* Sections 5, 6 and 9, respectively.

country of residence.⁵² But to the extent that countries impose mandatory safety rules, they are more likely to be doing so on behalf of their residents than on behalf of local shoppers where these categories differ. Thus, party choice ends up giving way to state legislative intent.

2. Choice-of-Law Clauses

Rome II provides for enforcement of choice-of-law clauses for non-contractual obligations if the agreement was "entered into after the event giving rise to the damage occurred" or "where all the parties are pursuing a commercial activity. . . by an agreement freely negotiated before the event giving rise to the damage occurred."⁵³ There are three qualifications: (1) the choice must be "expressed or demonstrated with reasonable certainty by the circumstances of the case" and must "not prejudice the rights of third parties; (2) " the court must apply the law of the country where all relevant elements are located; and (3) European Community law takes precedence if all relevant elements are located in one or more Member States.⁵⁴

Apart from contractual choice of law, Rome II permits escape from the general rule where the tort has a "manifestly closer connection" with the law of another country.⁵⁵ Most interestingly from the standpoint of our analysis, these provisions specify that "[a] manifestly closer connection with another country might be based in particular on a pre-existing relationship between the parties, such as a contract, that is closely connected with the tort/delict in question."

Rome II thus makes somewhat clearer than is sometimes the case in the US that a choice-of-law clause may cover both contract and tort claims. This makes sense, since there is nothing inherent in the tort nature of the claim that necessarily should preclude private ordering concerning the applicable law. By contrast, Second Restatement § 187 states that enforcement applies to the "law of the state chosen by the parties to govern their contractual rights and duties,"⁵⁶ which can be taken to mean that the choice-of-law clause cannot work to choose the law to govern a tort claim.

However, although some aspects of Rome II happen to align with our choice-facilitation approach, its overall thrust is not motivated by that policy. Indeed, it is difficult to find any consistent policy rationale behind Rome II. Rather, Rome II expresses a penchant for political compromise in the interest of achieving some sort of harmonization. But without a coherent policy rationale, the general rules of Rome II may fail to produce the sensible order that businesses find attractive when making their locational decisions.

⁵² To be sure, these choices are unlikely to make much practical difference since consumers typically shop from or near their homes.

⁵³ Rome II, Article 14(1)(b).

⁵⁴ *Id.* Article 14.

⁵⁵ *Id.* Article 4(3) and 5(2).

⁵⁶ See Restatement (Second) of Conflicts, §187(1) and (2) (1971). In the case law, this issue generally arises as one of interpretation of contract rather than a general rule of validity. See Ribstein, *supra* note 31, ___, n. 55.

C. CONSTITUTIONAL RULES: MUTUAL RECOGNITION

Over the last thirty years the EC has developed rules within the framework of the "four freedoms" – that is, free movement of goods, of services and establishment, of persons and citizenship,⁵⁷ and of capital – embodied in the Treaty of Rome. These rules comprise a kind of "constitutional" restriction on the private international law rules of EC Member States, and by implication on the Convention and Regulation discussed above. In general, cases decided by the European Court of Justice have established a principle of mutual recognition that limits the extent to which European member state laws can be applied to burden commerce among Member States. These cases might, for example, place in doubt the application of the Rome II place of injury test to the extent that this would result in liability for products that complied with manufacturing and design standards in the home country.

Of particular importance to the issues in this paper are the provisions on free movement of goods and services and the right of establishment. With respect to the free movement of goods, the EC Treaty prohibits not only customs duties and discriminatory taxes, but also quotas and "measures having equivalent effect."⁵⁸ *Dassonville*⁵⁹ held that an exclusive importer arrangement that limited imports by other dealers due to the fact that only that importer could obtain the requisite certificate of authenticity had the effect of a restriction on trade.

Following *Dassonville*, *Cassis de Dijon*⁶⁰ extended commercial protection beyond overt member state discrimination. The ECJ held that Germany could not bar sale of a French liqueur that did not meet German standards for minimum alcohol content because the effect of the German rule would be to impose a second burden on a product that fully met home country standards. This rule has potentially very broad implications. In effect, the rule protects sellers of standardized products who would be subjected to an extra burden whenever they have to customize products for buyers in different countries.⁶¹ This could sharply restrict Member States' ability to impose any regulation or liability on sellers that differed from regulation or liabilities sellers faced in their home countries.

The ECJ retreated from the broadest implications of *Cassis de Dijon* in *Keck and Mithouard*,⁶² which held that member states could regulate "selling arrangements" of foreign goods (in this case, a rule against selling products at a loss), even if goods must then be modified for sale outside the home state, unless the regulation discriminates either specifically or in effect against goods from another Member State. In this more

⁵⁷ See EC Treaty, Article 39 of the EC Treaty (prohibiting restrictions on the basis of nationality).

⁵⁸ *Id.* Article 28.

⁵⁹ *Procureur du Roi v Benoit and Gustave Dassonville*, Case 8-74, European Court Reports 1974 page 0837.

⁶⁰ Case [120/78](#), *Rewe-Zentral v Bundesmonopolverwaltung fuer Branntwein* [1979] ECR 649.

⁶¹ See Basedow, *supra* note 18; Horatia Muir Watt, *Experiences From Europe: Legal Diversity and the Internal Market*, 39 TEX. INT'L L.J. 429 (2004).

⁶² Criminal proceedings against Bernard Keck and Daniel Mithouard, Joined cases C-267/91 and C-268/91 European Court Reports 1993 page I-06097.

recent case, the court expressed reluctance to embrace a broad mandate of economic freedom.⁶³

The right of establishment is set forth in Article 48 of the Treaty, which provides that companies formed in accordance with member state law shall “be treated in the same way as natural persons who are nationals of Member States.” In 1999 the European Court of Justice held under this provision in *Centros*⁶⁴ that Denmark could not bar a UK corporation from opening a “branch” in Denmark merely because the corporation had never done business in the UK. The Court held in later cases that Germany could not deny a Dutch corporation the right to sue,⁶⁵ and that the Netherlands could not impose local regulation on a locally-based company that had incorporated elsewhere solely in order to avoid these regulations.⁶⁶ These cases heralded constitutional protection for US-style corporate charter competition in Europe.⁶⁷

As to services, Article 50(3) of the Treaty prohibits discrimination in favor of nationals. Moreover, Article 49 goes beyond discrimination and in the direction of the protection of movement of goods by requiring member states to abolish restrictions on the freedom to provide services. Until such abolition, Article 54 requires member states to “apply such restrictions without distinction on grounds of nationality or residence.” For example, Belgium could not require a French licensed service to also hold a Belgian license⁶⁸ and Germany could not require a lawyer from another member country to hire a local attorney to officially handle client matters within Germany.⁶⁹ A similar approach

⁶³ *Id.*, para 14. For a discussion of these alternative bases of freedom of trade and protection of economic liberty, see JUKKA SNELL, *GOODS AND SERVICES IN EC LAW: A STUDY OF THE RELATIONSHIP BETWEEN THE FREEDOMS* (2002).

⁶⁴ *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, Case C-212/97 [1999] E.C.R. I-1459 (1999), 2 C.M.L.R. 551 (1999).

⁶⁵ *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)*, Case C-208/00 [2002] E.C.R. I-9919 (2002).

⁶⁶ *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, Case C-167/01, [2003], E.C.R. I-10155 (2003).

⁶⁷ European countries can still inhibit jurisdictional competition if justified “on grounds of public policy, public security or public health” under Article 46 of the Treaty of Rome. Countries can also regulate outside of company law, such as by imposing legal capital-type regulation under insolvency laws. See John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, ECGI Working Paper 54/2005 (June 2005), available at http://papers.ssrn.com/paper.taf?abstract_id=860444. They can also inhibit firms' ability to reincorporate in other countries, which would be a real constraint on the charter market. See *The Queen and HM Treasury and Commissioners of Inland Revenue ex parte Daily Mail and General Trust PLC* on the interpretation of Articles 52 and 58 of the EEC Treaty, and the provisions of Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services, Case 81/87, (OJ 1973, L 172, page 14) (holding that the right of establishment did not prevent the UK from blocking transfer of a company's headquarters to another country to keep the company from avoiding payment of capital gains tax).

⁶⁸ *Van Wesemael and Others*, Joined Cases 110 and 111/78 [1979] ECR 35.

⁶⁹ *Commission v. Germany (Lawyers' services)*, Case 427(85) [1988] ECR 1123.

has been embodied in the electronic commerce directive of 2000, though it accommodates conflicting public policies.⁷⁰

Although these rules have been analogized to US constitutional protection under the Commerce and Full Faith and Credit Clauses,⁷¹ in fact the European cases go beyond any duty the U.S. Constitution imposes on states to recognize other states' laws. The closest potential US analogy to the protections in the Treaty of Rome is under the Full Faith and Credit Clause which, like the Treaty, requires mutual state recognition of the lawmaking authority of other states. Justice Jackson described the clause as protecting against the "disintegrating influence of provincialism."⁷² However, as a practical matter, a state need have only some principled basis for refusing to follow another state's law. Although some old full faith and credit cases involving fraternal benefit organizations hold that the constitution compels application of the state in which the organization was formed,⁷³ this rule has never been applied beyond this limited context. *Allstate Insurance Co v. Hague*⁷⁴ indicates the current state of U.S. law. The Court let Minnesota apply its law to an insurance contract issued in Wisconsin to a Wisconsin insured and the accident occurred in Wisconsin simply because the decedent worked in Minnesota, his widow became a Minnesota resident after the accident, and the insurer was doing business in Minnesota. The Court thus indicated that under both the Full Faith and Credit and Due Process Clauses a state could apply local law as long as it had enough interest that it was not acting arbitrarily or unfairly. The main constitutional limit on a forum's power to choose its own law came in *Phillips Petroleum Co. v. Shutts*,⁷⁵ where the Court held that Kansas court could not apply its law to land leases with no connection to Kansas solely in order to "bootstrap" itself into position to hear a class action involving the leases.

Some U.S. Commerce Clause jurisprudence also should have a familiar ring to Europeans, because the Court has used this Clause to limit a state's ability to excessively burden interstate commerce. For example, the Court has struck down state regulation of the length of interstate trains,⁷⁶ and trucks,⁷⁷ as well as truck mudguard regulations that

⁷⁰ See Ralf Michaels, *EU Law as PIL? Reconceptualizing Country of Origin Principle as Vested Rights Theory*, Duke Law School Legal Studies, Research Paper Series Research Paper No. 122 August 2006, available at <http://ssrn.com/abstract=927479>.

⁷¹ See Watt, *supra* note 61.

⁷² Robert H. Jackson, *Full Faith and Credit-The Lawyer's Clause of the Constitution*, 45 COLUM. L. REV. 1, 17 (1945).

⁷³ See, e.g., *Order of United Commercial Travelers v. Wolfe*, 331 U.S. 586 (1947); *Sovereign Camp of Woodmen of the World v. Bolin*, 305 U.S. 66 (1938); *Modern Woodmen of America v. Mixer*, 267 U.S. 544 (1925); *Supreme Council of the Royal Arcanum v. Green*, 237 U.S. 531 (1915).

⁷⁴ 449 U.S. 302 (1981).

⁷⁵ 472 U.S. 797 (1985).

⁷⁶ *S. Pac. Co. v. State of Arizona*, 325 U.S. 761, 767 (1945).

⁷⁷ *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662 (1981); *Raymond Motor Trans., Inc. v. Rice*, 434 U.S. 429 (1978).

differed from those in place in other states.⁷⁸ However, the US has never come close to favoring state-of-origin regulation under the Commerce Clause.

In short, by limiting the extent to which European countries can burden the flow of commerce among the member states, the ECJ cases discussed above potentially offer much broader protection from the chaos created by disparate state laws than is available in the US. In several respects, however, the European cases are a dubious basis for rationalizing choice of law.

To begin with, the principle that emerges from these cases is murky. Since any rule that is imposed on an international good at the point of sale potentially could impede international trade, it is not clear when regulation should be allowed in the selling country. The courts might apply some sort of interest analysis in applying these rules. But what interests should the court attribute to the home and host countries? Should the court assume that home countries are interested in free trade while host countries want to protect consumers? If so, then what should we make of a case like *Alpine Investments*,⁷⁹ where the home country regulated cold-call securities sales, including those in other countries? The ECJ held that Article 59 of the Treaty of Rome does not preclude countries from regulating to “protect investor confidence in national financial markets.” But should this not instead be the job of the host country?⁸⁰

Second, *Keck*'s distinction between selling arrangements and product rules is problematic under the *Cassis de Dijon* dual-burden approach. Regulation of selling arrangements might have an effect similar to regulation of production standards in requiring standardized products to be customized for individual jurisdictions. For example, a seller may want to build a brand by imposing standard restrictions on resellers, or to enter into standardized contracts. A significant part of what makes franchising work is advertising and discipline at the franchisor level. Conversely, regulating production standards may not impose a dual burden to the extent that sellers easily can target sales to particular jurisdictions and design or price their products for those jurisdictions.

Most importantly from the standpoint of our analysis, the dual burden cases cannot be rationalized under our choice-facilitation approach. To be sure, the country-of-origin test makes it easy for manufacturers and sellers to choose the applicable law by deciding where to locate. However, it is important to emphasize that our approach is based on facilitating the contracting parties' *mutual* choice. Consumers are not clearly in a better position to evaluate the law of the seller's location than are sellers to choose in which countries to sell. On the other hand, the application of host country regulation of selling methods does not necessarily effectuate consumer choice, since it relegates consumer choice to selecting a country's entire body of selling method regulation through physical exit. Perhaps allowing the seller to choose country of origin regulation will lead to a race to the bottom because consumers are poorly informed. But it is not clear why applying the host country rule does not lead to an equally serious problem of over-regulation.

⁷⁸ See *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959).

⁷⁹ *Alpine Investments BV v. Minister van Financien*, Case C384/93 [1995] ECR I-1141.

⁸⁰ See SNELL, *supra* note 63 at 127.

Ralf Michaels draws a dichotomy between place-of-conduct rules, which he says support markets, and place-of-injury rules, which he says support state policies.⁸¹ However, the rules do not easily divide along these lines. If Europe's country-of-origin rule does not facilitate mutual choice of law, as discussed immediately above, then they arguably do not support well-functioning markets. A choice-facilitation approach might better reconcile the member states competing concerns than does Europe's unprincipled approach.

It might be said that the country-of-origin approach tracks firms' ability to choose the state of incorporation under the internal affairs doctrine, now constitutionally supported in Europe under the freedom of establishment. To be sure, the application of free establishment to corporate formation can be reconciled with the contractual approach to the extent that it effectively embodies the internal affairs doctrine, which we have shown is a rule for enforcing contractual choice of law.⁸² Perhaps consumers can be said to be buying into the goods' country of origin in the same sense that shareholders are signing onto the country of establishment or incorporation. But it is not clear that this works as well for products in consumer markets as for securities traded in efficient public securities markets.

In general, though the ECJ cases offer the US a way out of the murk that has been left by the choice of law revolution, the path is obscure and can easily turn into a maze without better guidance. To some extent the country-of-origin approach harks back to vested rights cases, which offered a clear general rule but that ignored state regulatory interests without a principled basis for doing so. Michaels argues that the country-of-origin rule offers the clarity of vested rights plus the firmer policy foundation of promoting free trade.⁸³ This principle cannot alone support healthy markets, however, because it has no natural limit: every law that affects goods coming from elsewhere potentially burdens trade. Michaels would impose a limit by applying the rule only to protect the formal granting of rights as by incorporation or license. But if incorporation is enough to trigger the principle, it is not clear why a choice-of-law clause also would not suffice. The internal affairs doctrine is essentially a choice-of-law rule.⁸⁴ There is no reason why the state's perfunctory role in the incorporation process should make a significant difference in promoting recognition of firm's choice of the incorporating state. This illustrates the need for a better approach to determining when the country-of-origin rule should apply.

D. SUMMARY

In short, Europe has uniform rules that not only generally codify choice of law, but offer greater assurance that choice-of-law clauses will be enforced than the mostly common law US rules. This is particularly true of contract cases, assuming that courts

⁸¹ See Michaels, *supra* note 7.

⁸² See Larry E. Ribstein & Erin A. O'Hara, *Corporations and the Market for Law*, ___ ILL. L. REV. ___ (forthcoming 2008).

⁸³ See Michaels, *supra* note 70.

⁸⁴ Ribstein & O'Hara, *supra* note 82.

interpret "unlawful" in the narrow way the Rome I Regulation evidently intends.⁸⁵ However, Rome II makes clear that this broad protection of choice-of-law clauses is not available to cases placed in the "tort" category, and that none at all applies to non-commercial tort situations. The ECJ cases provide a limited basis for allowing firms to rely on the permissive rules of their country of origin, but the principle underlying these cases is unclear, and it does not seem to be related to party autonomy. Thus, while Europe offers some protection for the law market, it is not a reliably safe harbor.

IV. EUROPE AND US LAW MARKET INSTITUTIONS

We have shown that Europe offers somewhat more clarity than the chaos of US choice-of-law rules. However, the lack of a principled basis for European rules and the gaps in their protection of party autonomy raise a doubt whether the European system will produce better results in terms of a more efficient market for law. This Part shows that the important difference between the US and Europe regarding choice of law amounts to that between rules and institutions. US institutions may be better suited to producing a robust market for law than Europe's general rules.

More specifically, the institutions of the US and European federal systems differ in at least three important ways that influence their accompanying markets for law. First, the cultural, legal, and language differences are greater among European countries than among US states.⁸⁶ These differences create greater barriers to mobility in Europe, and the lesser mobility will result in less powerful discipline of member nation lawmaking.

Second, the federal government plays different roles in the US and Europe. Congress can act fairly quickly and effectively to respond to protect States from one another and to respond to powerful interest groups. In contrast, the European Parliament may take years to adopt a broad directive, and when it acts the directive may have less direct effect than an US federal law. Also, while the US Supreme Court has been much less active in actively promoting jurisdictional competition than has the ECJ, federal courts in the US have played a subtle but important role in facilitating jurisdictional competition that cannot be replicated in the European Union. Specifically, the US federal courts provide a venue for litigation by parties from different states. Because state courts may display a home bias, the federal courts may prove particularly hospitable to interstate firms defending against local firms. Indeed, an extensive survey of cases involving choice-of-law clauses indicates that federal courts are more likely to enforce party choice of governing law than are the U.S. State courts.⁸⁷ Thus, the US federal government arguably imposes a more effective constraint on US state legislatures and courts than does the European federal government.

Third, cutting against these advantages of the US federal system, Europe's institutions are better able to achieve coordination through private international law rules at the federal level than can the US. Congress and the US courts have shown no taste for enacting choice-of-law rules. By contrast, choice of law in Europe has moved to the top

⁸⁵ See *supra* text accompanying note 40.

⁸⁶ See Christian Kirchner & Richard Painter, *Regulatory Competition in EU Corporate Law After Inspire Art: Unbundling Delaware's Product for Europe*, 2 *European Company and Financial Law Review*, no. 2 (2005).

⁸⁷ See Ribstein, *supra* note 31. See also O'Hara & Ribstein, *supra* note 21, Ch. 4.

of the legal agenda as a free trade issue. Thus, to the extent that uniform choice-of-law rules are capable of producing an efficient system, Europe is better able than the US to produce these rules. In an area such as electronic commerce, which is outside the classic contractual choice of law scenarios, Europe has been able to use its rulemaking advantage as a basis for developing private international law rules. Unfortunately, as discussed above, Europe has failed to fully capitalize on that international lawmaking advantage because its rules have been motivated partially by political compromise that compromises coherent policymaking.

To illustrate the two systems in operation, consider an example of how enforcement of jurisdictional choice has been established in the two settings. In the US, although the internal affairs doctrine in corporate law has never received Constitutional protection, it developed early in corporate history because of firms' ability to avoid states that would not recognize it.⁸⁸ By contrast, most of Europe clung to the real seat rule until that rule was effectively upended by ECJ cases applying the right of establishment in the Treaty of Rome. Analogously, routine enforcement of contractual choice of law has developed in the US as a result of court decisions and individual state statutes,⁸⁹ while in Europe routine enforcement was imposed by the Rome I Convention. Other types of jurisdictional competition have developed in the US as an accidental or intentional byproduct of specific federal laws.⁹⁰ Thus, party choice has developed and strengthened in both the US and Europe, but by different routes: dynamic competition in the U.S. and top-down constitutional rule in Europe.

Both the European and US approaches have their advantages and drawbacks. Top-down lawmaking can be quicker, but as we have seen in our analysis of Rome II, may be more likely to reach wrong results. The dynamic forces of jurisdictional competition may take some time, but the presence of a framework in which all of the relevant interests can be heard makes it more likely that the evolution will produce efficient results.

Since the US and European systems each have desirable features, perhaps the best outcome is for them to converge. The US might adopt some variation on the coordination mechanisms that are starting to take hold in Europe – Rome I and Rome II and constitutional rules preventing individual states from imposing excessive regulatory burdens. Then, perhaps, state courts in California or Illinois would not be able to regulate national firms through litigation.

At the same time, Europe might borrow from the US and become a more open and dynamic system in which firms can avoid oppressive laws and in which jurisdictions like Delaware and South Dakota can essentially sell their laws in a national market. One possible way to achieve that result could be through widespread adoption of the Hague Convention on Enforcement of Judgments.⁹¹ If parties can effectively choose their law by

⁸⁸ See Ribstein & O'Hara, *supra* note 82.

⁸⁹ See O'Hara & Ribstein, *supra* note 21, ch. 3-4; Ribstein, *supra* note 31.

⁹⁰ An example is the competition for trust law, which was triggered by U.S. tax laws. See Robert H. Sitkoff & Max Schanzbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005).

⁹¹ Convention on the Recognition and Enforcement of Foreign Judgment in Civil and Commercial

choosing where to litigate, then the Convention could help to introduce an American-style law market in Europe.

Indeed, it may be that Europe already is experiencing a version of a US-style law market. As discussed above, there has been a distinct evolution from the Rome I Convention to the Rome I Regulation regarding enforcement of party autonomy.⁹² This movement was evident very recently in a shift from the June, 2007 draft to the December, 2007 draft, which adopted the current restrictive language on application of connected countries' mandatory rules.⁹³ It is possible that these moves reflect the recognition of key interest groups in Europe that mobile parties will avoid non-enforcing countries or use arbitration or other mechanisms to control their governing laws. If so, European countries had little to lose by officially embracing party autonomy in contract cases. Thus, party mobility may already be having a political effect in Europe.

Although Europe can emulate some aspects of the U.S. system, it would do well to capitalize on its advantages as well. The EU can use its greater capacity for top-down rulemaking to do what the U.S. has not shown a willingness to do – adopt a federal choice-of-law statute. In particular, the European Parliament might adopt a federal choice-of-law statute like the one we have elsewhere proposed for the US.⁹⁴ Our proposed statute theoretically could constrain states from inefficiently prohibiting enforcement of choice-of-law clauses by requiring prohibitions to be embodied in state statutes rather than imposed ad hoc by courts. This would force interest groups to incur costs to enact super-mandatory rules, thereby providing a measure of public support for such rules. Analogously, European Union member states might be required to designate their statutes as super-mandatory in order to be entitled to have their restrictions upheld by the ECJ. Once designated as super-mandatory, however, those laws should be entitled to respect in all the other member states.

Such a rule arguably would be only a short step from the current provisions of the Rome I regulation, which gives super-mandatory effect only to a limited category of laws. The difference is that instead of leaving it up to the ECJ to define "unlawful" on a case-by-case basis, creating uncertainties about the limits of this category, individual countries could clearly identify these rules at the time they enact the relevant statute.

It is far from clear, however, whether these reforms would promote a law market in Europe. Because of the basic institutional differences between Europe and the US discussed above, firms and individuals inherently have less mobility in Europe than they do in the US. Europeans therefore are less able to use exit or the threat of exit to effectively oppose super-mandatory rules. Because mobility is so crucial to the operation of the law market, it is not clear how much difference these fixes would make in a system where mobility is more costly. On the other hand, higher mobility costs are likely to have greater effects on some industries than on others. Language and custom barriers do not always prevent a market for law in, for example, shipping regulations, just as they have not prevented a rapid expansion of outsourcing.

Matters.

⁹² See *supra* text accompanying notes ___.

⁹³ [need to add cite]

⁹⁴ See O'Hara & Ribstein, *supra* note 21, ch. 10.

V. CONCLUSION

The goal of a choice-of-law system should be to maximize efficiency by both effectuating political sovereignty and enabling jurisdictional choice. The first choice-of-law revolution recognized jurisdictions' competing claims in an increasingly mobile world. A second revolution is underway which is increasingly empowering individuals and firms to choose the applicable law. Our theory seeks to accommodate this second revolution with the competing claims of state sovereignty.

This paper analyzes developments in US and European choice of law against this background. The first choice-of-law revolution seemingly has left the US in chaos by giving state courts and legislatures wide scope to effectuate parochial interests. In Europe, meanwhile, uniform and federal choice-of-law rules are being developed that seem to impose some order on choice of law. It therefore might seem that the US would have much to learn from Europe.

On closer examination, the rules in Europe lack a firm foundation and therefore may not provide much guidance. At the same time, peeking through the chaotic weeds of the US system is a kind of disciplined order based on individuals' ability in many situations to contract for the applicable law, backed by the federal government's ability to intervene when the states fail to regulate sensibly. These basic institutional differences between the two regions may prevent complete convergence.

Nevertheless, we see some potential for converging approaches, where the U.S. learns that there are advantages to some federal lawmaking regarding choice of law, while Europe sees the advantages of an open, dynamic approach. The two systems ultimately may find different tradeoffs between voice and exit, but they can learn from each other in finding the way.

Finally, it is important to emphasize that our analysis is at least as much positive as it is normative in nature. We have suggested not only that institutions *should* be designed to reflect the type of mobility that provides a basis for the law market, but that party mobility in fact drives a law market even under current rules. Our analysis lends itself to empirical testing. Specifically, do the choice-of-law rules that we actually observe arise from party mobility in Europe, or are they simply the results of conventional political lobbying? From this perspective, Europe offers an opportunity for comparative institutional analysis that could deepen our understanding of how the law market works.