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THE COSTLY PROBLEM OF POORLY DRAFTED CHOICE OF LAW CLAUSES

Daniel C.K. Chow*

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I. CHOICE OF LAW CLAUSES IN THE LITIGATION OF CONTRACT DISPUTES

Professor John Coyle’s Article, *The Canons of Construction for Choice-of-Law Clauses*,¹ illustrates why lawyers and their clients dislike choice of law issues that arise in the litigation of business disputes. Resolving choice of law issues can lead to unpredictable results, and can be time-consuming and costly. For example, suppose that A, a seller of goods, enters into a contract to sell goods to B, a buyer, located in a different jurisdiction. The seller delivers goods that do not meet the expectations of the buyer and a dispute arises. Suppose that, after trying unsuccessfully to resolve the dispute informally, the parties reluctantly enter into court-based litigation over the dispute when a basic preliminary legal issue arises in the trial: which substantive law governs the sales contract? In the absence of an effective choice of law clause, if A brings a lawsuit in the jurisdiction in which A has its headquarters, then the court will decide the choice of law issue using the choice of law rules of A’s jurisdiction. If instead B brings the lawsuit in B’s

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1. 92 WASH. L. REV. 631 (2017).

jurisdiction, then that court will decide the choice of law issue based on the choice of law rules of B's jurisdiction. While both sets of choice of law rules might use some variation of the basic modern approach of a multi-factor balancing test,² the outcomes of such balancing tests are difficult to predict. Each jurisdiction might apply the test differently, giving more or less weight to different factors over others so neither the buyer nor the seller can be certain of the outcome ahead of time.³

Moreover, according to the prevailing conflicts approach,⁴ the choice of law determination needs to be made separately on each legal issue,⁵ adding to the complexity and cost of the task. If, in our hypothetical, the sale is an international sale of goods, the choice of law issue might involve choosing between two different national laws in different languages. In that case, legal experts would need to be hired to offer their interpretations of foreign law.⁶ Often times, the end result in a dispute involving an international sales contract brought in a U.S. court is that foreign law governs some issues and U.S. law governs others,⁷ making the trial complex and tedious. Worse yet, the resolution of the choice of law issue is merely a preliminary issue within the larger trial.⁸ Once the applicable law has been chosen, the court still must decide the basic issue on the merits—in our hypothetical, the condition of the goods—in accordance with the chosen law. No wonder most clients find choice of law issues to be overly complex and wasteful.

The complex, unpredictable, and costly nature of choice of law litigation is why it is now common practice for contracting parties to

2. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (AM. LAW INST. 1971) (the factors to be balanced include the following: the place of contracting, the place of negotiation of the contract, the place of performance, the location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation and place of business of the parties).

3. *Compare* Bell Helicopter Textron, Inc. v. Arteaga, 113 A.3d 1045, 1053–60 (Del. 2015), with *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 848–50 (Tex. 2000).

4. *Compare* Bell Helicopter Textron, Inc. v. Arteaga, 113 A.3d 1045, 1053–60 (Del. 2015), with *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 848–50 (Tex. 2000).

5. *Compare* Bell Helicopter Textron, Inc. v. Arteaga, 113 A.3d 1045, 1053–60 (Del. 2015), with *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 848–50 (Tex. 2000).

6. In an international context, one possibility is that the court in A's jurisdiction will choose the substantive law of its jurisdiction; B's court will choose the law of B's jurisdiction. A's court might be hesitant to choose the law of B's jurisdiction, which might be a foreign law in a foreign language. This could lead to a race to the courthouse and to a battle of anti-lawsuit injunctions. *See* DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 690–94 (3rd ed. 2015).

7. *See, e.g.,* ITAR-TASS Russian News Agency v. Russian Kurier, Inc., 153 F.3d 82, 90–92 (2d Cir. 1998) (issue of ownership of copyright governed by Russian law while infringement governed by U.S. law).

8. *See* Joan Steinman, *Reverse Removal*, 78 IOWA L. REV. 1029, 1049 (1993).

agree upon a particular jurisdiction's law at the outset before a dispute erupts in a written choice of law clause in the sales contract.⁹ Suppose that, in order to avoid the complexity of choice of law litigation just described, the parties in our hypothetical insert a choice of law clause into their contract, choosing the law of A's or B's jurisdiction or a third law. The approach of U.S. courts today is to accept the parties' choice of law in most cases and not to reject it unless the law chosen has no connection to the parties or to the transaction that is the subject of the dispute.¹⁰ Yet, suppose that instead of carefully drafting a choice of law clause or finding a suitable sophisticated modern model clause, the lawyers for the seller and the buyer simply use a generic or boilerplate choice of law clause. In that case, there is a good chance that the parties will find themselves in the thick of litigation because the boilerplate clause will likely contain gaps and ambiguities that the court will need to fill or resolve through judicial interpretation.¹¹ The lawyers for the seller and the buyer will offer the court contending interpretations that favor their respective clients and the parties will find themselves right back in the situation that the choice of law clause was intended to avoid: embroiled in costly and wasteful litigation over preliminary issues of choice of law.

II. CHOICE OF LAW AND INTERPRETIVE TOOLS FOR THE COURTS

The preceding scenario is the basic situation described and dissected in Professor Coyle's Article.¹² Based on exhaustive research, the Article identifies a number of common gaps and ambiguities in generic choice of law clauses and makes a significant contribution to the academic literature by identifying the canons of construction and the interpretive presumptions which courts have developed to fill in the gaps and resolve

9. *See id.*

10. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (AM. LAW INST. 1971) ("The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue unless either (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.").

11. Coyle, *supra* note 1, at 697–99.

12. *Id.*

the ambiguities.¹³ Part II of the Article sets forth the most common gaps and ambiguities as follows with the canon of construction following in brackets:

1. When the choice of law clause chooses the law of jurisdiction X, does the choice mean just the internal law of X or does it include X's choice of law rules? [Internal law only]¹⁴
2. Does the choice of law clause choose substantive law or does it also include procedural law? [Substantive law only]¹⁵
3. Are the terms "governed by," "interpreted in accordance with," or "construed in accordance with" the law of a particular jurisdiction equivalent or do they have different meanings? [They are equivalent]¹⁶
4. When the clause chooses the law of a state, does the law include federal law, which then preempts state law? [Preemptive federal law]¹⁷
5. Does the clause refer to choice of law for contract claims only, or does it also include tort and statutory claims? [Contract claims only] [Contract claims plus related tort and statutory claims]¹⁸

The last item on this list dealing with the scope of the choice of law clause indicates that there are two opposing judicial approaches. One approach finds only contract claims to be within the scope of the choice of law clause;¹⁹ the other holds that related tort and statutory claims are also included within the scope of the clause.²⁰ Each approach has adherents in different jurisdictions.²¹

Professor Coyle's Article then goes on to assess the canons by examining whether they reach results that are consistent with the expectations of the parties.²² To make this assessment, the Article used a series of questionnaires and e-mail exchanges with eighty-six practicing lawyers.²³ The Article finds that while lawyers agree with most of the

13. *Id.*

14. *Id.* at 643–47.

15. *Id.* at 648–55.

16. *Id.* at 656–61.

17. *Id.* at 661–66.

18. *Id.* at 666–80.

19. *Id.* at 666–72.

20. *Id.* at 672–80.

21. *Id.* at 673–80.

22. *Id.* at 688–700.

23. *Id.* at 639.

results reached under the canons, at least two of the canons produce results that are inconsistent with the expectations of the parties.²⁴ The Article then argues that these canons should be replaced and that the courts should adopt interpretive results more consistent with the expectations of the parties.²⁵

III. A ROLE FOR THE LEGAL ACADEMY GOING FORWARD

The work of identifying existing legal problems in doctrinal law and offering a scholarly resolution to the identified problems is one of the core duties of the legal academy.²⁶ In many cases, the legal academy addresses the judiciary in offering solutions to resolve a doctrinal problem because the judiciary is frequently the most effective agent of change.²⁷ The Third Restatement of Property,²⁸ for example, is not so much a restatement of existing law; rather, it is more of an attempt to influence courts to adopt changes to the ancient common law property rules that can be traced to medieval England but that are out of place in the modern U.S. economy and society.²⁹ This exhibited preference for inducing change by attempting to influence the courts³⁰ makes sense when change is sought in common law fields such as real property and contracts, where much of the law is judge-made on an incremental basis. Professor Coyle's Article falls within this time-honored tradition.

However, in the case of the problem of costly and wasteful litigation that is incurred due to poorly drafted choice of law clauses, the most effective avenue for change is not in offering U.S. courts new interpretive tools to resolve the gaps and ambiguities in poorly drafted choice of law clauses. Rather, the most effective method is for the legal academy to directly address the needs of the contracting parties who are responsible for drafting the choice of law clauses. While this can be done by drafting model choice of law clauses geared toward modern international business,³¹ more than offering model clauses is required.

24. The two canons inconsistent with the parties' expectations are the canon against non-contractual claims and the canon in favor of substantive law. *Id.* at 648–72.

25. *Id.* at 706–08.

26. See Michael L. Closen & Robert J. Dzielak, *The History and Influence of the Law Review Institution*, 30 AKRON L. REV. 15, 22–23 (1996).

27. See *id.*

28. RESTATEMENT (THIRD) OF PROPERTY (AM. LAW INST. 2007).

29. See Anita Bernstein, *Onlookers Tell an Extraordinary Entity What to Do*, 79 BROOK. L. REV. 381, 394 (2014).

30. Closen & Dzielak, *supra* note 26.

31. Professor Coyle's Article contains such model clauses. See Coyle, *supra* note 1, at 646–47.

The legal academy can more effectively assist the parties by identifying and analyzing the issues that frequently arise in choice of law adjudication that many parties seem to either ignore or misunderstand. That way, the parties can make an informed choice on these issues at the outset and actually achieve the desired result. The discussion in section II.B below of the United Nations Convention on Contracts for the International Sale of Goods³² (CISG) is one prominent example of an area where many parties need to make more informed choices.

There are at least three reasons why an approach focusing on the parties, not the courts, is preferable.

A. The Slow Pace of Change in U.S. and International Courts

Attempts to influence courts in their interpretations of the law are inefficient because courts are independent actors who rarely respond to outside influences. As an example, the drafters of the Restatements of Property have spent several decades attempting to influence the interpretation of common law real property rules without any noticeable progress.³³ Attempts to influence the courts to replace certain canons of construction with new ones in the interpretation of boilerplate choice of law clauses might meet a similar response.

As litigation moves beyond the domestic sphere to the international sphere, the shortcomings of an approach focusing on the courts become even more evident. Many contracts today involve not only domestic transactions but also international transactions, a trend that is likely only to increase.³⁴ The court that is faced with filling in the gaps and ambiguities left unresolved by a choice of law clause might be a court in a foreign nation. Even if U.S. courts were to adopt new canons of construction and approaches proposed by the American legal academy, international courts are unlikely to be as receptive. If one of the parties brings a lawsuit in a foreign court, the court will apply its own conflicts rules to resolve a choice of law dispute and will probably ignore any attempt by the American legal academy to influence the approach of U.S. courts. For example, if a sales contract involves the sale of goods from a seller in the United States to a buyer in France and the dissatisfied buyer brings a lawsuit in a French court, the court will apply

32. United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. Treaty Doc. No. 98-9 [hereinafter CISG].

33. See Bernstein, *supra* note 29, at 394.

34. Ya-Wei Li, Note, *Dispute Resolution Clauses in International Contracts: An Empirical Study*, 39 CORNELL INT'L L.J. 789, 797 (2006).

its own conflicts rules and resolve any ambiguities in a choice of law clause in accordance with local rules. There is little chance that the French court will pay any attention to canons of construction used by U.S. courts. As international contracts grow in number and their disputes are increasingly resolved in foreign jurisdictions, judicial canons of construction that are limited to U.S. courts become even less useful. On the other hand, while foreign courts are not likely to be receptive to U.S. interpretative presumptions, they are far more likely to enforce a well-drafted choice of law clause.³⁵ As set forth in section III.C below, the stakes involved in having a well-drafted choice of law clause are much higher in an international context.

B. The Expectations of the Parties and Awareness of Unresolved Legal Issues in Choice of Law

Professor Coyle's Article points out that the empirical research into the expectations of the contracting parties reveals that U.S. parties are completely unaware of some of the gaps and ambiguities in generic choice of law clauses.³⁶ This lack of awareness by the parties of some of the basic issues involved in modern choice of law analysis points to a pressing need for U.S. parties to pay closer attention to these issues so they can make informed decisions. The legal academy can meet this need by identifying the issues which parties are most often unaware of and by providing scholarly analysis of those issues.

One prominent example of a fundamental issue that often eludes U.S. parties is the role of the CISG³⁷ in international commercial sales contracts.³⁸ Many U.S. lawyers are unaware that the CISG automatically governs commercial contracts for the international sale of goods when the parties have their places of business in different contracting nations.³⁹ For example, both the United States and Germany are contracting states to the CISG, so if the seller has its place of business in

35. For example, in the European Union, currently consisting of twenty-eight European countries, Article 3 of Rome I states that "[a] contract shall be governed by the law chosen by the parties." Regulation 593/2008, ch. 2, art. 3, 2008 O.J. (L177) 10 (EC). Rome I is intended to harmonize the approach of all EU states on choice of law issues involving contractual obligations. *See id.*

36. Coyle, *supra* note 1, at 697–99.

37. *See* CISG, *supra* note 32.

38. Most U.S. lawyers do not learn about the CISG in law school contract classes, except by way of passing it at all. The author taught first year contract using a popular casebook that did not include a single reference to the CISG.

39. *See* CISG, *supra* note 32, at art. 6, 12 ("The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.")

the United States,⁴⁰ and the buyer has its place of business in Germany, a commercial contract is automatically governed by the CISG unless the parties opt out.⁴¹ As most important trading nations are members of the CISG,⁴² most international commercial sales contracts are governed by the CISG. When U.S. parties are aware of the CISG, many parties will seek to opt out of the CISG in favor of local law.⁴³ However, even in that scenario, a common problem is that many parties are unable to effectively opt out of the CISG through choice of law clauses because the language of the clause is not sufficiently precise.⁴⁴

The desire to opt out of the CISG also points to an even more basic issue: an almost reflexive preference for U.S. law (i.e., the Uniform Commercial Code) without first thoroughly investigating whether the parties would be better off under U.S. law, the CISG, or some other foreign source of law. More attention by the legal academy to this issue and other issues presently ignored by U.S. parties could provide direct benefits in the drafting of more sophisticated international contracts that avoid costly and time-consuming litigation.⁴⁵

C. *International Dispute Resolution*

Much of the discussion so far has focused on choice of law issues that arise in court-based litigation, but in international contract disputes, litigation is not the preferred method of dispute resolution. Rather,

40. *See* CISG, *supra* note 32, at art. 10.

41. *See id.* at art. 6.

42. *See Status: United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)*, UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html [<https://perma.cc/9H34-S3UV>].

43. *See* CHOW & SCHOENBAUM, *supra* note 6, at 33 (citing cases in which parties attempted—unsuccessfully—to opt out of the CISG).

44. *See id.*

45. U.S. lawyers seem to have a strong preference for the Uniform Commercial Code over the CISG based upon a prejudice in favor of using U.S. law over other sources of law. *See id.* As a result, they often attempt to opt out of the CISG in favor of the UCC. However, many opt out clauses are poorly drafted resulting in needless litigation. *See id.* However, under some factual scenarios, the U.S. party would be better off under the CISG than under the UCC. *See id.* at 200 (discussing at note 1 a factual scenario under which a U.S. seller would be better off under the CISG than under the UCC). The legal academy can assist the practicing bar by showing how the CISG can be better for U.S. parties under some circumstances. This would allow U.S. lawyers to come to a more sophisticated understanding of the CISG and so they will not always want to opt out of the CISG, leading to the costly litigation over poorly drafted opt out clauses. In the alternative, a more sophisticated understanding of the CISG and why it is part of U.S. federal law will allow lawyers who wish to opt out of the CISG in favor of the UCC to draft more precisely and effective choice of law clauses.

parties today have a strong preference for arbitration over litigation in international business disputes.⁴⁶ Arbitration has the benefits of speed, efficiency, enforceability of the decision,⁴⁷ and the mitigation of hostilities that may arise from adversarial court-based litigation that could irreparably damage the business relationship of the parties.⁴⁸ Addressing the courts as a method of dealing with unresolved choice of law issues in litigation overlooks the preference of modern parties to use arbitration to resolve their international business disputes. Instead, the focus should be on drafting an effective arbitration agreement.

Choosing arbitration over litigation as the preferred method of dispute resolution requires a well-written arbitration agreement. Refined canons of construction aimed at the judiciary cannot address this need. Without a well-written arbitration agreement, litigation may be the only alternative.⁴⁹ Among the issues that the written arbitration clause must address is the scope of the arbitration (i.e., the claims that the parties agree are subject to the arbitration). Most parties do not wish to subject every conceivable claim to arbitration as that would undermine one of the benefits of arbitration: a narrow scope to streamline the resolution of particular issues. Professor Coyle points out that one of the ambiguities in generic choice of law clauses is that they do not specify all of the claims that are subject to choice of law.⁵⁰ This ambiguity is less likely to exist in arbitration agreements because parties who choose arbitration will need to make a conscious choice about the scope of the claims subject to arbitration. By having to specify the scope of the claims subject to arbitration, the parties are also required to think about the scope of the claims subject to choice of law because the same type of claims subject to arbitration are also subject to choice of law. While parties to a choice of law clause might not pay attention to this issue, parties to an arbitration clause will usually consider it because the scope of the arbitration is a basic issue that all parties will need to address.

Parties to an international contract dispute have strong incentives to draft an effective arbitration agreement. Without one, an international

46. *See id.* at 592–93.

47. The Convention for the Recognition and Enforcement of Foreign Arbitral Awards creates an effective enforcement mechanism for arbitral awards in the international arena. *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. 5, June 10, 1958, S. Treaty Doc. No. 90-21.

48. *See* CHOW AND SCHOENBAUM, *supra* note 6, at 592.

49. Susan L. Karamanian, *The Road to the Tribunal and Beyond: International Commercial Arbitration and United States Courts*, 34 GEO. WASH. INT'L L. REV. 17, 33–36 (2002).

50. Coyle, *supra* note 1, at 666–67.

dispute has the potential of being brought in any jurisdiction in which the transaction comes into contact.⁵¹ In modern commerce, the international sale of goods involves the transport of goods, usually by ocean carriage, from the seller to the buyer. A lawsuit can potentially be brought in any jurisdiction with which the vessel transporting the goods comes into contact.⁵² To avoid these uncertainties, the parties need to draft an effective arbitration agreement that selects an exclusive forum in which disputes can be brought, such as the London Court of Arbitration, the International Chamber of Commerce based in Paris, or the China International Economic Arbitration Commission. As part of the arbitration agreement, the parties need to include a choice of law provision that will bind the arbitrators. The arbitration agreement should include, in addition to a clause dealing with choice of law, clauses on choice of forum, choice of arbitrators, and choice of language. The legal academy can contribute to effective dispute resolution of international contracts by providing legal analysis of the many issues that the parties must consider in drafting an effective arbitration agreement, which includes a comprehensive choice of law clause.

CONCLUSION

Professor Coyle's Article demonstrates that reliance by the parties on generic or boilerplate clauses is a poor and costly method for dealing with the modern need for an expertly drafted choice of law clause. Sophisticated parties with deep pockets may be able to achieve expertly drafted dispute resolution clauses, but even some of these parties might not be aware of the many complexities in modern dispute resolution and might not be making a conscious choice on these issues. Less sophisticated parties have fewer options to avoid costly litigation. When the parties use a generic or boilerplate choice of law clause, the parties might find themselves embroiled in costly litigation over the meaning of the many gaps and ambiguities in such clauses.

The most effective method of avoiding the costly and wasteful litigation that ensues from the use of poorly drafted or boilerplate choice of law clauses is for the parties to draft effective choice of law clauses, not to provide interpretive tools to the courts for resolving ambiguities in poorly drafted clauses. The legal academy can assist parties in achieving this result. But the parties are best served not simply by having better model clauses but by having a better understanding of the many complex

51. *See* *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13–14 (1972).

52. *Id.*

issues in modern choice of law, issues that many parties overlook. This gap is especially acute in international contract disputes. Having an understanding of the issues that arise in choice of law analyses will help the parties make informed choices that they cannot make if they simply adopt model clauses that they do not fully understand. The legal academy can fulfill an important need by directly addressing the needs of the parties so that the parties can make an informed choice on the many issues involved in choice of law clauses. With the help of the legal academy, the parties can draft or adopt effective choice of law clauses that avoid the need for costly and wasteful litigation.