2008

Rules and Institutions in Developing a Law Market: Views from the United States and Europe

Erin O'Connor

Rules and Institutions in Developing a Law Market: Views from the United States and Europe

Erin Ann O'Hara*
Larry E. Ribstein†

Developments in European choice of law seem to offer the United States 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 United States. 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 United States. However, decentralized American-style federalism might have something to offer Europe because choice of law in the United States 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 United States and Europe have advantages that each could learn from the other.

 Professor of Law, Director, Law and Human Behavior Program, and Associate Dean for Academic Affairs, Vanderbilt University Law School. B.A. 1987, University of Rochester; J.D. 1990, Georgetown University Law Center. Thanks to Larry Helfer for advice and guidance on this project.

† Professor of Law, Mildred Van Voorhis Jones Chair, University of Illinois Urbana-Champaign College of Law. B.A. 1968, John Hopkins University; J.D. 1972, University of Chicago Law School.

I. INTRODUCTION

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 noncontractual obligations (referred to here as Rome II) provide general answers for a wide range of conflict of laws questions. In addition, 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 from the application of multiple laws where this could impede trade and travel in the European Community.

Meanwhile, the United States continues to muddle through, as people and firms face disparate choice-of-law regimes across the states that force them to be subject to both unsuitable substantive legal rules and considerable uncertainty about what rules apply to their transactions in the first place. While federal law theoretically plays a role through the Due Process[1] and Full Faith and Credit[2] 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 United States in choice of law, its lessons for the United States are not as clear as they might seem. In order to evaluate properly American 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-

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 94-104.

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.[6]

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 due to their ability 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 international markets gives firms a strong incentive to seek federal or global standards when states refuse to enforce contractual choice.[7] In short, states must either get on the jurisdictional-choice bandwagon or lose their power to regulate altogether. As a result, 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 either repeal these laws or enforce 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.

---

4. *See, e.g.*, EUGENE F. SCOLES & PETER HAY, CONFLICT OF LAWS 15-41 (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 9-35 (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, 281 (1966); Willis L.M. Reese, *Choice of Law: Rules or Approach*, 57 CORNELL L. REV. 315, 330 (1972); Joseph William Singer, *Real Conflicts*, 69 B.U. L. REV. 1, 33-34 (1989).

6. *See* SCOLES & HAY, *supra* note 4, at 15-41; SYMEONIDES, *supra* note 4, at 9-35.

7. *See* SCOLES & HAY, *supra* note 4, at 652-75.

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 Article evaluates European and American 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 Rome show some promise in constraining the costs of fragmented regulation. However, no general rules, including those in Europe, can fully specify the situations in which states' or nations' mandatory rules should trump parties' power to specify the applicable law in their contracts. To make matters worse, European default rules on choice of law lack any central theory, including one designed to accommodate the development of a market for law, which may make it harder to resolve ambiguities in those rules. Thus, despite the European Union's substantial investment in developing uniform choice-of-law rules, member nations cannot fully reap the efficiency gains of the law market.

On the other hand, despite the U.S. failure to squarely address the challenges of conflicting jurisdictions in a global trade environment, the United States' 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 U.S. experience offers lessons for Europe.

In general, our analysis contrasts two approaches to conflict of laws—a European-type system based on centralized substantive *rules* that determine the applicable law and an American-type system offering *institutions* that facilitate mobility and other pressure on jurisdictions to recognize party autonomy. Additionally, the institutional approach is necessarily *dynamic* in that it 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 II below describes the most important objectives of choice of law in a law market. Part III provides a brief glimpse of American conflicts rules, primarily to set up the comparison with the European approach. Part IV discusses the emerging European rules under Rome I and II and the European Court of Justice's interpretation of the Treaty of Rome. Part V revisits European 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 United States ultimately has an edge in its ability to provide a dynamic framework in which an effective law market can operate.

II. THE OBJECTIVES OF CHOICE OF LAW

This Part provides a basis for analyzing choice-of-law rules that we will use to assess American 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 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 simultaneously defects in political markets on the one hand and in commercial markets on the other.[8] We see two basic mechanisms for maximizing social welfare—the political process, or voice, and jurisdictional competition, or exit.[9] Individual interests are sometimes best served by exit, and other times by voice. Ideally, law 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 transactions. In System I, the regulatory decisions of government are final, and parties have no way to avoid bad laws other than by lobbying for better ones. Even

8. In other words, we do not see fundamental differences between the goals of 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, 145 (Jürgen Basedow & Toshiyuki Kono eds., 2006).

9. 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. *See* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

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 some party choices. Thus, designing choice-of-law rules is a matter of finding the optimal compromise between these two systems. The following Subparts 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. Political costs include the winners' ability to use the governing political system to impose costs on the losers.[10] Interest group dynamics created by the political system and its surrounding environment are a significant determinant of political costs.[11] 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.[12]

An interest group's influence depends significantly on its ability to raise money and generate supportive activities. Thus, all else equal, the group will be more successful if it can overcome free riding by individual members.[13] If people think they can enjoy the benefits of others' lobbying efforts, they may choose not to contribute to the cause.[14] Thus, a group can increase its relative influence by inducing more beneficiaries to contribute to the common cause.[15] Lawyer interest groups can be politically powerful because their members' interests are often fairly homogeneous and their organizing costs are

10. *See* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 23-24 (1962).

11. *See* MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 111-31 (1965).

12. *See* Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 341-44, 362-83 (1988) (discussing the economic theory of legislation).

13. *See* OLSON, *supra* note 11, at 48-57.

14. *Id.* at 48.

15. *See id.* at 137-41.

offset to some extent by the nonpolitical benefits of bar associations.[16] Lawyers therefore may be able to gain political benefits at the expense of many other much larger but also much more unwieldy groups of voters.[17]

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.[18] 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.[19]

Although interest groups may cause wealth transfers, competition between interest groups can defeat inefficient laws.[20] 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 amid rapidly evolving technology and markets. Moreover, what little information they do have comes from the very interest groups whose influence they seek to avoid. The information deficit is a particular 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 law-making 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.

16. *See id.*

17. *See id.*

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

19. Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 391-93 (2003).

20. *See* Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371, 386-88 (1983).

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.[21] With costless mobility, people do not need political power in order to obtain the bundle of government services (and taxes) that they prefer.[22] 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.

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.[23] 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.[24] 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 Coasean bargaining.

Allowing the parties to shop for law might seem necessary to subvert laws intended to protect local residents. We acknowledge some of those costs in Subpart 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 the law entirely. As

21. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 419-20 (1956).

22. *See id.* at 419-23.

23. *See id.*

24. *See id.* at 419.

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, groups, or informational intermediaries have an incentive to learn about these and avoid contracts that are governed by them. Merchants who trick their customers or who 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 lose from the exit. These "exit-affected" groups are then added to the mix of proregulatory and antiregulatory 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 unilaterally determine the applicable law, other parties may be denied the protection of efficient regulation. An obvious example is where a child pornographer selling online could escape American laws by selling the pornography from an offshore location, thereby maintaining a market that leaves the rest of American society, including its 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 is incorporated under laws that do 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, because 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.[25] 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.[26] 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.[27] This is the general principle for

---

25. 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).

26. Ribstein, *supra* note 19, at 410.

27. Others have also come to this conclusion. *See* Larry Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277, 329-34 (1990); Michael Whincop & Mary Keyes, *Putting the 'Private' Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 MELB. U. L. REV. 515, 517-18 (1997).

contractual choice of law in the United States as summarized by section 187 of the Restatement (Second) of Conflict of Laws.[28]

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.[29] 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.

---

28. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

29. 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).

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 the parties' 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,[30] but rather to produce the sort of efficient results expected in a well-ordered market: selection of the jurisdiction that has the "comparative regulatory advantage;"[31] in other words, the law of the state with the best information and incentives to act. Like actual bargains, the 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 in making 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

30. Some have objected to the term *hypothetical bargain* on the ground that it does not adequately assess the parties' intentions. *See* Jürgen Basedow, Lex Mercatoria *and the Private International Law of Contracts in Economic Perspective*, *in* AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW, *supra* note 8, at 57, 65-71.

31. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 21.18, at 633-34 (7th ed. 2007); Michaels, *supra* note 8, at 167 (recommending comparative regulatory advantage for an efficiency-based approach); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, 1179-80 (2000).

process can produce inefficient regulation. Accordingly, we turn to a branch of law and economics, 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.[32] 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 overcome not only groups that oppose the regulation, but also "exit-affected interest groups," groups that are harmed when firms avoid contacts with states that will not enforce choice-of-law clauses. 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 to determine readily whether to give laws super-mandatory effect.

---

32. For example, the RESTATEMENT (SECOND) OF CONFLICT OF LAWS provides that the choice-of-law clause will not be given effect if either

> 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 . . . 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, . . . [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).

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 proregulatory 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.

III. A BRIEF GLIMPSE OF U.S. CONFLICTS LAW

This Part provides a very brief description of American conflicts law, primarily as a backdrop for the discussion of the European developments in Part IV.

As detailed elsewhere, modern U.S. 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.[33] 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.[34]

The vested-rights approach largely has been replaced in the United States by a state interest approach to choice of law.[35] In an influential series of articles in the 1960s, Brainerd Currie sought to avoid the artificiality of vested-rights analysis by encouraging courts to explicitly recognize the role of state interests.[36] Although Currie sought to marry state policy with clear rules, his main contribution ended up being to provide support for courts' tendency to use choice of law to favor residents, forum law, and plaintiffs. Currie explicitly

33. *See* ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET (forthcoming 2008); O'Hara & Ribstein, *supra* note 31, at 1152.

34. *See* O'Hara & Ribstein, *supra* note 31, at 1152.

35. *See* SYMEONIDES, *supra* note 4, at 10-29.

36. These articles are reprinted in BRAINERD CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS (1963).

assumed that states would want to protect their residents. The forum bias was inherent in Currie's mechanism for allocating the governing law, which most frequently resulted in the application of forum law. And because plaintiffs usually choose the forum, the forum law bias in turn abetted an increasing judicial preference for protecting plaintiffs.

By the time the Restatement (Second) of Conflict of Laws was promulgated in 1971, its drafters faced a chaotic legal scene in which state courts applied a variety of differing approaches to choice-of-law issues. The American Law Institute attempted to accommodate all of these systems by combining a set of rules with a multifactor analysis that simply lists all of the considerations the courts were applying in deciding on the applicable law.[37] The Second Restatement thus left the courts free to reach just about any result they wanted. However, the Restatement's compromise did not bring unity, as states have continued to apply many different approaches. And, as discussed below, the U.S. Constitution brings only a minimal amount of order to this chaos.[38]

Interestingly, the most important recent influences on the law governing private parties in the United States have not been 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 Dormant Commerce Clause, to do business throughout the country without suffering state discrimination in favor of local firms. These factors provide the basic mobility that enables firms and people to escape oppressive laws.

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.[39] Second, the federal courts, through federal diversity jurisdiction, can give interstate firms a refuge from possibly parochial state courts.[40] Third, firms have been able to gain enforcement of contractual choice-of-court and arbitration clauses. Enforcement of the former has been boosted by United States

37. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187.
38. *See infra* Part IV.
39. *See infra* text accompanying notes 102-104.
40. *See* O'HARA & RIBSTEIN, *supra* note 33 (manuscript at ch. 3).

Supreme Court decisions,[41] while the latter is enforced pursuant to the Federal Arbitration Act.[42]

This mobility, in turn, has given them significant leverage to insist on enforcement of choice-of-law clauses. The current rule, embodied in section 187 of the Second Restatement, places a heavy thumb on the scale in favor of enforcement of the parties' contract.[43] The Restatement calls for application of the open-ended default choice-of-law rule 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.[44] Although the Restatement's fundamental policy exception seems open-ended, in fact, the courts quite generally enforce contractual choice of law, confining the exception to a few narrow categories of cases.[45] American 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.[46]

Thus, the United States has fostered an active law market, not because of the choice-of-law rules themselves, but because of the dynamism inherent in the institutional features of the American federal system. The loose nature of American choice-of-law rules leaves much room for improvement, particularly regarding tort law. This gives American 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 United States can draw no more than limited guidance from these developments.

IV. THE NEW EUROPEAN UNION APPROACH

Europe offers two opportunities for improvement over the current chaotic American conflicts system. First, Europe has approved

41. *See, e.g.*, Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 593-95, 1991 AMC 1697, 1703-04 (1991); The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15, 1972 AMC 1407, 1418 (1972).

42. *See* 9 U.S.C. § 2 (2000).

43. *See* RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 187 (1971).

44. *Id.* §§ 187(2), 188.

45. *See* Ribstein, *supra* note 19, at 380-82 (discussing exceptions to the parties' chosen law in choice-of-law clauses).

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

uniform choice-of-law rules, commonly known as the Rome Convention, for contractual obligations,[47] and the Rome II Regulation, for noncontractual obligations.[48] The Rome Convention has been replaced by a regulation.[49] These rules, which are discussed below in Subpart A, help ensure that the same choice-of-law rules will be applied across the European Union, in contrast to the situation in the United States in which the applicable rule varies from one state court to another.

Second, as will be 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 United States.

Although these developments create somewhat more order in European choice of law than exists in the United States, they are not clearly a better approach to the law market than the apparently chaotic U.S. 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 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,[50] with the main exception that the parties' choice is subject to

47. Convention on the Law Applicable to Contractual Obligations, 1980 O.J. (L 266) 34 [hereinafter Rome Convention].

48. Council Regulation 864/2007, On the Law Applicable to Non-Contractual Obligations (Rome II), art. 1, 2007 O.J. (L 199) 40, 43 [hereinafter Rome II Regulation]. The Convention does not cover marriage and family obligations, wills, promissory notes, company law, trustees, privacy and defamation. *Id.*

49. *See* Regulation of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I), 2005/0261/COD (Mar. 31, 2008) (adopted June 6, 2008) [hereinafter Rome I Regulation].

50. *See id.* art. 3.

"overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful."[51] This contrasts with the Rome 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."[52] The Convention defines "mandatory rules" as provisions "which cannot be derogated from by contract."[53] The Rome I Regulation states that "'overriding mandatory provisions' should be distinguished from the expression "provisions which cannot be derogated from by agreement" and should be construed more restrictively."[54] The use of the word *unlawful* in the Regulation suggests that choice-of-law clauses would be unenforceable only when contract provisions are prohibited by public law regulations, rather than, for example, a 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 United States, which are embodied in section 187 of the Second Restatement.[55] This section qualifies enforcement of contractual choice of law 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 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 Rome Convention or the Rome I Regulation.[56]

B. Rome II

The Rome II Regulation providing choice-of-law rules for tort cases offers a stronger contrast with American rules than does the

51. *Id.* art. 9(3).

52. Rome Convention, *supra* note 47, art. 7(1).

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

54. Rome I Regulation, *supra* note 49, recital 37. "Provisions which cannot be derogated from by agreement" is the language used for application of the law "[w]here all other elements relevant to the situation at the time of the choice are located." *Id.* art. 3(3).

55. *See* Ribstein, *supra* note 19, at 373.

56. For an analysis highlighting similarities between American and European law under the Rome Convention, see Giesela Rühl, *Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency*, *in* CONFLICTS OF LAWS IN A GLOBALIZED WORLD 153, 153-83 (Eckart Gottschalk et al. eds., 2007).

Rome Convention and Rome I Regulation.[57] The Rome II 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 United States in the early part of the twentieth 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.[58]

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.[59]

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.[60] Put differently, the justification for the Rome II 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.[61] More importantly, the Regulation aligns with choice facilitation in the important respect that it includes a specific rule respecting party autonomy.[62] However, the Regulation 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,[63] or where the case is more closely connected to another

57. *See* Symeon C. Symeonides, *Rome II and Tort Conflicts: A Missed Opportunity*, 56 AM. J. COMP. L. 173, 173 (2008).

58. Rome I Regulation, *supra* note 49, art. 4(1).

59. *Id.* recital 16.

60. *See* Symeonides, *supra* note 57, at 191-92.

61. *See* O'Hara & Ribstein, *supra* note 31, at 1210-19.

62. Rome II Regulation, *supra* note 48, art. 4(3).

63. *Id.* art. 4(2).

jurisdiction.[64] There are also special rules for products liability,[65] unfair competition[66] and industrial actions.[67] 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.[68]

This rule usually will result in applying the law of the country where the victim habitually resided. Because 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 law of the state of the victim's residence applies only if the

64. *Id.* art. 4(3).
65. *Id.* art. 5.
66. *Id.* art. 6.
67. *Id.* art. 9.
68. *Id.* art. 5(1)-(2).

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 manufacture 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 the residence of the victim 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 country of residence.[69] 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 noncontractual 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."[70] 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.[71]

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.[72] Most interestingly from the standpoint of our analysis, these provisions specify that "[a] manifestly closer connection with another country might be based in

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

70. Rome II Regulation, *supra* note 48, art. 14(1).

71. *See id.* art. 14.

72. *Id.* arts. 4(3), 5(2).

particular on a pre-existing relationship between the parties, such as a contract, that is closely connected with the tort/delict in question."[73]

Rome II thus makes somewhat clearer than is sometimes the case in the United States that a choice-of-law clause may cover both contract and tort claims. This makes sense, because there is nothing inherent in the tort nature of the claim that necessarily should preclude private ordering concerning the applicable law. By contrast, section 187 of the Second Restatement states that enforcement applies to the "law of the state chosen by the parties to govern their contractual rights and duties,"[74] which can be taken to mean that the choice-of-law clause cannot work to choose the law to govern a tort claim.

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.

C. Constitutional Rules: Mutual Recognition

Over the last thirty years, the European Community has developed rules within the framework of the "four freedoms"—that is, free movement of goods, of services and establishment, of persons and citizenship, and of capital—embodied in the Treaty Establishing the European Community (EC Treaty).[75] These rules comprise a kind of constitutional restriction on the private international law rules of European Community member states and by implication on the Rome Convention and the Rome I 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

73. *Id.*

74. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(1) (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 19, at 380 n.56.

75. *See* Treaty Establishing the European Community arts. 39-60, Nov. 10, 1997, 1997 O.J. (C 340) 173, 193-99, [hereinafter EC Treaty] (prohibiting restrictions on the basis of nationality).

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 Article 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."[76] *Procurer du Roi v. Benoît and Gustave Dassonville* 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.[77]

Following *Dassonville*, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein* extended commercial protection beyond overt member state discrimination.[78] The European Court of Justice held that Germany could not bar the 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.[79] 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.[80] 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 European Court of Justice retreated from the broadest implications of *Rewe-Zentral AG* in *Criminal Proceedings Against Bernard Keck and Daniel Mithouard*, 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

---

76. *Id.* art. 28.

77. Case 8-74, Procureur du Roi v. Dassonville, 1974 E.C.R. 837, 854.

78. Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein, 1979 E.C.R. 649, 665.

79. *Id.* at 664-65.

80. *See, e.g.*, Horatia Muir Watt, *Experiences from Europe: Legal Diversity and the Internal Market*, 39 TEX. INT'L L.J. 429, 447-50 (2004) (noting that the implication of the court's decision in *Rewe-Zentral AG* was to ensure that laws of each member state were harmonized).

another member state.[81] In this more recent case, the Court expressed reluctance to embrace a broad mandate of economic freedom.[82]

The right of establishment is set forth in article 48 of the EC 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."[83] In 1999, the European Court of Justice held under this provision in *Centros v. Erhuers-og Selskabsstyrelsen* that Denmark could not bar a United Kingdom corporation from opening a "branch" in Denmark merely because the corporation had never done business in the United Kingdom.[84] The Court held in later cases that Germany could not deny a Dutch corporation the right to sue,[85] 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.[86] These cases heralded constitutional protection for American-style corporate charter competition in Europe.[87]

As to services, article 50(3) of the EC Treaty prohibits discrimination in favor of nationals.[88] Moreover, article 49 goes beyond discrimination and in the direction of the protection of movement of goods by requiring member states to abolish restrictions

81. Joined Cases C-267/91 & C-268/91, Keck & Mithouard, 1993 E.C.R. I-6097, I-6130 to 32.

82. *Id.* at I-6131. 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 70-126 (2002).

83. EC Treaty art. 48.

84. Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, I-1490.

85. Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919, paras. 1-2.

86. Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. 1-10,155, I-10, 223 to 38.

87. 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. EC Treaty art. 46. 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*, 58 CURRENT LEGAL PROBS. 369, 401 (2006). They can also inhibit firms' abilities to reincorporate in other countries, which would be a real constraint on the charter market. For an interpretation of articles 52 and 58 of the EC Treaty, see Case 81/87, The Queen v. H.M. Treasury (*Ex parte Daily Mail*), 1988 E.C.R. 5483, 5505-14 (discussing the abolition of restrictions on movement and residents within the European Community for nationals of member states with regard to establishment and the provision of services). The Court held that the right of establishment did not prevent the United Kingdom from blocking transfer of a company's headquarters to another country to keep the company from avoiding payment of capital gains tax. *Id.*

88. EC Treaty art. 50.

on the freedom to provide services.[89] Until such abolition, article 54 requires member states to "apply such restrictions without distinction on grounds of nationality or residence."[90] For example, Belgium could not require a French licensed service to also hold a Belgian license[91] and Germany could not require a lawyer from another member country to hire a local attorney to officially handle client matters within Germany.[92] A similar approach has been embodied in the Electronic Commerce Directive of 2000, though it accommodates conflicting public policies.[93]

Although these rules have been analogized to U.S. constitutional protection under the Commerce and Full Faith and Credit Clauses,[94] in fact the European cases go beyond any duty the U.S. Constitution imposes on states to recognize other states' laws. The closest potential American analogy to the protections in the EC Treaty is under the Full Faith and Credit Clause, which, like the Treaty, requires mutual state recognition of the law making authority of other states.[95] Justice Jackson described the clause as protecting against the "disintegrating influence of provincialism."[96] 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 Clause cases involving fraternal benefit organizations hold that the Constitution compels application of the state in which the organization was formed,[97] this rule has never been applied beyond this limited context.

---

89. *Id.* art. 49.

90. *Id.* art. 54.

91. Joined Cases 110 & 111/78, Ministère Pub. v. van Wesemael, 1979 E.C.R. 35, 48-55.

92. Case 427/85, Comm'n v. Germany, 1988 E.C.R. 1123, 1167-68.

93. *See* Ralf Michaels, *EU Law as Private International Law? Re-conceptualizing the Country-of-Origin Principle as Vested Rights Theory* 7-8 (Duke Law School Legal Studies Paper No. 122, 2006), *available at* http://ssrn.com/abstract=927479.

94. *See* Watt, *supra* note 80, at 437.

95. *See* U.S. CONST. art. IV, § 1.

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

97. *See, e.g.*, Order of United Commercial Travelers v. Wolfe, 331 U.S. 586, 589 (1947) (holding that the Full Faith and Credit Clause of the Constitution required that South Dakota adhere to the contractual obligations of the parties entered into in Ohio); Sovereign Camp of the Woodmen of the World v. Bolin, 305 U.S. 66, 75 (1938) (holding that the judgment of the Kansas City Court of Appeals had not given full faith and credit to the judicial proceedings of Nebraska); Modern Woodmen of Am. v. Mixer, 267 U.S. 544, 551 (1925) (holding that the law of the state in which a membership society was formed governed the law of the contract); Supreme Council of the Royal Arcanum v. Green, 237 U.S. 531, 542-45 (1915) (holding that courts in New York failed to give full faith and credit to the laws of Massachusetts when a corporation organized under Massachusetts law had contractual provisions outlawed by a New York court).

Allstate Insurance Co. v. Hague[98] indicates the current state of American law. The Supreme Court let Minnesota apply its law to an automobile insurance contract issued in Wisconsin to a decedent who had been a citizen of Wisconsin and had died in an accident there because the decedent worked in Minnesota, traveled there, did business there, and his widow became a Minnesota resident before she filed suit against Allstate.[99] 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.[100] The main constitutional limit on a forum's power to choose its own law came in *Phillips Petroleum Co. v. Shutts*, where the Court held that the Supreme Court of Kansas 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.[101]

Some U.S. Commerce Clause jurisprudence limits a state's ability to excessively burden interstate commerce and therefore should seem familiar to Europeans. For example, the Court has struck down state regulation of the length of interstate trains[102] and trucks,[103] as well as truck mudguard regulations that differed from those in place in other states.[104] However, the United States 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 European Court of Justice cases discussed above potentially offer much broader protection from the chaos created by disparate state laws than is available in the United States. 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. Because 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

98. 449 U.S. 302 (1981).
99. *Id.* at 313-19.
100. *Id.* at 320.
101. 472 U.S. 797, 821 (1985).
102. *Id.* at 781-82.
103. Kassel v. Consol. Freightways Corp. of Del., 450 U.S. 662, 671 (1981); Raymond Motor Trans., Inc. v. Rice, 434 U.S. 429, 447 (1978).
104. *See* Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 529 (1959).

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 BV v. Minister van Financiën*, where the home country regulated cold-call securities sales, including those in other countries?[105] The European Court of Justice held that article 59 of the EC Treaty does not preclude countries from regulating to "protect investor confidence in national financial markets."[106] But should this not instead be the job of the host country?[107]

Second, *Keck*'s distinction between selling arrangements and product rules is problematic under the *Rewe-Zentral AG* 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.[108] 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, because 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

105. Case C-384/93, Alpine Invs. BV v. Minister van Financiën, 1995 E.C.R. I-1141, I-1169.

106. *Id.* at I-1182.

107. For a discussion of the approach to harmonization with respect to member state regulation, see SNELL, *supra* note 82, at 127.

108. *See, e.g.*, O'Hara & Ribstein, *supra* note 31, at 1213 (noting that a place-of-manufacture rule could be favorable for a manufacturer because it would allow them to choose where to locate).

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 overregulation.

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.[109] However, the rules do not easily divide along these lines. If Europe's country-of-origin rule does not facilitate mutual choice of law, then it arguably does 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' abilities 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 incorporation 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.[110] 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 European Court of Justice cases offer the United States a way out of the murk 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.[111] 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

109. *See* Michaels, *supra* note 8, at 179-80.

110. *See* Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 697-98.

111. *See* Michaels, *supra* note 8, at 179.

would not suffice. The internal affairs doctrine is essentially a choice-of-law rule.[112] There is no reason why the state's perfunctory role in the incorporation process should make a significant difference in promoting recognition of a 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 U.S. rules. This is particularly true of contract cases, assuming that courts interpret "unlawful" in the narrow way the Rome I Regulation evidently intends.[113] 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 no protection applies at all to noncommercial tort situations. The European Court of Justice 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 reliable safe harbor.

V. EUROPEAN AND U.S. LAW MARKET INSTITUTIONS

We have shown that the European Union rules offer somewhat more clarity than the chaos of U.S. 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 as to whether the European system will produce better results in terms of a more efficient law market. This Part shows that the important difference between the United States and Europe regarding choice of law amounts to that between rules and institutions. American institutions may be better suited to producing a robust market for law than Europe's general rules.

More specifically, the institutions of the U.S. 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

112. Ribstein & O'Hara, *supra* note 110, at 697-98.
113. *See supra* Part IV.A.

among the states within the United States.[114] These differences create greater barriers to mobility in Europe, which results in less powerful discipline of member nation law making.

Second, the federal government plays different roles in the United States 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 American federal law. Also, while the U.S. Supreme Court has been much less active in promoting jurisdictional competition than has the European Court of Justice, federal courts in the United States have played a subtle but important role in facilitating jurisdictional competition that cannot be replicated in the European Union. Specifically, the U.S. 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 American state courts.[115] Thus, the U.S. federal government arguably imposes a more effective constraint on U.S. state legislatures and courts than does the European federal government.

Third, cutting against these advantages of the U.S. federal system, Europe's institutions are better able to achieve coordination through private international law rules at the federal level than can the United States. Congress and the federal judiciary have shown no taste for enacting choice-of-law rules. By contrast, choice of law in Europe has moved to the top of the legal agenda as a free trade issue.[116] Thus, to the extent that uniform choice-of-law rules are capable of producing an efficient system, Europe is better able than the United States 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.[117] Unfortunately, as discussed above, Europe has failed to fully capitalize on that international lawmaking

---

114. *See* Christian Kirchner et al., *Regulatory Competition in EU Corporate Law After* Inspire Art*: Unbundling Delaware's Product for Europe*, 2 EUROPEAN CO. & FIN. L. REV., 1, 2 (2005).

115. *See* Ribstein, *supra* note 19, at 420; *see also* O'HARA & RIBSTEIN, *supra* note 33 (manuscript at ch. 4).

116. *See supra* Part IV.

117. *See* Michaels, *supra* note 93, at 7-8.

advantage because its rules have been motivated partially by political compromise that dilutes 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 United States, 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.[118] By contrast, most of Europe clung to the real seat rule until that rule was effectively upended by European Court of Justice cases applying the right of establishment in the EC Treaty.[119] Analogously, routine enforcement of contractual choice of law has developed in the United States as a result of court decisions and individual state statutes,[120] while in Europe routine enforcement was imposed by the Rome Convention.[121] Other types of juris-dictional competition have developed in the United States as an accidental or intentional byproduct of specific federal laws.[122] Thus, party choice has developed and strengthened in both the United States and Europe, but by different routes: dynamic competition in the United States and top-down constitutional rule in Europe.

Both the European and U.S. 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.

Because the American and European systems each have desirable features, perhaps the best outcome is for them to converge. The United States 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

118. *See* Ribstein & O'Hara, *supra* note 110, at 677-78.

119. *Id.* at 706-07.

120. *See* O'HARA & RIBSTEIN, *supra* note 33 (manuscript at chs. 3-4); Ribstein, *supra* note 19, at 371-85.

121. Rome Convention, *supra* note 47, art. 3(1).

122. *See, e.g.*, Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 359 (2005) (noting that changes in the federal tax code spurred competition between states for trusts).

California or Illinois would not be able to regulate national firms through litigation.

At the same time, Europe might borrow from the United States 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.[123] If parties can effectively choose their law by 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 an American-style law market. As discussed above, there has been a distinct evolution from the Rome Convention to the Rome I Regulation regarding enforcement of party autonomy.[124] 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. It is possible that these moves reflect the recognition of key interest groups in Europe that mobile parties will avoid nonenforcing 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 United States system, it would do well to capitalize on its advantages as well. The European Union can use its greater capacity for top-down rule making to do what the United States 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 United States.[125] 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

123. Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters, art. 4, Feb. 1, 1971, 1144 U.N.T.S. 249.

124. *See supra* Part IV.

125. *See* O'HARA & RIBSTEIN, *supra* note 33 (manuscript at ch. 10).

designate their statutes as super-mandatory in order to be entitled to have their restrictions upheld by the European Court of Justice. 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 European Court of Justice 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 United States discussed above, firms and individuals inherently have less mobility in Europe than they do in the United States. Europeans therefore are less able to use exit or the threat of exit to effectively oppose individual nations' 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.

VI. 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 Article analyzes developments in United States and European choice of law against this background. The first choice-of-law revolution has left the United States 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 United States 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 American 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 United States 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.