

Governing Law Clauses in Commercial Agreements—New York's Approach

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I. INTRODUCTION—THE NEED FOR GOVERNING LAW CLAUSES

The parties to a commercial agreement have an understandable desire that the rights and obligations under the agreement be as well defined and predictable as possible. Entry into the agreement is, after all, motivated largely by the parties' wish to make the behavior of the other party, and thereby the achievement of the desired economic results, certain and predictable.¹ The principal method by which this objective is achieved is the careful drafting of the agreement. But disputes do occur and if a party resorts to a court of law, the judge must interpret the agreement within the framework of a legal system. To which legal system will the judge resort? Absent a governing law clause, a court will apply certain of today's generally accepted conflict-of-laws rules to determine the law governing an agreement. These rules may have some merit; they do not have, unfortunately, the merit of certainty and predictability,² and the larger the number of jurisdictions having some connection with the transaction, the less predictable it is which law the court will apply. Each disputed issue will call for its own conflict-of-laws analysis, so that different issues under the same agreement may be governed by different laws. The problem is aggravated further when the jurisdictions which have some connection with the transaction belong to different legal cultures. While it may be of little consequence whether the law of New York or the law of New Jersey is applied to the construction of an agree-

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1. Judge Breitel, in his dissent in *Miller v. Miller*, 22 N.Y.2d 12, 27, 237 N.E.2d 877, 886, 290 N.Y.S.2d 734, 747 (1968), emphasized the need to satisfy the "reasonable expectations" of persons participating in transactions and said that "this pragmatic significance of expectations varies with the type of legal rule involved. It is undoubtedly strongest in contract cases." *Id.* at 28, 237 N.E.2d at 886, 290 N.Y.S.2d at 747.

2. See Section II A *infra*.

ment, a choice between the law of New York, Germany and Saudi Arabia may prove extremely important. For this reason parties to commercial agreements, hoping to increase certainty and predictability, are generally anxious to incorporate an agreement on governing law. Today, nearly all major commercial agreements which have contacts with more than one jurisdiction, be it with several states or several nations, contain a *stipulatio juris*, a choice-of-law provision or governing law clause.³

3. A typical choice-of-law clause reads: "This Agreement shall be governed by, and construed in accordance with, the law of the State of New York." Often, the clause refers to the "laws" of the named jurisdiction. In order to make clear that the reference is to the whole body of law rather than to statutory laws, "law" appears to be preferable.

This Article deals only with the stipulation of the law which governs a contract, i.e., the law of a sovereign state or country. Commercial contracts may state that they shall be governed by rules of a private international organization. For example, letters of credit frequently refer to the Uniform Customs and Practice for Commercial Documentary Credits issued by the International Chamber of Commerce. This stipulation of the UCP has been expressly authorized by the New York Uniform Commercial Code, N.Y.U.C.C. § 5-102(4)(McKinney 1964). *Capehart Corp. v. Shanghai Commercial Bank, Ltd.*, 49 App. Div. 2d 521, 369 N.Y.S.2d 751 (1975); *Oriental Pac. (U.S.A.), Inc. v. Toronto Dominion Bank*, 78 Misc. 2d 819, 357 N.Y.S.2d 957 (Sup. Ct. N.Y. County 1974). *Hurwitz v. Hurwitz*, 216 App. Div. 362, 215 N.Y.S. 184 (1926), involved a marriage settlement which referred to the Jewish laws of Israel and Moses. The court found that the conflict-of-laws rules did not apply since the stipulated laws were not "foreign laws". The court held that the parties could define their respective rights and privileges by reference to these religious laws as long as they were not contrary to New York law.

Relatively little has been written in recent years about the validity and scope of governing law clauses. The most comprehensive study is Prebble, *Choice of Law to Determine the Validity and Effect of Contracts: A Comparison of English and American Approaches to the Conflict of Laws* (Parts I-II), 58 CORNELL L. REV. 433, 635 (1973). A good presentation of the development of the doctrine of party autonomy in choice of law in the United States is Yntema, *Contract and Conflict of Laws: "Autonomy" in Choice of Law in the United States*, 1 N.Y.L.F. 46 (1955). Other articles are: Lowe, *Choice of Law Clauses in International Contracts: A Practical Approach*, 12 HARV. INT'L L.J. 1 (1971); Weintraub, *Choice of Law in Contract*, 54 IOWA L. REV. 399 (1968); Johnston, *Party Autonomy in Contracts Specifying Foreign Law*, 7 WM. & MARY L. REV. 37 (1966); Reese, *Power of Parties to Choose Law Governing Their Contract*, 1960 PROC. AM. SOC'Y INT'L L. 49; Nurick, *Choice-of-Law Clauses and International Contracts*, 1960 PROC. AM. SOC'Y INT'L L. 56; McCartney, *The Use of Choice-of-Law Clauses in International Commercial Contracts*, 6 WAYNE L. REV. 340 (1960); Ehrenzweig, *Contracts in the Conflict of Laws* (Part I), 59 COLUM. L. REV. 973 (1959); James, *Effects of the Autonomy of the Parties on Conflict of Laws Contracts* (Parts I-II), 36 CHI.-KENT L. REV. 34, 87 (1959); Levin, *Party Autonomy: Choice-of-Law Clauses in Commercial Contracts*, 46 GEO. L.J. 260 (1957-58); Sommers, Broches & De-laume, *Conflict Avoidance in International Loans and Monetary Agreements*, 21 LAW & CONTEMP. PROB. 463 (1956); Comment, *Party Autonomy - Past and Present*, 12 S. TEX. L.J. 214 (1970); Comment, *Choice of Law for International Contracts: An American Critique*, 2 TEX. INT'L L.F. 227 (1966); Comment, *Conflict of Laws: "Party Autonomy" in Contracts*, 57 COLUM. L. REV. 553 (1957); Note, *Commercial Security and Uniformity Through Express Stipulations in Contracts as to Governing Law*, 62 HARV. L. REV. 647 (1949); Annot., 112 A.L.R. 124 (1938).

Why do parties to an agreement select a particular governing law? It has been frequently said that parties like to stipulate the law which gives them the most advantages. This is a fiction.

In the author's experience, there are two reasons why a specific law is chosen. First, often a party to an international transaction retains the lawyer in whom it has confidence irrespective of the jurisdiction in which he practices. If one party has the bargaining power to determine the applicable law, the legal system of his lawyer will be chosen. Secondly, parties tend to prefer the law of the jurisdiction in which they reside or in which they customarily do business. This desire is usually not based on any deep knowledge of this law, but rather on a vaguely felt preference for dealing with what appears to be familiar rather than with the unfamiliar.

Because of New York City's role as a leading international financial center, New York lawyers are frequently involved in multi-jurisdiction transactions which may have little or no contact with New York. If a New York lawyer is asked to draft the agreements for such transactions, his client usually expects him to provide for the application of his own law, that of New York. The client may also hope to see New York law stipulated because of the widespread belief that New York has a well-developed commercial law and that New York judges are competent, free from prejudice against foreigners and accustomed to handling commercial cases.⁴ This widely held conviction is the reason why parties to international agreements having little or no connection with New York so frequently agree on New York law as the governing law. The participants in today's international commercial transactions desperately need a commercial *ius gentium*⁵ or a law merchant,⁶ and many lending institutions and merchants believe that New York law could fill this rôle. It would be of advantage to New York's status as an international banking and commercial center if its courts would take an understanding attitude towards this desire and resist the temptation to be provincial. New York courts have in fact demonstrated this understanding attitude in several cases in which they relied, in finding an overriding New York interest in

4. This belief in the characteristics of New York judges only becomes important if the stipulation of New York law is accompanied by a submission to New York jurisdiction.

5. Gaius, *INSTITUTES* 1.1; *DIGEST* 1.1.1.4.

6. See *Bank of Conway v. Stary*, 51 N.D. 399, 200 N.W. 505 (1924). U.C.C. § 1-105, Official Comment 3 (1972 version) states that the Code "is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries."

applying its own law, on New York's role as an international commercial center.⁷

This Article will review New York decisional and statutory law in order to ascertain the effect and scope which has been given in New York to governing law clauses.

II. THE VALIDITY OF CHOICE-OF-LAW CLAUSES

The practicing attorney usually faces the question of the validity of a governing law clause in two instances: (i) when he structures an "across the border" international or interstate⁸ transaction, and (ii) when he is requested to render an opinion with respect to an agreement which contains a governing law clause.⁹

7. See *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 24 N.Y.2d 372, 248 N.E.2d 576, 300 N.Y.S.2d 817 (1969) (New York Statute of Frauds provision held applicable where New York's interest is demonstrated by enacting legislature's intent to protect nonresidents coming to New York because of its international clearing house and market place status); *J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.*, 37 N.Y.2d 220, 333 N.E.2d 168, 371 N.Y.S.2d 892, cert. denied, 423 U.S. 866 (1975) (New York law held applicable to a cause of action arising from instruction of defendant Ugandan bank to New York agent bank not to reimburse drafts drawn by plaintiff Israeli partnership as beneficiary of letter of credit issued by defendant because of New York's overriding interest as a financial capital of the world in protecting expectations of contracting parties). *Accord*, *Pallavicini v. International Tel. and Tel. Corp.*, 41 App. Div. 2d 66, 341 N.Y.S.2d 281 (1973), *aff'd*, 34 N.Y.2d 913, 316 N.E.2d 722, 359 N.Y.S.2d 290 (1974); *Ehrlich-Boher & Co. v. Univ. of Houston*, 49 N.Y.2d 574, 581, 427 N.Y.S.2d 604, 608-09 (1980).

The court in *Bache & Co. v. International Controls Corp.*, 339 F. Supp. 341, 348 (S.D.N.Y.), *aff'd per curiam*, 469 F.2d 696 (2d Cir. 1972), referred to New York's position as the leader in securities transactions. *Cf.* Letter, dated October 4, 1976, from Michael Gruson to the New York State Law Revision Commission urging a change in the 1972 revision of U.C.C. § 9-103 in order to permit the filing of financing statements in New York in certain international transactions (arguing that permitting such filing would be in keeping with New York's role as an international financial center).

8. Our conflict-of-laws rules do not distinguish between international and interstate conflicts. *But see* H. GOODRICH & E. SCOLES, *CONFLICT OF LAWS* 4 (4th ed. 1964).

9. If a New York lawyer renders an opinion to the effect that an agreement which stipulates the applicability of New York law is valid, legal, binding and enforceable in accordance with its terms, his opinion implies that the governing law clause is valid and effective. Even in the case of an agreement which stipulates the applicability of a foreign law, a New York opinion may be required as a result of the transaction's New York contacts or because the parties submitted to the jurisdiction of New York courts. What does an opinion mean that states that an agreement which is governed by a foreign law constitutes, under the law of the State of New York, a legal, valid and binding agreement enforceable in accordance with its terms? It means that (i) under New York law the provision in the agreement pursuant to which the foreign law is specified as controlling is valid and effective, and (ii) no provision in the agreement violates a public policy of the State of New York, the violation of which would cause a New York court not to enforce such provision. *But see* note 149 *infra* for decisions looking to the public policy of a state other than the forum. If one of the parties to the agreement is a New York corporation the opinion also means that the agreement is within the corporate power and authority of the New York party and has been duly

The legal issue is whether a New York state court or a federal court in New York sitting in a diversity action¹⁰ will uphold this choice-of-law clause as being valid and effective.

Ultimate resolution of the question depends, of course, on the criteria set by the courts, and in determining which jurisdiction's law applies to an agreement containing a governing law clause, the courts could conceivably follow one of three conflict-of-laws approaches: (A) the grouping of contacts or the interest analysis test, (B) the rule of applying the law of the jurisdiction chosen by the parties if the transaction bears a reasonable relationship to that jurisdiction, and (C) in the case of agreements which are allegedly usurious, the rule of validation.

A. Grouping of Contacts and Interest Analysis

In *Auten v. Auten*,¹¹ the New York Court of Appeals adopted the "center of gravity" or "grouping of contacts" theory of conflict of laws. Under this approach the court will apply the substantive law of the jurisdiction "which has the most significant contacts with the matter in dispute."¹² *Auten v. Auten* was an action for installments due under a separation agreement which did not contain a governing law clause. Although *Auten v. Auten* is a non-commercial case, its approach has been applied to commercial cases.¹³

Although the grouping of contacts approach and the interest analysis approach discussed below¹⁴ are usually applied in cases in which no choice-of-law clause is involved, at least one New York case has applied the grouping of contacts approach to a situation

authorized, executed and delivered by such party. See Gruson, *American Lawyers and Legal Opinions of Foreign Counsel*, in 1975 ANN. PROC. OF THE FORDHAM CORP. L. INST., 296 (1976). It is essential that the opinion state the assumption that the agreement is legal, valid, binding and enforceable under its governing foreign law or that New York counsel obtain an opinion by foreign counsel to that effect. If the agreement is not legal and valid under the stipulated law, the New York court applying such law will also find it illegal or invalid.

10. Where jurisdiction is based upon diversity of citizenship, federal courts must apply the conflict-of-laws rules of the forum state to determine what body of substantive law should apply. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941); *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300, 1303 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971).

11. 308 N.Y. 155, 124 N.E.2d 99 (1954).

12. *Id.* at 160, 124 N.E.2d at 102.

13. *E.g.*, *Index Fund, Inc. v. Insurance Co. of N. Am.*, 580 F.2d 1153, 1162 (2d Cir. 1978), *cert. denied*, 440 U.S. 912 (1979); *Uniroyal, Inc. v. Heller*, 65 F.R.D. 83, 90 (S.D.N.Y. 1974).

14. See text accompanying notes 19-21 *infra*.

in which the agreement in question contained such a clause. In *Haag v. Barnes*,¹⁵ a child support agreement between a resident of Chicago and a resident of New York stipulated Illinois law as the governing law. The provision in the agreement under which plaintiff waived all causes of action against defendant in return for specified support payments was valid under Illinois law. Under New York law the agreement was subject to judicial review for fairness. The New York woman brought an action seeking additional support payments. The New York Court of Appeals affirmed the granting of a motion to dismiss, finding that Illinois law was applicable either under the "traditional" test, which gives effect to the intention of the parties, or under the center of gravity test. The court stated:

The traditional view was that the law governing a contract is to be determined by the intention of the parties [citations omitted]. The more modern view is that "the courts, instead of regarding as conclusive the parties' intention or the place of making or performance, lay emphasis rather upon the law of the place 'which has the most significant contacts with the matter in dispute.'" . . . Whichever of these views one applies in this case, however, the answer is the same, namely, that Illinois law applies. . . . But, even if the parties' intention and the place of the making of the contract are not given decisive effect, they are nevertheless to be given heavy weight in determining which jurisdiction "has the most significant contacts with the matter in dispute" [Citing *Auten v. Auten*]. And, when these important factors are taken together with other of the "significant contacts" in the case, they likewise point to Illinois law.¹⁶

The court in *Haag v. Barnes* did not expressly reject the "traditional view" in favor of the grouping of contacts approach but it appears that the court favored the *Auten v. Auten* ap-

15. 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961).

16. *Id.* at 559-60, 175 N.E.2d at 443-44, 216 N.Y.S.2d at 68-69 (citations omitted). The court listed the following "other" Illinois contacts: (1) both parties were designated in the agreement as being "of Chicago, Illinois", and the defendant's place of business was and always had been in Illinois; (2) the child was born in Illinois; (3) the persons designated to act as agents for the principals (except for a third alternate) were Illinois residents, as were the attorneys for both parties who drew the agreement; and (4) all contributions for support had always been made from Chicago.

proach.¹⁷ The lesson of *Haag v. Barnes* is that if the court applies the grouping of contacts approach in a case involving a contract which contains a choice-of-law clause, it will apply the substantive law of the jurisdiction which has the most significant contacts with the transaction; and while the intention of the parties is not given decisive effect under this approach, it is weighed very heavily in reaching a determination.¹⁸

The grouping of contacts approach is part of a new "flexible" method of reaching conflict-of-laws decisions, which also includes an analysis of the governmental interests of the jurisdictions whose substantive law might be applicable. Under this approach, the law of the jurisdiction having the most interest in the disputed issue will be applied. Interest analysis has been most frequently applied in torts cases,¹⁹ but the New York Court of Appeals in *Intercontinental Planning, Ltd. v. Daystrom, Inc.*²⁰ did apply interest analysis in determining the law applicable to a contract. This case involved a suit for a finder's fee under an oral modification to a written contract. The contract did not stipulate a governing law. As restated by the court in that case, the interest analysis approach "gives to the place 'having the most interest in the problem' paramount control over the legal issues arising out of a particular factual context. . . . [T]he rule which has evolved clearly in our most recent decisions is that the law of the jurisdiction having the greatest interest in the litigation will be applied and that the facts or contacts which obtain significance in defining State interests are those which relate to the purpose of the particular law in conflict.'"²¹

B. Reasonable Relation Test

1. Common Law

Recent New York cases have followed the rule that a contractual provision setting forth the law applicable to the agreement in question will be followed so long as the transaction bears a reason-

17. After all, Judge Fuld is the author of both decisions.

18. In *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), the court said: "Moreover, by stressing the significant contacts, it enables the court, not only to reflect the relative interests of the several jurisdictions involved . . . , but also to give effect to the probable intention of the parties and consideration to 'whether one rule or the other produces the best practical result.'" *Id.* at 161, 124 N.E.2d at 102 (emphasis added).

19. *E.g.*, *Tooker v. Lopez*, 24 N.Y.2d 569, 249 N.E.2d 394, 301 N.Y.S.2d 519 (1969).

20. 24 N.Y.2d 372, 248 N.E.2d 576, 300 N.Y.S.2d 817 (1969).

21. *Id.* at 382, 248 N.E.2d at 582, 300 N.Y.S.2d at 825 (citations omitted).

able relationship to the law chosen or, more precisely stated, to the jurisdiction whose law is chosen. The cases have followed this rule in spite of *Auten v. Auten*.²²

*A.S. Rampell, Inc. v. Hyster Co.*²³ was an action for breach of a distributorship contract. Defendant was an Oregon corporation doing business in New York and the contract stipulated Oregon law as governing. The New York Court of Appeals decided that Oregon law governed the construction of the agreement "since the parties intended it to be applicable and it [the agreement] has a reasonable relation to it."²⁴ The court cited in support of its statement two pre-*Auten* Court of Appeals decisions²⁵ and did not discuss the approach suggested by *Auten v. Auten*.²⁶

The *Auten* approach was openly rejected in the well-reasoned decision in *Reger v. Nat'l Ass'n of Bedding Manufacturers Group Insurance Trust Fund*.²⁷ One of the issues before the New York Supreme Court in this case was whether New York or Illinois law should apply to a terminated group life insurance policy which provided that it was governed by Illinois law.²⁸ The insurance terminated when the employer went out of business and the insured decedent, who was not notified of his right to convert the group life insurance into individual life insurance, failed to convert the policy. The plaintiff, widow of the insured decedent and beneficiary of

22. 308 N.Y. 155, 124 N.E.2d 99 (1954). See text accompanying notes 11-13 *supra*.

23. 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957). See note 111 *infra*.

24. *Id.* at 381, 144 N.E.2d at 379, 165 N.Y.S.2d at 486.

25. *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*, 269 N.Y. 22, 26, 193 N.E. 617, 618, *remittitur amended*, 269 N.Y. 602, 199 N.E. 691 (1935), *cert. denied*, 297 U.S. 705 (1936); and *Dougherty v. Equitable Life Assurance Soc'y*, 266 N.Y. 71, 80, 193 N.E. 897, 899 (1934).

26. *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954). See text accompanying notes 11-13 *supra*. The Court of Appeals in *Gaines v. Jacobsen*, 308 N.Y. 218, 124 N.E.2d 290 (1954), a case involving a separation agreement providing for application of Connecticut law, accepted that the stipulated law governs the agreement. The court then applied the law of the forum only because the question to be decided had never arisen in Connecticut and the court assumed that the law of Connecticut is the same as the law of New York. In *Wyatt v. Fulrath*, 16 N.Y.2d 169, 211 N.E.2d 637, 264 N.Y.S.2d 233 (1965), the Court of Appeals held that a husband and wife, who were Spanish domiciliaries, in depositing money in joint accounts in New York banks had manifested their intention that New York law should govern their rights. This was held to be the case regardless of whether the agreements governing the accounts expressly provided that the New York law of survivorship should apply or merely did so by implication. Since there were also significant contacts with New York, New York law was applicable in determining title to the property.

27. 83 Misc.2d 527, 372 N.Y.S.2d 97 (Sup. Ct. Westchester County 1975). For further discussion, see text accompanying notes 122-24 *infra*.

28. *Id.* at 538, 372 N.Y.S.2d at 112. The certificate of insurance, a summary of the provisions of the group policy which is delivered to the insured, was silent on governing law.

the policy, sued the group policy sponsor for negligence. The insured decedent and the plaintiff were New York residents, the employer of the insured which had sponsored the group insurance for its employees was located in New York, and the certificate of insurance was delivered to the insured in New York. The court conceded that "the paramount interests in this litigation weigh heavily in favor of the beneficiary and support application of New York law."²⁹ However, the court refused to follow the *Auten v. Auten* approach and held that Illinois law applied:

The courts of this State have recognized, as controlling, contractual provisions pertaining to which State law governs, where the law chosen bears a reasonable relationship to the transaction. . . .

Even our governmental analysis test gives way to a fundamental fairness rule whereby the laws of the jurisdiction under which the parties have patterned their conduct prevails. . . . At bar, it is clear that the parties to the master policy all believed that Illinois law applied and their expectations should not be accorded any less weight than those of the insured or his beneficiary.³⁰

Similarly in *Kahn v. Great-West Life Assurance Co.*³¹ the New York Supreme Court upheld the governing law clause in a group insurance policy as a valid exercise of the contracting parties' autonomy, refusing to apply the "center of gravity" or "grouping of contacts" doctrine.³² The New York Supreme Court took a

29. *Id.* at 542, 372 N.Y.S.2d at 116.

30. *Id.* at 539, 543, 372 N.Y.S.2d at 114, 117.

31. 61 Misc. 2d 918, 307 N.Y.S.2d 238 (Sup. Ct. Richmond County 1970). This was an action by the designated beneficiary on a certificate of insurance issued under a group life insurance policy against the Canadian insurance carrier which had contested the coverage on the ground that the insured, a New York resident, had made fraudulent statements in his application. The group policy as well as the certificate of insurance provided that the policy was governed by Illinois law, under which the insurer had a complete defense based on the misrepresentation. Under New York law, it could not assert a defense.

32. The court reached the result on the basis of a rather one-sided understanding of the doctrine of *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954). The court said that "this doctrine is motivated by our public policy to protect our domiciliaries from the inequities of foreign laws that might advantage the domiciliaries of those foreign States vis-a-vis ours," and that in the instant case "there is admitted fraud in the application, and the *raison d'être* for the implementation of the 'center of gravity' doctrine is totally lacking." 61 Misc. 2d at 923, 307 N.Y.S.2d at 244.

In *Antinora v. Nationwide Life Ins. Co.*, 76 Misc. 2d 599, 350 N.Y.S.2d 863 (Sup. Ct. Monroe County 1973), the court granted a motion for summary judgment in an action brought by the plaintiff insured against his former employer (who was also the insurance

similar approach in *Sears, Roebuck & Co. v. Enco Associates*,³³

carrier) to recover money due under an accident and health group insurance policy. The policy stated that it was governed by the laws of Ohio but the certificate of insurance did not mention the governing law. When the employee resigned from his employment he was not given notice of his conversion privileges and he did not convert his coverage to an individual policy. Section 162(5) of the N.Y. INS. LAW (McKinney 1966, Supp. 1979-80) required such notice. The court held that New York law must prevail even though the group contract was entered into and delivered in Ohio, the contracting parties to the master policy were Ohio corporations and the master policy itself stated that the law of Ohio should apply. Although the court cited *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), and referred to New York's dominant interest in the resolution of the questions under consideration, 76 Misc. 2d at 605-06, 350 N.Y.S.2d at 870, the court probably thought that the New York law on notification of conversion privileges constituted a public policy which must prevail over a stipulated law. The decision should not be read as applying the principle of *Haag v. Barnes*, 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961). The court could also have argued that plaintiff was never advised of the governing law clause and could have relied on the approach taken in *Fricke v. Isbrandtsen Co.*, 151 F. Supp. 465 (S.D.N.Y. 1957). See text accompanying notes 99-106 *infra*. As the court pointed out, it was logical for the insured to assume that the insurance coverage was governed by New York law since the certificate of insurance (which did not refer to the choice of Ohio law in the group insurance policy) was delivered to him in the State of New York, 76 Misc. 2d at 606, 350 N.Y.S.2d at 871. *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. 1975), disagrees with the decision in the *Antinora* case on two points: the policy expressed in New York's law on notification of conversion rights does not constitute a fundamental public policy which overrides a choice of law provision; and failure to mention the governing law in the certificate of insurance is of no consequence because the expectations of the parties to the master policy that the stipulated law applies should not be accorded any less weight than those of the insured or his beneficiary.

Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund, 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. 1975); *Kahn v. Great-West Life Assurance Co.*, 61 Misc. 2d 918, 307 N.Y.S.2d 238 (Sup. Ct. 1970); and *Antinora v. Nationwide Life Ins. Co.*, 76 Misc. 2d 599, 350 N.Y.S.2d 863 (Sup. Ct. 1973), are group insurance cases. The need for giving effect to a choice of law provision set forth in the group policy is especially strong because it would not be practical to have such a policy governed by different laws depending upon the persons insured. This need for uniformity and certainty is, of course, not basically different from the need for certainty in all commercial agreements.

33. 83 Misc. 2d 552, 370 N.Y.S.2d 338 (Sup. Ct. Westchester County 1975), *aff'd*, 54 App. Div. 2d 13, 385 N.Y.S.2d 613 (1976), *modified*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977). The case involved an architect's contract which stipulated the application of Michigan law. The court held that defendant's motion to dismiss must be granted regardless of whether New York or Michigan law applied. In dictum, the court said that it would find that Michigan law governed the agreement. It stated that the "interest analysis" of *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), was not appropriate because this is "a commercial transaction in which the parties have expressed their intent to have the law of the State of Michigan applied and under the circumstances, the intent of the parties should be given effect. . . . It has been held that where the contract provides that the law of another State is to apply, that law will be applied so long as the contract has a reasonable relation to it." *Id.* at 563, 370 N.Y.S.2d at 348.

In *Levey v. Saphier*, 83 Misc. 2d 146, 370 N.Y.S.2d 808 (Sup. Ct. Nassau County 1975), the court gave effect to a stipulation of New York law in an option and voting agreement among shareholders and former shareholders of a Delaware corporation. The court found the contacts with New York to be "substantial". *Id.* at 149, 370 N.Y.S.2d at 813.

In *General Elec. Credit Corp. v. Beyerlein*, 55 Misc. 2d 724, 286 N.Y.S.2d 351 (Sup. Ct.

and the Appellate Division in *Crisafulli v. Childs*³⁴ in a dictum summarized New York law by stating:

The traditional view of the choice of law rules concerning contracts, *where the parties have not expressed such choice in their agreement*, has been rejected in this State in favor of the application of the law of the jurisdiction having the greatest interest in the litigation. . . .³⁵

Monroe County 1967), *aff'd*, 30 App. Div. 2d 762, 292 N.Y.S.2d 32 (1968), the court gave effect to a governing law clause without discussion.

In *Clurman v. Clurman*, 84 Misc. 2d 148, 373 N.Y.S.2d 951 (Sup. Ct. N.Y. County 1975), *aff'd*, 51 App. Div. 2d 915, 382 N.Y.S.2d 281 (1976), a case involving a separation agreement, the court stated that it is well established under New York law that where it can be ascertained, the intent of the parties shall govern as to which state's law shall apply.

In *National Equip. Rental, Ltd. v. Graphic Art Designers, Inc.*, 36 Misc. 2d 442, 234 N.Y.S.2d 61 (Sup. Ct. Nassau County 1962), the court discussing a governing law clause said: "Express stipulations in furtherance of business convenience or necessity and voluntarily made should not be lightly disregarded." *Id.* at 444, 234 N.Y.S.2d at 63.

In *re Sik's Estate*, 205 Misc. 715, 129 N.Y.S.2d 134 (Sur. Ct. N.Y. County 1954), involved a contract between two residents of Yugoslavia for payment in U.S. dollars from a New York account. The agreement did not stipulate a governing law. The court found that the parties presumably intended the agreement to be governed by the law which had power and jurisdiction over the account and stated that the law determining the validity of an agreement is "the law which the parties intended to govern it, provided the transaction has some reasonable connection with the place where such law operates." *Id.* at 719, 129 N.Y.S.2d at 138. In *In re Rosenbergs' Estates*, 131 N.Y.S.2d 59 (Sur. Ct. N.Y. County 1954), the court held that New York law applied to the opening of a bank account with a New York bank by Germans resident in Holland. The court stated:

The law which determines the validity of a contract . . . is the law which the parties intended to apply, provided the transaction has some reasonable connection with the place where such law operates. . . . The parties voluntarily transferred the money to a bank in New York and chose a form of account recognized by the law of this State. All parties intended the law of New York to govern the transaction.

131 N.Y.S.2d at 66-67 (Citation omitted). A clear intention (although not expressed in a governing law clause) that New York law was to govern an agreement was given effect in *In re Estate of Bulova*, 29 Misc. 2d 160, 216 N.Y.S.2d 26 (Sur. Ct. N.Y. County), *aff'd*, 14 App. Div. 2d 249, 220 N.Y.S.2d 541 (1961).

34. 33 App. Div. 2d 293, 307 N.Y.S.2d 701 (1970).

35. *Id.* at 296, 307 N.Y.S.2d at 704 (emphasis added). Although this case applies the special conflict-of-laws rule relating to usury, the court in this passage stated the generally applicable conflict-of-laws rule relating to contracts.

In *Gambar Enterprises, Inc. v. Kelly Services, Inc.*, 69 App. Div. 297, 418 N.Y.S.2d 818 (1979), the Appellate Division upheld a governing law clause in a service contract stipulating Michigan law and summarized New York law by stating:

Traditionally, where the parties have manifested their intentions to have an agreement governed by the law of a particular jurisdiction, their intentions have been honored. . . . In this respect, the general rules concerning the law governing a contract are subordinate to the primary canon of construction requiring that the intention of the parties be given effect. . . . The jurisdiction whose law the parties intended to apply, however, must bear a reasonable relation to the agree-

This dictum impliedly rejects the application of the interest approach in cases where the parties have included a choice-of-law clause in their agreement.³⁶

ment. . . ; and the enforcement of the provision applying a foreign rule of law must not violate a fundamental public policy of New York. . . .

Id. at 303, 418 N.Y.S.2d at 822. The court found a reasonable relation to Michigan because the contract was accepted by one party in Michigan, and performance of the contract required substantial activities in Michigan by the same party although the performance by the other party took place in New York.

In *Employers' Liab. Assurance Corp. v. Aresty*, 11 App. Div. 2d 331, 205 N.Y.S.2d 711 (1960), *aff'd*, 11 N.Y.2d 696, 180 N.E.2d 916, 225 N.Y.S.2d 764 (1962), a case involving a liability insurance policy which did not contain a governing law clause, the court gave effect to the intention of the parties as to the governing law, stating: "At the time the contract was executed in the instant case there can be no doubt that the parties intended the measure of their obligation thereunder to be determined by New York law." *Id.* at 333, 205 N.Y.S.2d at 714. *But see* dissent of Judge Valente, *id.* at 336, 205 N.Y.S.2d at 717.

36. *I.S. Joseph Co. v. Toufic Aris & Fils*, 54 App. Div. 2d 665, 388 N.Y.S.2d 1 (1976), is confusing. The court affirmed a judgment dismissing a petition for a stay of arbitration and granting a cross-petition to direct the parties to proceed to arbitrate. The agreement under consideration was a grain sales agreement between a Minnesota seller and a French-Lebanese purchaser. The agreement incorporated by reference the standard contract of the North American Export Grain Association which contained an arbitration clause providing for arbitration of any controversy in New York under the laws of the State of New York and consenting to the jurisdiction of the courts of New York in connection therewith. The seller argued that the agreement was governed by the law of Louisiana. After stating that Louisiana law and New York law did not substantially differ with respect to the issues under consideration, the court found that as to the portion of the contract relating to arbitration, New York had the most significant contacts and under New York law the agreement to arbitrate was valid. Alternatively, the court relied upon the first sentence of U.C.C. § 1-105 (1962 version) which deals with governing law clauses and found that "[h]ere the parties have agreed that the law of New York shall govern as to arbitration and, at least as to the provision for arbitration, the transaction bears a reasonable relation to New York." *Id.* at 666, 388 N.Y.S.2d at 3. The clause providing for arbitration in New York was not a governing law clause. It merely stated where and under which procedure (*i.e.*, N.Y. Civ. Prac. Law § 7501 (McKinney 1963)) arbitration should take place, and was similar to a forum selection or jurisdiction clause. Therefore, the court correctly resorted to *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), when considering which law governed the validity of the arbitration clause. But the reference to U.C.C. § 1-105 was misplaced since § 1-105 does not apply to arbitration clauses. It has never been suggested that the place of arbitration must be reasonably related to the transaction. If the clause providing for arbitration under New York law is read as a governing law clause limited to the issue of arbitration, the court in effect followed *Haag v. Barnes*, 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961), by analyzing the effectiveness of this clause under *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954).

In *Electronic & Missile Facilities, Inc. v. Curtis*, 38 Misc. 2d 423, 236 N.Y.S.2d 594 (Sup. Ct. N.Y. County 1962), the court held that New York law governed an arbitration clause. The clause stipulated that application for the appointment of an arbitrator should be made to the New York Supreme Court and that said court should have jurisdiction over every party in connection with such arbitration. The court asserted that the clause was evidence of the fact that the parties clearly intended New York law to govern the arbitration provisions of the contract and stated that this expressed intention of the parties should not be frustrated. The court did not mention the requirement of a reasonable relationship be-

Several decisions of the Federal District Court for the Southern District of New York have applied the New York conflict-of-laws rule under discussion. The most recent is *Fleischmann Distilling Corp. v. Distillers Co. Ltd.*,³⁷ an action arising out of distributorship agreements between United States distributors of imported Scotch whiskey and British distillers. The agreements provided that they were to be governed by the law of England. The court said:

The canon in New York . . . is that the intent of the parties shall govern as to the choice of law regarding their contract, provided that intent can be discovered and that the state chosen bears a reasonable relationship to the agreement.³⁸

The court cited in support for this statement *A.S. Rampell v. Hyster Co.* and several older cases.³⁹ The court found that the reasonable relation was met, for the contracts were executed in the United Kingdom, the distillers were incorporated in the United Kingdom, performance by the distillers occurred in the United Kingdom, and payment was made and title to the goods passed in the United Kingdom.

In *B.M. Heede, Inc. v. West India Machinery and Supply Co.*,⁴⁰ a suit for breach of contract by a New York company against a Puerto Rican company, the court again upheld the choice of New York law summarizing the applicable rule as follows:

The parties may stipulate in the contract the law to be

tween the transaction and the State of New York but in fact established such relationship by pointing out that one of the parties resided in New York and that the contract was made in New York. The court distinguished *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), because that case attempted to give effect to the probable intention of the parties, whereas here the actual intention of the parties was known. The court stated that where there is an express choice of law clause, *Auten v. Auten* does not apply. If one accepts the court's premise that a governing law clause must be read into the arbitration clause, the decision follows the pattern of New York cases. The *Electronic & Missile Facilities* and the *I.S. Joseph Co.* cases mention as alternative bases for decision that an arbitration clause relates to the law of remedies which are governed by the law of the forum.

37. 395 F. Supp. 221 (S.D.N.Y. 1975). Unless otherwise indicated, the federal decisions cited below were rendered in diversity cases.

38. *Id.* at 229.

39. *A.S. Rampell, Inc. v. Hyster Co.*, 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957); *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*, 269 N.Y. 22, 198 N.E. 617, *remittitur amended*, 269 N.Y. 602, 199 N.E. 691 (1935), *cert. denied*, 297 U.S. 705 (1936); *Westchester Mortgage Co. v. Grand Rapids & Ionia R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927).

40. 272 F. Supp. 236 (S.D.N.Y. 1967).

applied in determining questions of validity (or, at least, closely related subjects) and interpretation, where the law chosen has some reasonable relationship with the contract and where the fundamental public policy of the forum is not vitiated. . . . The New York State court decisions require no different result.⁴¹

The court found a reasonable relation because plaintiff was a New York corporation, and the agreement was at least partially executed in New York and partially performable in New York.⁴²

41. *Id.* at 241. The court cited in support *A.S. Rampell, Inc. v. Hyster Co.*, 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957), and referred to *Wyatt v. Fulrath*, 16 N.Y.2d 169, 211 N.E.2d 637, 264 N.Y.S.2d 233 (1965).

42. Plaintiff's principal place of business was in New York. Defendant's only office was in Puerto Rico and it did no business in New York. Initial contact was made in Puerto Rico, most negotiations were by mail, and the contract was signed by defendant in Puerto Rico and by plaintiff in New York.

Other recent relevant decisions of the District Court for the Southern District of New York follow. In *Skandia Am. Reinsurance Corp. v. Schenck*, 441 F. Supp. 715 (S.D.N.Y. 1977), the court said in dictum that "New York courts have generally permitted the contracting parties to choose the applicable law . . . [and] will uphold choice of law clauses in insurance contracts provided that the law chosen bears a reasonable relationship to the transaction and violates no substantial state public policy." *Id.* at 723. However, the governing law clause in that case was limited to arbitration proceedings and did not extend to the event of insolvency. *CBS, Inc. (CBS Records Division) v. Tucker*, 412 F. Supp. 1222 (S.D.N.Y. 1976), gave effect to a governing law clause in a recording contract providing for New York law, stating, "New York conflict of laws rules . . . give great deference to such an expression of intent in the contract itself." *Id.* at 1226 n.5. In *Nakhleh v. Chem. Constr. Corp.*, 359 F. Supp. 357 (S.D.N.Y. 1973), a motion for summary judgment was denied. The case involved a claim for a finder's fee based upon an alleged oral contract, which, plaintiff claimed, by its terms included an agreement that it was to be governed by Saudi Arabian law. Summary judgment was not appropriate since there was a question of fact as to whether an oral contract existed and, if so, whether there was an intention to apply Saudi Arabian law. The court found that there was a "dearth of recent New York cases dealing with the recognition of the parties' choice of law intention," *id.* at 360, but believed that New York courts would follow § 187 of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971) and concluded that New York would apply a choice-of-law rule giving effect to the parties' intention regarding the law applicable to the contract. In *Bache & Co. v. International Controls Corp.*, 339 F. Supp. 341 (S.D.N.Y.), *aff'd per curiam*, 469 F.2d 696 (2d Cir. 1972), the court said that a court would determine applicable law by looking to the "center of gravity" or the "grouping of contacts" theory of law only if there is no explicit provision, no clear intention and no expectation of the parties as to the law that would apply. *Id.* at 348.

In *Oakley v. National W. Life Ins. Co.*, 294 F. Supp. 504 (S.D.N.Y. 1968), the court followed the *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), approach and applied New York law to a group life insurance policy. The court stressed that its decision was "necessitated by the fact that the parties to [the] contract did not specify what law would govern" and further noted that "[t]here is nothing in the New York cases to indicate that the parties could not specify which law would govern as long as the law chosen bears a reasonable relation to the transaction." 294 F. Supp. at 510.

The court in *Boyd v. Curran*, 166 F. Supp. 193, 196 (S.D.N.Y. 1958), stated that a

The Federal Court of Appeals for the Second Circuit in *General Electric Co. v. Masters Mail Order Co.*⁴³ lent support to this view of New York law by referring in a dictum to the "familiar doctrine that parties to a multi-state contract can agree as to which state's law will govern, provided the state selected has a direct and substantial relation to the transaction."⁴⁴

This review of New York cases shows that New York courts overwhelmingly have not applied the grouping of contacts theory of *Auten v. Auten* in cases where the parties have agreed on an applicable law. Several New York Supreme Court decisions expressly refused to follow the *Auten* test in cases where the parties had agreed on a governing law and where that law had a reasonable relationship to the transaction.⁴⁵ One post-*Auten* Court of Ap-

choice-of-law clause will be given effect if there are "pertinent contacts with New York."

In *Reines Distribs., Inc. v. Admiral Corp.*, 256 F. Supp. 581 (S.D.N.Y. 1966), the court gave effect to a governing law clause stipulating that the law of Illinois was applicable. The court did not discuss the question at length because Illinois was the place where the contract was executed and where the defendant had its principal place of business. *Id.* at 586. It presumably applied New York conflict-of-laws rules in reaching its decision; see *National Fruit Prod. Co. v. Dwinell-Wright Co.*, 47 F. Supp. 499, 502-04 (D.C. Mass. 1942), *aff'd*, 140 F.2d 618 (1st Cir. 1944).

In *United States v. Framen Steel Supply Co.*, 435 F. Supp. 681 (S.D.N.Y. 1977), an action brought under 28 U.S.C. § 1345, the court gave effect to a governing law clause without discussion.

The New York conflict-of-laws rule under discussion was applied by the Federal District Court for the Eastern District of New York in *Weight Watchers of Quebec Ltd. v. Weight Watchers Int'l, Inc.*, 398 F. Supp. 1047 (E.D.N.Y. 1975), a diversity action by two Canadian franchisees against a New York franchisor for breach of the franchise agreement. The court gave effect to a stipulation of New York law in the two franchise agreements, stating:

The court will honor a choice-of-law rule consented to by the parties where there is a reasonable basis for the choice or the chosen state has some relation to the agreement.

Id. at 1051 n.17.

In *H.B. Fuller Co. v. Hagen*, 363 F. Supp. 1325 (W.D.N.Y. 1973), the court did not give effect to the stipulation of Minnesota law in an employment contract for a salesman who was hired in Buffalo, N.Y., signed his contract in New York, called upon customers in the Western New York area, was supervised from the employer's Buffalo office and had no contact with Minnesota. The employer's headquarters were located in Minnesota and the employer signed the contract there. Not stating any legal rule nor citing any authority, the court concluded that New York law controlled. Presumably the court found that there was no reasonable relationship to Minnesota.

43. 244 F.2d 681 (2d Cir.), *cert. denied*, 355 U.S. 824 (1957).

44. *Id.* at 687. While this was a diversity case in which New York conflict-of-laws rules are applicable, the court stated the rule in general terms.

45. *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. 1975); *Sears, Roebuck & Co. v. Enco Assoc.*, 83 Misc. 2d 552, 370 N.Y.S.2d 338 (Sup. Ct. 1975), *aff'd*, 54 App. Div. 2d 13, 385 N.Y.S.2d 613 (1976), *modified*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977); *Kahn v. Great-West Life Assur-*

peals decision, *A.S. Rampell, Inc. v. Hyster Co.*,⁴⁶ stated the rule that the law chosen by the parties prevails if the agreement has a reasonable relation to the stipulated law. However, *A.S. Rampell, Inc. v. Hyster Co.* preceded *Haag v. Barnes* and relied only on pre-*Auten* cases. Since *Haag v. Barnes* the New York Court of Appeals did not again address the question of whether the doctrine of *Auten v. Auten* should be applied if an agreement contains a governing law clause. Possibly one New York Appellate Division decision has adopted the approach of *Haag v. Barnes*; however, this decision deals with an arbitration clause and is not clearly reasoned.⁴⁷ Federal courts in New York have consistently interpreted New York law to be that the intent of contracting parties governs as to applicable law, provided that the state whose law is chosen bears a reasonable relationship to the contract. Although federal courts sometimes express the rule in different words, no different meaning seems intended. They never mention the *Haag v. Barnes* approach in this context.

The Uniform Commercial Code (U.C.C.) became law in New York in 1964, three years after *Haag v. Barnes* was decided, and the legislative preference for upholding party agreements on governing law expressed in U.C.C. section 1-105(1) must be considered in assessing the validity of that decision. Furthermore, it should be

ance Co., 61 Misc. 2d 918, 307 N.Y.S.2d 238 (Sup. Ct. 1970); *Electronic & Missile Facilities, Inc. v. Curtis*, 38 Misc. 2d 423, 236 N.Y.S.2d 594 (Sup. Ct. 1962).

46. *A.S. Rampell, Inc. v. Hyster Co.*, 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957). See text accompanying notes 23-26 *supra*.

47. *I.S. Joseph Co. v. Toufic Aris & Fils*, 54 App. Div. 2d 665, 388 N.Y.S.2d 1 (1976). *Joy v. Heidrick & Struggles, Inc.*, 93 Misc. 2d 818, 403 N.Y.S.2d 613 (Civ. Ct. N.Y. County 1977), was an action for the breach of an employment contract which contained a governing law clause stipulating Illinois law. The court cited *RESTATEMENT (SECOND) OF CONFLICT OF LAWS*, § 187(2) (1971) as reflecting New York law and held that Illinois had no "substantial relation to or reasonable basis for" the parties. *Id.* at 821, 403 N.Y.S.2d at 615. The agreement was executed and performed in New York, the employee was a resident of New Jersey and the employer was a Delaware corporation with offices in various cities, including New York City and Chicago. The only connection to Illinois was that the employer gave its Illinois office address under its signature in the agreement and notices under the agreement were to be given to the address "indicated below," *i.e.*, the Illinois address. The court then held that under the grouping of contacts and interest analysis approach, New York law governed. In dictum the court said that the reasonable relation doctrine is "the traditional view, but [is] not rigidly followed." *Id.* It is not clear what the court meant, as the opinion itself followed the "traditional" approach.

In *Watts v. Swiss Bank Corp.*, 43 Misc. 2d 758, 252 N.Y.S.2d 196 (Sup. Ct. N.Y. County 1964), modified on other grounds, 24 App. Div. 2d 849, 264 N.Y.S.2d 667 (1965), the court applied New York law to agreements entered into in connection with custodial accounts. Although the agreements stated that New York law was to apply, the court, without explaining the need for doing so, also analyzed the transaction in relation to *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954).

pointed out that the agreement in *Haag v. Barnes* was not a commercial agreement. Thus, it is likely that the suggestion of *Haag v. Barnes*, that is, to apply the *Auten v. Auten* test even if the agreement in question contains a choice-of-law clause, has no longer any force. However, until the suggestion of *Haag v. Barnes* has been rejected by the Court of Appeals, the danger remains that a court will hold it to be the law of New York.

Although conflict-of-laws cases decided before *Auten v. Auten* are only of limited relevance today, they show that in upholding the expressed intent of parties to an agreement as to the governing law, the present law is consistent with prior New York law.⁴⁸ The

48. These cases reflect the "vested rights rule," according to which the law of the place of making governed the validity and effect of a contract while matters of performance were governed by the place of performance. The rule left no room for the parties to choose the law governing their agreement. RESTATEMENT OF CONFLICT OF LAWS §§ 332, 358 (1934). *Louis-Dreyfus v. Paterson Steamships, Ltd.*, 43 F.2d 824 (2d Cir. 1930), applying federal conflict-of-laws rules. *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115 (2d Cir. 1931), involving a bill of lading which contained a clause stating that the contract should be governed by English law. The contract was entered into in Italy and Judge Learned Hand, applying federal conflict-of-laws rules, found that Italian law applied. He said: "People cannot by agreement substitute the law of another place. . . . Some law must impose the obligation, and the parties have nothing whatever to do with that." *Id.* at 117.

The cases indicate, however, that in its pure form this rule never represented the law of the State of New York. Numerous New York cases state that the intention of the parties takes precedence over the mechanical rules which only look to the *lex loci contractus* or the *lex loci solutionis*. In *Chinchilla v. Foreign Tankship Corp.*, 195 Misc. 895, 91 N.Y.S.2d 213 (N.Y. City Ct. 1949), *modified on other grounds*, 197 Misc. 1058, 97 N.Y.S.2d 835 (Sup. Ct. 1950), *aff'd*, 278 App. Div. 556, 102 N.Y.S.2d 438 (1951), the court stated in dictum that the parties to a transaction do not have *complete* autonomy in the choice of law that governs their transaction. This was a claim for breach of an employment contract which stipulated Panamanian law only for "all cases of illness or injury incurred while in the service of the vessel." *Id.* at 900, 91 N.Y.S.2d at 218. Since this condition for the application of Panamanian law to the breach of contract claim was not met, the court applied New York law.

In *Hal Roach Studios, Inc. v. Film Classics, Inc.*, 156 F.2d 596 (2d Cir. 1946), the court, in a diversity action presumably but not clearly applying New York law, affirmed the validity of rescission of a film distribution contract in accordance with a default clause. The court gave effect to a governing law clause in the agreement providing for New York law to govern the agreement, stating:

Where, however, there is no single place of performance, and there are many jurisdictions with which the contract has close association, there seems no reason, apart from the policy of the forum, why the parties cannot specify the law of one jurisdiction as controlling, so long as there is that sufficient relationship to make it reasonable that the law chosen should apply.

Id. at 598.

In *Kleve v. Basler Lebens-Versicherungs-Gesellschaft*, 182 Misc. 776, 45 N.Y.S.2d 882 (Sup. Ct. N.Y. County 1943), the court said that "[o]ur courts recognize that it is the intention and agreement of the parties which are controlling" as to governing law. *Id.* at 780, 45 N.Y.S.2d at 885. In *Duval v. Skouras*, 181 Misc. 651, 44 N.Y.S.2d 107 (Sup. Ct. N.Y. County 1943), *aff'd*, 267 App. Div. 811, 46 N.Y.S.2d 888 (1944), *aff'd*, 270 App. Div. 841, 61 N.Y.S.2d 379 (1946), the court stated: "These general rules [relating to the law of the place where the

Restatement (Second) of Conflict of Laws also allows the parties to a contract considerable autonomy in choosing the law applicable to their contract but the Restatement approach differs in several respects from the approach taken by the New York courts.⁴⁹

contract is made and the law of the place of performance], however, yield to the primary canon of construction, which requires that, where it can be ascertained, the intention of the parties shall govern." *Id.* at 653, 44 N.Y.S.2d at 109. In *Goodman v. Deutsch-Atlantische Telegraphen Gesellschaft*, 166 Misc. 509, 2 N.Y.S.2d 80 (Sup. Ct. Kings County 1938), the court stated that although a manifest intention of the parties as to a governing law will be upheld, the references to German law in the deed of trust under consideration did not amount to an agreement that German law should govern the rights and liabilities of the trustee. In *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*, 269 N.Y. 22, 198 N.E. 617 (1935), *remittitur amended*, 269 N.Y. 602, 199 N.E. 691 (1936), *cert. denied*, 297 U.S. 705 (1936), the court stated: "The intent of the parties, express or implied, generally determines the law that governs a contract." *Id.* at 26, 198 N.E. at 618. See also *Dougherty v. Equitable Life Assurance Soc'y*, 266 N.Y. 71, 193 N.E. 897 (1934). In *Strebler v. Wolf*, 152 Misc. 859, 273 N.Y.S. 653 (Sup. Ct. N.Y. County 1934), the court upheld the stipulation of French law in an antenuptial agreement stating: "[I]t is the intention of the parties that governs and by express or implied agreement they may select another jurisdiction." *Id.* at 861-62, 273 N.Y.S. at 657. In *F.A. Straus and Co. v. Canadian Pacific R.R.*, 254 N.Y. 407, 173 N.E. 564 (1930), the court upheld a governing law clause in a bill of lading which stipulated the law of Great Britain but held that certain provisions of the bill of lading violated the public policy of New York. In *Smith v. Compania Litografica de la Habana*, 127 Misc. 508, 217 N.Y.S. 39 (Sup. Ct. Kings County 1926), *aff'd*, 220 App. Div. 782, 222 N.Y.S. 902 (1927), the court stated: "The general rule is that the *lex loci contractus prima facie* determines the validity, obligation and legal effect of a contract. This rule yields to an express or implied contrary intention of the parties that some other law is to control." *Id.* at 511-12, 217 N.Y.S. at 42. *Burns v. Burns*, 190 N.Y. 211, 82 N.E. 1107, 150 N.Y.S. 1029 (1907), upheld a governing law clause stipulating that a life insurance policy should be governed by Ohio law. In *Stumpf v. Hallahan*, 101 App. Div. 383, 91 N.Y.S. 1062 (1905), *aff'd*, 185 N.Y. 550, 77 N.E. 1196, 145 N.Y.S. 1119 (1906), the court stated: "These general rules are subordinate to the primary canon of construction, which requires that where it can be ascertained the intention of the parties shall govern." *Id.* at 386, 91 N.Y.S. at 1063. In *Union Nat'l Bank of Chicago v. Chapman*, 169 N.Y. 538, 62 N.E. 672, 129 N.Y.S. 536 (1902), the court wrote: "[T]he contract must be construed and determined under the law of the state where it was executed unless it could fairly be said that the parties at the time of its execution clearly manifested an intention that it should be governed by the laws of another state." *Id.* at 545, 62 N.E. at 674, 129 N.Y.S. at 915 (emphasis in the original). In *Wilson v. Lewiston Mill Co.*, 150 N.Y. 314, 44 N.E. 959, 110 N.Y.S. 1065 (1896), the court said: "[T]he intention of the parties so far as it is disclosed must control." *Id.* at 323, 44 N.E. at 961, 110 N.Y.S. at 1068. See also *China Mut. Ins. Co. v. Force*, 142 N.Y. 90, 36 N.E. 874, 103 N.Y.S. 258 (1894). In *Dyke v. Erie Ry.*, 45 N.Y. 113, 18 N.Y.S. 793 (1871), the court stated:

The generally received rule for the interpretation of contracts, is that they are to be construed and interpreted according to the laws of the State in which they are made unless from their terms, it is perceived that they were entered into with a view to the laws of some other State.

Id. at 116, 18 N.Y.S. at 794. In *Thompson v. Ketcham*, 8 Johns. 189 (N.Y. 1811), Chief Judge Kent approvingly cited Lord Mansfield's statement that "the law of the place [of making] can never be the rule, where the transaction is entered into with an express view to the law of another country . . ." *Id.* at 193 (emphasis in the original).

49. The relevant section of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971)

2. Uniform Commercial Code, Section 1-105

The rule that the parties to an agreement may choose a gov-

provides:

§ 187. Law of the State Chosen by the Parties.

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) 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.

(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen law.

Section 188 of the Restatement provides that in the absence of an effective choice of law by the parties the law of the state which has the most significant relationship to the transaction applies. See generally Reese, *Contracts and the Restatement of Conflict of Laws, Second*, 9 INT'L & COMP. L.Q. 531 (1960); Sedler, *The Contracts Provisions of the Restatement (Second): An Analysis and a Critique*, 72 COLUM. L. REV. 279 (1972).

The distinction between facultative or dispositive rules of law (§ 187(1)) and non-facultative or imperative rules of law (§ 187(2)) has not been applied by New York cases. However, the last sentence in Official Comment 1 to U.C.C. § 1-105 (1972 version) states that "an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen." The New York Court of Appeals in *Freedman v. Chem. Constr. Corp.*, 43 N.Y.2d 260, 372 N.E. 2d 12, 401 N.Y.S.2d 176 (1977), supported the distinction in the following dictum:

As a general matter, the parties' manifested intentions to have an agreement governed by the law of a particular jurisdiction are honored. . . . It is as though the law of the selected jurisdiction were incorporated into the agreement by reference [citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, Comment c]. But where, as with the Statute of Frauds, the issue arguably cannot be controlled by voluntary agreement, there is some question whether, in the absence of a reasonable basis for choosing the law of the jurisdiction designated by the parties, their choice of law will be honored. . . .

Id. at 265 n., 372 N.E. 2d at 15 n., 401 N.Y.S.2d at 179-80 n.

Scientific Holding Co. v. Plessey Inc., 510 F.2d 15, 21-22 (2d Cir. 1974), erroneously relied in a diversity case on RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187(1) (1971) in upholding a choice-of-law clause. The question before the court was whether an amendment to a contract to purchase the assets of a corporation, when in writing and signed by the corporate president, was invalid for lack of consideration under the New York Statute of Frauds. The purchaser was the Delaware subsidiary of an English corporation; the seller was a Barbados corporation. Negotiations relating to the sales contract were held by American lawyers, primarily in New York although partially by telephone between New York and

erning law, so long as there is a reasonable relation between the transaction and the jurisdiction whose law was chosen, is expressed in the first sentence of section 1-105(1) of the New York Uniform Commercial Code.⁵⁰ This sentence provides that "when a transac-

Chicago. The closing took place in Barbados where the amendment in question was also signed. The purchase agreement stipulated the applicability of New York law and the amendment did not contain a governing law clause. Plaintiff claimed that the governing law clause did not apply to the amendment and that Barbados law governed the amendment. Since Barbados law required new consideration to accomplish a binding modification of an existing contract, the amendment would have been invalid. The court held that the parties intended the governing law clause to apply to the amendment and upheld the governing law clause relying on Restatement § 187(1). This reliance is misplaced. The Statute of Frauds and the requirement of consideration are mandatory rules of law, *i.e.* rules which the parties could not alter or modify by agreement within a particular legal system. See Section III B *infra* and RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, Comment d, at 564, Illustration 6, at 566 (1971). The principle suggested in Restatement § 187(1) could not validate the choice-of-law clause because the particular issue was not one which the parties could have resolved by an explicit provision in their agreement directed to that issue. For this reason, the court should have upheld the governing law clause under the reasonable relationship rule rather than under § 187(1). Curiously, the court cited neither a New York decision nor U.C.C. § 1-105(1).

The distinction between facultative and imperative rules is discussed in Reese, *supra* note 3, at 50-51; Yntema, "Autonomy" in *Choice of Law*, 1 AM. J. COMP. L. 341, 355, 357 (1952); James, *supra* note 3, at 38; Prebble, *supra* note 3, Part I, 491. See note 116 and text accompanying note 130 *infra*.

It should be noted that the Restatement requires a "substantial relationship" rather than a "reasonable relationship" between the transaction and the chosen state. However, if there is no substantial relationship, the Restatement would still uphold the choice-of-law clause if there is a "reasonable basis for the parties' choice." Comment f to § 187 explains that "when contracting in countries whose legal systems are strange to them as well as relatively immature, the parties should be able to choose a law on the ground that they know it well and that it is sufficiently developed." RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, Comment f, at 567 (1971). No New York court has clearly held that a "reasonable basis" is sufficient. *Joy v. Heidrick & Struggles, Inc.*, 93 Misc. 2d 818, 821, 403 N.Y.S.2d 613, 615 (Civ. Ct. N.Y. County 1977), and *Weight Watchers of Quebec Ltd. v. Weight Watchers Int'l, Inc.*, 398 F. Supp. 1047, 1051 n.17 (E.D.N.Y. 1975), cite with approval RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187(2)(a) (1971) but the decisions did not rely on a "reasonable basis" test. *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 542, 372 N.Y.S.2d 97, 116-17 (Sup. Ct. 1975), cites with approval Comment f to § 187 of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971) which states that "[t]he parties to a multistate contract may have a reasonable basis for choosing a state with which the contract has no substantial relationship" and concluded that the choice-of-law provision under consideration had a reasonable basis to support application of Illinois law.

50. N.Y. U.C.C. § 1-105 (McKinney 1964, Supp. 1979-80) reads in full:

§1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law.

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable

tion bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties." U.C.C. section 1-105(1) does not contain a rule of general applicability, *i.e.*, a rule which allows the parties to choose the "law" to apply to their "transaction" whether or not such transaction is covered by the U.C.C.⁵¹ However, as one of the very few statutory expressions⁵² of a general principle of conflict of laws it

law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Bulk transfers subject to the Article on Bulk Transfers. Section 6-102.

Applicability of the Article on Investment Securities. Section 8-106.

Perfection provisions of the Article on Secured Transactions. Section 9-103.

The last clause referring to § 9-103 is in the version of the 1972 Official Text and became law in the State of New York on July 2, 1978 (1977 N.Y. Laws ch. 866, § 38). See Adams, *The 1972 Official Text of the Uniform Commercial Code: Analysis of Conflict of Laws Provisions*, 45 MISS. L.J. 281, 315 (1974); Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477, 529 (1973).

The N.Y. BANKING LAW (McKinney 1971) contains in § 138 and § 204-a(3) rules which modify in certain instances the provisions of U.C.C. § 1-105 with respect to liability for contracts performable and deposits repayable at foreign branch offices of domestic and foreign banking corporations. Another exception to U.C.C. § 1-105 is Section 143(2) of the N.Y. INSURANCE LAW (McKinney 1966).

Articles discussing U.C.C. § 1-105 are: Comment, *The Uniform Commercial Code and Conflict of Laws*, 9 AM. J. COMP. L. 458 (1960); Cullen, *Conflict of Laws Problems Under the Uniform Commercial Code*, 48 KY. L.J. 417 (1960); DeB. Katzenbach in Malcolm, *Panel Discussion on the Uniform Commercial Code*, 12 BUS. LAW. 49, 68 (1956); Nordstrom, *Choice of Law and the Uniform Commercial Code*, 24 OHIO ST. L.J. 364 (1963); Nordstrom & Ramerman, *The Uniform Commercial Code and the Choice of Law*, 1969 DUKE L.J. 623 (1969); reprinted in 3 UCC L.J. 230 (1971); Rheinstein, *Conflict of Laws in the Uniform Commercial Code*, 16 LAW & CONTEMP. PROB. 114 (1951); Tuchler, *Boundaries to Party Autonomy in the Uniform Commercial Code: A Radical View*, 11 ST. LOUIS U.L.J. 180 (1967).

51. *Whitaker v. Harvell-Kilgore Corp.*, 424 F.2d 549, 550 (5th Cir. 1970) (Rive J., concurring); *Associates Discount Corp. v. Cary*, 47 Misc.2d 369, 262 N.Y.S.2d 646 (Civ. Ct. N.Y. County 1965).

52. Another example of a statutory choice-of-law provision is N.Y. EST. POWERS & TRUSTS LAW § 7-1.10 (McKinney 1967) (formerly § 12-a N.Y. PERS. PROP. LAW). Section 7-1.10 provides that if a non-domiciliary settlor stipulates that New York law should govern his trust of personal property, "such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust," provided that certain additional requirements relating to the situs of the corpus or the trustee are met. In *Shannon v. Irving Trust Co.*, 246 App. Div. 280, 285 N.Y.S. 478 (1936), *aff'd*, 275 N.Y. 95, 9 N.E.2d 792 (1937), a trust indenture provided that New Jersey law should govern whereas most contacts of the trust were with New York. The court held that the New York legislature, in passing 1930 N.Y. Laws ch. 849, as amended, 1933 N.Y. Laws ch. 573, codified as § 12-a N.Y. PERS. PROP. LAW "and making New York law applicable to the trusts of a non-resident when he so

demands attention and carries great weight, even in cases where it is not directly applicable. This is especially true in New York, where the rule of the first sentence of U.C.C. section 1-105(1) and the common law choice-of-law rule relating to governing law clauses are substantially the same.⁵³

According to Official Comment 1, U.C.C. section 1-105(1) "states affirmatively the right of the parties to a multi-state transaction or a transaction involving foreign trade to choose their own law." That right is limited to jurisdictions to which the transaction has a "reasonable relation." What constitutes a "reasonable" relation? Official Comment 1 explains that "[o]rdinarily the law chosen must be that of a jurisdiction where a *significant enough portion* of the *making or performance* of the contract is to occur or occurs." (Emphasis added.) This language indicates that the choice will be upheld if a significant portion of *either* the making *or* the performance occurs in the chosen state. The contacts occurring in the chosen jurisdiction need not constitute a significant portion of the whole contract; rather, they are only measured against that part of the contract which is the making or that part which is the performance.

The Official Comment recognizes that "ordinarily," *i.e.*, in most cases, the jurisdiction whose law has been stipulated has a connection to the making or the performance of the contract. However, there may be other kinds of acceptable contacts. If two German corporations, having their principal places of business in Germany, enter into an agreement in New York that will be performed in Canada, it appears that they should be permitted to stipulate German law even though no element of the making or performance occurs in Germany. If the parties were limited in their choice of governing law to the law of the place of making or the place of performance, U.C.C. section 1-105 would merely represent a revival of Chancellor Kent's teaching, which gave the parties a choice between the law of the place of making and the place of performance.⁵⁴ U.C.C. section 1-105(1) does not require that the acceptable relation consist of a physical connection with the territory of the chosen jurisdiction. Performance could, for example, consist of a

declared, by implication provided that the law of another State would apply when such intention was declared." *Id.* at 284, 285 N.Y.S. at 482. See also N.Y. Est. Powers & Trusts Law § 3-5.1(h) (McKinney 1967).

53. See Section II B(1) *supra*.

54. The views of KENT, COMMENTARIES ON AMERICAN LAW, 458 (2d ed. New York 1832) are summarized in Yntema, *supra* note 3, at 50.

required omission of an action. In addition, the contacts found sufficient in cases applying the common law conflict-of-laws rule concerning governing law clauses should be relevant for the interpretation of U.C.C. section 1-105(1).

The Official Comment says that the test of a "reasonable relation" is "similar" to that laid down by the United States Supreme Court in *Seeman v. Philadelphia Warehouse Co.*⁵⁵ In *Seeman*, plaintiff, a Pennsylvania corporation having its place of business in Philadelphia, had entered into a loan agreement with a borrower conducting its business in New York. The transaction would have been void as usurious under New York law, but was valid under Pennsylvania law. The contract in *Seeman* did not contain a governing law clause, but the agreement, although probably entered into in New York, provided for repayment in Pennsylvania and the court held that Pennsylvania law applied under the rule which permits the parties to a contract made in one place and performed in another to contract for the interest rate of either place, whichever is higher. The court expanded the freedom of the parties to arrange a transaction so that a certain law would apply, but at the same time put a limit on that freedom by saying that it is subject to the qualification:

that the parties must act in good faith, and that the form of the transaction must not "disguise its real character." . . . The effect of the qualification is merely to prevent the evasion or avoidance at will of the usury law otherwise applicable, by the parties' entering into the contract or stipulating for its performance at a place which has no normal relation to the transaction and to whose law they would not otherwise be subject.⁵⁶

Thus, the draftsmen of the U.C.C. derived the "reasonable relation" test from a case which did not involve the stipulation by the parties of a governing law and which gave the parties only a choice between the law of the place of making and the place of performance. It is difficult to apply the concept set forth in *Seeman* to contracts containing a governing law clause. The reference in the Official Comment to the *Seeman* case may be read to mean that when it is shown that contacts with a chosen jurisdiction did not occur in the normal course of the transaction, but

55. 274 U.S. 403 (1927).

56. *Id.* at 408.

were contrived simply to validate the parties' choice of governing law, then the relation will be held unreasonable. However, to use the motives of the parties as a test for the validity of governing law clauses creates difficulties: *a priori*, each governing law clause is the expression of the motive to exclude or avoid all laws except for the one stipulated. The parties to a multi-state transaction can structure their transaction in such a way that all or most contacts of the transaction are with the state whose law they have chosen to govern their contract. They may negotiate in that state, execute and deliver the agreement and close the transaction in that state, submit to the jurisdiction of that state by appointing agents for the service of process, stipulate that some or all performance take place in that state, etc. The contacts with that state may be properly located and substantial; however, the parties may have followed this course of action only to make their governing law clause valid. All of the actions could have taken place in another state. The parties may have desired either to avoid the law of some states which they perceive to be disadvantageous or to obtain the benefit of a law which they perceive to be advantageous. Does this *motive* of the parties destroy the reasonableness of the relationship between the transaction and the chosen state, even though absent such motive one would conclude that the relation is reasonable because substantial? The court in *Seeman* warned that the concept of evasion should not be applied lightly when it said that the "good faith" qualification should not be taken "too literally";⁵⁷ it would otherwise destroy the rule which gives the parties a range of freedom to choose the applicable law in order to save the validity of their contract.

It is also difficult to perceive when a transaction has a "normal relation" to a jurisdiction. Does this mean that one of the parties must have its place of business in the state where the agreement is entered into or performed?⁵⁸ Does it mean that under similar circumstances people generally, or the parties to the contract under consideration in particular, would contract or perform in the same jurisdiction as the parties did in the transaction being considered? Does it mean that there must be a valid business reason for the

57. *Id.*

58. The court in *Seeman*, in order to show that the stipulation of performance in Pennsylvania did not constitute evasion of New York laws, emphasized that the lender was "organized and conducting its business in Pennsylvania, was subject to the laws of that state and had a legitimate interest in seeking their benefit." *Id.* at 408-09.

occurrence of certain acts in the stipulated jurisdiction?⁵⁹

Seeman refers to the "law otherwise applicable," i.e., the law of the place where the contract would normally have been entered into or the law of the place where the contract would normally have been performed, as the fixed point against which evasion is being measured. This approach made more sense under the mechanical rules of conflict of laws current in 1927. However, these fixed points no longer exist under the approach of *Auten v. Auten*. In order to find evasion under the *Auten* approach, the stipulated law would have to be different from the law of the jurisdiction which normally would have the most significant contacts with the matter in dispute; moreover, different laws may apply to different issues of the contract.

This discussion shows that the *Seeman* case does not provide much guidance for the interpretation of the first sentence of U.C.C. section 1-105(1). New York courts have not yet been faced with close cases in which difficult issues of reasonable relationship have been presented; no New York decision deals with the evasion or avoidance of a law by means of a governing law clause, and the facts in none of the reported cases appear to raise such an issue. The courts have looked at the contacts, weighed them and found them either sufficient or insufficient.⁶⁰

59. For example, suppose a California corporation and a German corporation negotiate and execute an agreement in New York (although the performance will take place in California and Germany) because the executives of both corporations enjoy spending two weeks in New York City and are of the opinion that "Wall Street lawyers" are more competent in handling complex transactions than other lawyers. Or suppose an Illinois lender and a Brazilian borrower agree that disbursement and payment of the loan shall take place in New York because in their opinion New York banks are more experienced in international monetary transactions than Chicago banks. Is the connection to New York normal or contrived because it is the result of opinion rather than facts?

60. The court in *Duplan Corp. v. W.B. Davis Hosiery Mills, Inc.*, 442 F. Supp. 86, 88 n. 1 (S.D.N.Y. 1977), did not give effect to a choice-of-law clause providing for New York law in a sales contract. The transaction had no contact with New York, and the fact that the seller had a New York office which was not involved in the transaction was not deemed sufficient.

In re *United E. Coast Corp.*, 6 U.C.C. REP. SERVICE 449 (E.D.N.Y. 1969), gave effect to the governing law clause providing for Illinois law in a security agreement where all contacts were in Illinois.

County Asphalt, Inc. v. Lewis Welding & Eng'r Corp., 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971), gave effect to the choice of Ohio law where "significant events" were to occur in Ohio, although most of the performance was to occur in New York.

L. Orlik Ltd. v. Helme Product Inc., 427 F. Supp. 771 (S.D.N.Y. 1977), gave effect to the choice of English law in a contract for the purchase by a New York and a New Jersey corporation of briar pipes in England. The court did not mention where the contract was

A helpful concept was suggested by the Federal District Court for the Eastern District of New York in *Triangle Underwriters, Inc. v. Honeywell, Inc.*⁶¹ The case involved the sale of computers to a New York corporation by the New York office of Honeywell, Inc. The sales agreement provided for the governing law to be that of Massachusetts, the location of Honeywell's principal place of business. The court said in upholding the choice-of-law clause that because Honeywell routinely entered into a large number of substantially identical agreements with customers in various states it had an interest in having those agreements governed by the same law. The court also said that "the courts in this state have allowed contractual choice of law provisions to stand despite minimal contacts with the chosen state."⁶²

It has frequently been said that the rule of the first sentence of U.C.C. section 1-105(1) is that the parties to a transaction may agree on the law of any jurisdiction to which the transaction bears a reasonable relation.⁶³ This statement is broader than the language of U.C.C. section 1-105(1). The first sentence of U.C.C. section 1-105(1) does not provide for the selection of the law of one of two states with which the transaction has a reasonable relationship if neither is the forum state. The provision authorizes application of a chosen law only in cases where the transaction *also* bears a reasonable relation to the forum state.⁶⁴ If in a case where the law

negotiated or entered into except that one amendment was negotiated by the parties in England. The court found that the "purchase in England" provided the reasonable relation.

Triangle Underwriters, Inc. v. Honeywell, Inc., 24 U.C.C. REP. SERVICE 1088 (E.D.N.Y. 1978), involved a computer sales agreement which stipulated Massachusetts law. The sale was made to a New York corporation by the New York office of a Minnesota corporation, which had its principal place of business in Massachusetts. The buyer was required to make payment in Massachusetts. Although the court found a reasonable relation to Massachusetts, it did not have to determine the effectiveness of the governing law clause, because the choice between New York and Massachusetts law made no difference.

Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp., 466 F. Supp. 846 (E.D.N.Y.), *aff'd without opinion*, 614 F.2d 1289 (2d Cir. 1979), gave effect to the stipulation of New York law in a contract for the purchase of steel strands by a New York manufacturer from a Dutch manufacturer.

61. *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 24 U.C.C. REP. SERVICE 1088 (E.D.N.Y. 1978).

62. *Id.* at 1091.

63. *E.g.*, *Associates Discount Corp. v. Cary*, 47 Misc.2d 369, 373, 262 N.Y.S.2d 646, 650 (Civ. Ct. 1965); Cullen, *supra* note 50, at 419; DeB. Katzenbach in Malcolm, *supra* note 50, at 69; Comment, *The Uniform Commercial Code, Article 1 General Provisions*, 29 ALBANY L. REV. 3, 4 (1965). Official Comment 1 to U.C.C. § 1-105 states: "That right [to choose their own law] . . . is limited to jurisdictions to which the transaction bears a 'reasonable relation.'"

64. The first sentence of U.C.C. § 1-105(1) is not addressed to governing law clauses

of a jurisdiction other than the forum has been chosen there is no such relation to the forum state, the court must apply the general conflict-of-laws rules relating to governing law clauses.⁶⁵ As has been shown, the general conflict-of-laws rule of New York relating to governing law clauses is the same as the rule set forth in the first sentence of U.C.C. section 1-105(1), except that it does not require a reasonable relation to the forum state.⁶⁶

Although a court considering the validity of a choice-of-law clause to which U.C.C. section 1-105 applies is directed first to establish the reasonable relation of the transaction in question to the forum, a review of the cases shows that this is never expressly done. *County Asphalt, Inc. v. Lewis Welding & Engineering Corp.*⁶⁷ applied U.C.C. section 1-105 in a diversity action for breach of a sales contract and upheld the parties' choice of Ohio law, even though only part of the contract's performance and defendant's residence were in Ohio. Defendant had agreed with plaintiff to sell and install two asphalt plants. Plaintiff was a New York corporation, the plants were to be installed in New York, and the contracts were executed there. The court assumed that New York was "appropriately related" to the transaction, and analyzed only the issue of whether Ohio was reasonably related to the transaction.⁶⁸ Strict compliance with U.C.C. section 1-105 demands, however, that the court, rather than assuming that New York is appropriately related, ask whether New York, the forum, is reasonably related to the transaction.

It is possible that the courts feel that in a case where a law other than New York law has been stipulated, the pendency of the

stipulating the law of the forum when there is no relationship to another jurisdiction.

65. The second sentence of U.C.C. § 1-105(1) does not apply, because it deals only with the law of the forum state. It would be absurd to argue that the law of the forum state should apply in a case where a governing law clause, which stipulated a law other than the forum law, was ineffective because a reasonable relation to the forum did not exist.

66. See Section II B(1) *supra*.

67. 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971).

68. The court reasoned as follows:

Therefore, if it is assumed that New York is "appropriately related" to the transaction herein involved, the question becomes whether Ohio is "reasonably related" to the "transaction." The answer is that it is; while most of the performance of the contracts was to occur in New York, significant events were to occur in Ohio. Certain parts for the equipment sold by defendant were to have been fabricated or shipped from defendant's plant located in Ohio. And the contracts provided plaintiff an exclusive remedy of repair or replacement of parts ". . . shipped to the Company. . . ."

Id. at 1303.

litigation in New York represents, or at least indicates the existence of, a sufficient relationship between the transaction and New York. Thus, the broader interpretation of the rule of the first sentence of U.C.C. section 1-105(1) correctly summarizes the rule of the sentence as applied by the courts.

It has been suggested that a reasonable relation to the chosen state could exist as to some aspects of a transaction but not as to others and that in such a case the governing law clause would be valid only with respect to the related aspects.⁶⁹ This suggestion is contrary to the language of U.C.C. section 1-105(1), which requires that *the* transaction bear the required relation, and contrary to Official Comment 1, which suggests that such relation of *the* transaction may be found if *some* significant aspect of the transaction occurs in the chosen jurisdiction. U.C.C. section 1-105(1) clearly implies that once the reasonable relation exists, the parties can subject the whole transaction to the chosen law. The contrary suggestion is irreconcilable with the expectations of the parties, who expect the choice-of-law clause to govern all aspects of the agreement unless the clause is specifically limited to certain aspects of the agreement.⁷⁰ If the clause were applied to some and not to other aspects of the transaction, it would lose its purpose.

If there is no agreement between the parties to a contract as to governing law, *i.e.*, if the parties have not made an express choice, then pursuant to the second sentence of U.C.C. section 1-105(1), the Uniform Commercial Code of the forum applies to the transaction if it bears an "appropriate relation" to the forum state. The same is true if the parties have chosen a jurisdiction other than the forum which does not bear a reasonable relation to the transaction.⁷¹ However, if the parties have chosen the law of the forum

69. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 9-1, p. 209 (1973); Adams, *supra* note 50, at 317. However, Goodrich, in *Conflict Necessities and Commercial Necessities*, 1952 Wisc. L. REV. 199, 201-02, argues that it is the purpose of U.C.C. § 1-105 to apply the stipulated law to the whole of a transaction, even if only one aspect of the transaction meets the reasonable relation requirement.

70. For examples of limited governing law clauses, see *Skandia Am. Reinsurance Corp. v. Schenck*, 441 F. Supp. 715 (S.D.N.Y. 1977); *Chinchilla v. Foreign Tankship Corp.*, 195 Misc. 895, 900, 91 N.Y.S.2d 213, 218 (N.Y. City Ct. 1949), *modified on other grounds*, 197 Misc. 1058, 97 N.Y.S.2d 835 (Sup. Ct. 1950), *aff'd*, 278 App. Div. 556, 102 N.Y.S.2d 438 (1951); *Shannon v. Irving Trust Co.*, 246 App. Div. 280, 285 N.Y.S. 478 (1936), *aff'd*, 275 N.Y. 95, 9 N.E.2d 792 (1937).

71. Adams, *supra* note 50, at 285. *But see* HENSON, *supra* note 69, at 209-10, who does not read Section 1-105(1) as governing the case where parties choose the law of a state to govern whose relation to the transaction is not reasonable. *See also* *Fuller Co. v. Compagnie Des Bauxites De Guinee*, 421 F. Supp. 938 (W.D. Pa. 1976), where a federal court in Penn-

and such choice fails because of a lack of a reasonable relation between the transaction and the forum, the court must apply the general conflict-of-laws rules of the forum; in that situation, it is unlikely that the relation to the forum could ever be deemed "appropriate."⁷²

3. Outlook

Once the concept is conceded that the parties to an agreement have the autonomy to agree on the law governing their agreement⁷³ it is difficult to justify on theoretical grounds the requirement of a reasonable relationship between the jurisdiction of the stipulated law and the transaction.⁷⁴ This requirement is a remnant from the time when party autonomy with respect to governing law developed as a narrowly limited exception to a legal doctrine which selected applicable law only on the basis of objective contacts. This is the theory underlying the *Seeman* case. The requirement of a reasonable relation was originally developed as the qualification on an exception. Today, the exception has become the rule but the qualification has remained.

If there is no longer an *a priori* applicable law, it is impossible to accuse the parties of evasion of such law. Even if one accepts the evasion approach, it arguably should only apply where the law of the forum is being evaded. Where (i) the parties chose the law of a jurisdiction other than the forum and there is no contact between the transaction and the forum or (ii) the parties chose the law of the forum even though there is no relation between the

sylvania found ineffective a choice-of-law clause stipulating the application of New York law, since New York did not have a reasonable relationship to the transaction (the retention of New York counsel did not constitute sufficient contact), and applied Pennsylvania law, because "Pennsylvania appears to be the *only* state bearing a reasonable relationship to this transaction." *Id.* at 946 (emphasis in the original). The court should have applied the second sentence of U.C.C. § 1-105(1), and found Pennsylvania law applicable only if the transaction bore an appropriate relationship to Pennsylvania, the forum state.

72. *Duplan Corp. v. W.B. Davis Hosiery Mills, Inc.*, 442 F. Supp. 86, 88 n.1 (S.D.N.Y. 1977), a case involving governing law clauses stipulating New York law in the seller's written confirmation of the buyer's oral purchase order. The court found that all "truly significant" contacts were with North Carolina, that New York had no relationship to the transaction and that the choice-of-law provision was ineffective. The court then applied *Auten v. Auten* without referring to the second sentence of U.C.C. § 1-105(1).

73. Braucher, *Impromptu Remarks*, 76 HARV. L. REV. 1718 (1963). See Official Comment 2 to U.C.C. § 1-102.

74. Comment, *The Uniform Commercial Code and Conflict of Laws*, *supra* note 50, at 464; Ehrenzweig, *supra* note 3, at 990; Levin, *supra* note 3, at 263; McCartney, *supra* note 3, at 365-66; Prebble, *supra* note 3, Part I, at 503; Reese, *supra* note 3, at 53; Tuchler, *supra* note 50, at 187.

transaction and the forum, the parties have not attempted to evade the law of the forum and the stipulation should be upheld. The frequently repeated argument that the relationship requirement is necessary in order to avoid the stipulation of "exotic"⁷⁵ laws betrays by its very absurdity the difficulty of formulating a convincing justification. The requirement was introduced into New York law for the first time in 1946 by a federal court presumably but not clearly applying New York law, *Hal Roach Studios, Inc. v. Film Classics, Inc.*⁷⁶ The court did not cite any authority in its support.

Today the reasonable relationship requirement is clearly a rule of New York law. However, it is to be hoped that the origin of this requirement and its weak theoretical basis will persuade the New York courts to interpret the requirement liberally. The New York courts will hopefully remember the approach taken in *Intercontinental Planning, Ltd. v. Daystrom, Inc.*⁷⁷ and *J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.*⁷⁸ when faced with a case where the parties have stipulated New York law mainly because of New York's role as a leading international financial center, and will find that the justified desire of the parties to subject their transaction to the well-developed laws of that center constitutes a reasonable relation. Ideally, any choice of law which has a reasonable basis should be effective.⁷⁹

C. Usury Law and the Rule of Validation

In determining the applicability of a particular state's usury law to a transaction, New York applies the "rule of validation" rather than the rules discussed above. The rule of validation is a

75. See COOK, *THE LOGICAL AND LEGAL BASIS OF THE CONFLICT OF LAWS*, 412, 418 (1942).

76. 156 F.2d 596 (2d Cir. 1946). It seems that the first New York case to mention the principle was *In re Rosenbergers' Estates*, 131 N.Y.S.2d 59 (Sur. Ct. 1954), which did not mention the *Hal Roach Studios* case. The concept of a substantial connection between the transaction and the chosen law was suggested by Cook, *supra* note 75, at 412, 418.

77. 24 N.Y.2d 372, 248 N.E.2d 576, 300 N.Y.S.2d 817 (1969).

78. 37 N.Y.2d 220, 333 N.E.2d 168, 371 N.Y.S.2d 892, *cert. denied*, 423 U.S. 866 (1975).

79. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187(2)(a) (1971) adds to the "substantial relationship" test an alternate test of "reasonable basis for the parties' choice." Several New York cases have approvingly cited this test. See note 49 *supra*. Tuchler, *supra* note 50, at 198 suggests that the words "reasonable relation" be interpreted to allow any reasonable stipulation of law. DeB. Katzenbach in Malcolm, *supra* note 50, at 75, urges that complete autonomy be allowed, if the choice is made in good faith and was not made to evade public policy.

conflict-of-laws approach applicable only to the specific substantive law of usury. The rule does not attempt to discover the intention of the parties, but rather assumes that it is their intention to enter into a valid agreement. The Restatement (Second) of Conflict of Laws expresses the rule as follows:

The validity of a contract will be sustained against the charge of usury if it provides for a rate of interest that is permissible in a state to which the contract has a substantial relationship. . . .⁸⁰

In other words, the forum will examine the general usury statutes of all states which have a substantial relationship to the contract in question and apply the statute which either sustains the contract in full or else imposes the lightest penalty for usury. The Supreme Court in *Seeman v. Philadelphia Warehouse Co.*⁸¹ stated that in the case of a contract made in one place and performed in another, if the interest rate allowed by the law of the place of performance is higher than that permitted by the place of contract, the parties may agree on the higher rate, without incurring the penalties of usury. Conversely, if the permitted rate of interest is higher at the place of contract than at the place of performance, the parties may lawfully contract for the higher interest rate.

The rule of validation has been followed by both New York state courts and federal courts applying New York law in diversity cases.⁸² Thus in *Speare v. Consolidated Assets Corp.*⁸³ the Court

80. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 203 (1971).

81. 274 U.S. 403 (1927).

82. In *Crisafulli v. Childs*, 33 App. Div. 2d 293, 307 N.Y.S.2d 701 (1970), the Appellate Division applied the rule of validation to impose Pennsylvania's less severe penalties for usury on a lender who had lent a borrower the purchase price of a cooling machine at an interest rate which exceeded the permissible rate in both New York and Pennsylvania. The loan papers were prepared in Pennsylvania, but were executed by the borrower in New York and then returned to Pennsylvania. The machine was located in New York and Uniform Commercial Code financing statements were filed in New York. In payment of the loan the borrower received the lender's check drawn on a Pennsylvania bank.

In *Hawkins v. Ringel*, 231 N.Y.S.2d 476 (Sup. Ct. Rockland County 1962), *rev'd on other grounds*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963), the New York Supreme Court held that the more lenient New Jersey usury law applied to a loan transaction where the note evidencing the loan was made payable in New Jersey, even though the moneys were loaned and the note made and delivered in New York. The court stressed that the rule of validation in New York will apply the *most favorable* usury law of any state having a "normal and important relation" to the transaction. *Id.* at 478.

In *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. Nassau County 1964), the court stated that where there is a question as to which law governs when applied to a contractual situation involving performance in more than one jurisdiction, it is presumed that the parties intend the contract to be governed by the law of a place where

of Appeals for the Second Circuit, applying New York law, held that New Jersey's usury statute would apply rather than New York's when the underlying transaction violated the usury laws of both states. The transaction involved a mortgage given on New Jersey property, where final agreement and signing of the contract occurred in New Jersey and more than one-third of the loan was to pay off a prior mortgage on New Jersey land. However, the loan was intended to furnish funds for renovating New York property, some negotiations were allegedly carried on in New York and some of the payments were made in New York. The court applied New Jersey law as the most favorable usury law related to the transaction. Although the court stressed that it could reach this result by applying either the grouping of contacts test or the rule of validation, it stated that the rule of validation was the law in New York:

Although New York generally follows the rule that
the validity of a contract will be governed by the law of

valid, rather than of a place where invalid. The court found that "[n]o claim is made here that the parties intended to circumvent any usury statute or to do anything other than enter into a valid contract." *Id.* at 841, 249 N.Y.S.2d at 183.

An older New York case, which without referring to the rule of validation by name applied its rationale, is *Westchester Mortgage Co. v. Grand Rapids & Ionia R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927). There the court applied Rhode Island's usury law rather than New York's to validate a loan transaction. The collateral was located in Rhode Island, the instruments were drafted in Rhode Island, and the related note was payable in Rhode Island. The borrower received the proceeds of the loan in the form of a check drawn on a Rhode Island bank. The court found that the parties intended to have Rhode Island law govern the validity and effect of their contract and applied the law of the validating state.

Other older cases, which reached the same result as the rule of validation, by first finding that the usury laws of the place of the contract's making applied to the contract, and by then finding that the parties made the contract in the state which validated the contract, are: *Cutler v. Wright*, 22 N.Y. 471, 4 N.Y.S. 813 (1860); *Wayne County Savings Bank v. Low*, 81 N.Y. 566, 48 N.Y.S. 179, 37 Am. Rep. 533 (1880); *Western Transp. and Coal Co. v. Kilderhouse*, 87 N.Y. 430, 53 N.Y.S. 328 (1882); *Sheldon v. Haxtun*, 91 N.Y. 124, 56 N.Y.S. 37 (1883); *United States Mortgage Co. v. Sperry*, 138 U.S. 313, 336 (1891); *Davis v. Collins*, 137 Misc. 396, 241 N.Y.S. 76 (N.Y. City Ct.), *aff'd*, 138 Misc. 740, 247 N.Y.S. 257 (Sup. Ct. 1930) (notes drawn and signed in Virginia and mailed to payee in Ohio; the court found that the parties intended to make the notes in Ohio and applied Ohio law, under which they were valid); *Katz v. Fischel*, 174 Misc. 589, 21 N.Y.S.2d 572 (Sup. Ct. 1940); *Talcott v. Jackson*, 137 N.Y.S.2d 416 (Sup. Ct. N.Y. County 1954).

London Finance Co. v. Shattuck, 221 N.Y. 702, 117 N.E. 1075 (1917), is a case in which the court held a loan invalid under the New York usury law and refused to apply the Massachusetts law under which the loan would have been valid. In that case the borrower signed a loan application, note and a confession of judgment in New York and a few days later received a check by mail from Boston. The court, in a memorandum decision without opinion, affirmed the Supreme Court's order, which found the claim that the contract had been made in Massachusetts to be "a mere subterfuge" for the purpose of evading the usury laws of New York. *Id.* at 703, 117 N.E. at 1075.

83. 367 F.2d 208 (2d Cir. 1966).

the state having the most significant contact with it [citing *Auten v. Auten*], it seems to follow a special rule with regard to usury, applying the law of any state connected with the transaction which will validate it [citations omitted], to give effect to the parties' apparent intention to enter a lawful contract.⁸⁴

It has been argued that after *Auten v. Auten* the rule of validation should no longer be followed in New York since under that case the intention of the parties is not controlling;⁸⁵ this suggestion has, however, been rejected by the courts.⁸⁶

84. *Id.* at 211.

In *Wiltsek v. Anglo-American Properties, Inc.*, 277 F. Supp. 78 (S.D.N.Y. 1967), the District Court for the Southern District of New York applied the usury law of Mississippi, rather than that of New York, as the more favorable usury law of a state having a "natural and substantial" or a "natural and significant" connection with the transaction. The notes evidencing the loan had been negotiated, executed and delivered in New York and would have been paid in New York. However, the underlying loan was made in Mississippi and the notes arose out of business dealings in Mississippi. In reaching its decision, the court stressed that the rule of validation is the applicable conflict-of-laws rule in New York.

In *Crylon Steel Co. v. Globus*, 185 F. Supp. 757 (S.D.N.Y. 1960), the same court applied Alabama's usury law to uphold the validity of a loan evidenced by a note payable in Alabama, but signed by a New York citizen in his business name. The court emphasized that under the rule of validation as applied in New York, a transaction would be upheld under the validating usury law of any jurisdiction having "appropriate contacts" with the transaction, and that the place of payment fulfilled the requirement as an "appropriate contact."

85. Sedler, *supra* note 49, at 315; Comment, *Usury in the Conflict of Laws: The Doctrine of Lex Debitoris*, 55 CAL. L. REV. 123 (1967).

86. *Wiltsek v. Anglo-American Properties, Inc.*, 277 F. Supp. 78 (S.D.N.Y. 1967); *Crylon Steel Co. v. Globus*, 185 F. Supp. 757 (S.D.N.Y. 1960). In *Crylon Steel* the court added the following footnote to its opinion:

Auten v. Auten which adopts the "center of gravity" approach to contracts conflicts questions does not disturb the [validation] rule. The overwhelming weight of authority views usury as a special conflicts problem and will apply any appropriate law which would sustain the transaction.

Id. at 759 (citations omitted; emphasis added). However, the trial judge in *Pioneer Credit Corp. v. Catalano*, 51 Misc. 2d 407, 273 N.Y.S.2d 310 (County Ct. Columbia County 1966), *aff'd*, 282 N.Y.S.2d 214 (App. Div. 1967), applied the "most significant contacts" rule approach of *Auten v. Auten* to a loan which was not usurious under Massachusetts law but was usurious and void under New York law and found Massachusetts law applicable. The Appellate Division in *Crisafulli v. Childs*, 33 App. Div. 2d 293, 307 N.Y.S.2d 701 (1970), rejected the approach of *Pioneer Credit Corp.*

Even if New York were to no longer follow the validation rule, and were to apply the law of a state which would invalidate an agreement as being usurious, the result might not be different if the debtor were a corporation. A corporation (other than certain corporations whose principal asset is a one or two family dwelling) may not plead the defense of usury in New York so long as the effective interest rate of the loan does not exceed 25% per annum. N.Y. GEN. OBLIG. LAW § 5-521 (McKinney 1978); N.Y. PENAL LAW § 190.40 (McKinney 1975, Supp. 1979-80). This provision has been held by the New York Court of Appeals to mean that a corporation may not plead usury as a defense or use usury affirmatively to recover usurious interest already paid. *Butterworth v. O'Brien*, 23 N.Y. 275 (1861). The statute has

Under the rule of validation there must be a link between the validating state and the underlying transaction. While certain New York cases have specifically cited the Restatement rule of validation which requires a "substantial relationship" as being the law of New York,⁸⁷ New York cases have generally required a less stringent link between the transaction and the validating jurisdiction, phrasing such a connection in terms of a "connection,"⁸⁸ a "natural and significant" contact,⁸⁹ "appropriate contacts"⁹⁰ or a "normal and important relation."⁹¹ Whether this factual link is satisfied will depend on the facts and circumstances surrounding the individual transaction.⁹²

The "good faith" requirement and the prohibition against "evasion" set forth in *Seeman v. Philadelphia Warehouse Co.* have been discussed above.⁹³ *Seeman* warns that the parties to a contract may not create contacts with a state which has "no normal relation" to the transaction in order to obtain the benefit of the lenient usury laws of that state.⁹⁴ *Seeman* needed the "eva-

been held to apply to foreign corporations litigating in the courts of New York. *Southern Life Ins. and Trust Co. v. Packer and Prentice*, 17 N.Y. 51 (1858). Most importantly, two New York Court of Appeals cases, *Rosa v. Butterfield*, 33 N.Y. 665, 669, 12 N.Y.S. 567, 568 (1865), and *Curtis v. Leavitt*, 15 N.Y. 9, 85, 5 N.Y.S. 661, 678 (1857), state that the legislature intended the "corporate exception" to the usury laws, first enacted in 1850, to apply even in the case of contracts governed by the laws of jurisdictions other than New York. Even the 25% ceiling does not apply to loans in an amount exceeding \$2,500,000. N.Y. GEN. OBLIG. LAW § 5-501(b) (McKinney 1978), as amended by ch. 369 McKinney's Session Laws of New York 1980.

87. *Crisafulli v. Childs*, 33 App. Div. 2d 293, 297, 307 N.Y.S.2d 701, 705 (1970).

88. *Speare v. Consolidated Assets Corp.*, 367 F.2d 208, 211 (2d Cir. 1966).

89. *Wiltsek v. Anglo-American Properties, Inc.*, 277 F. Supp. 78, 81 (S.D.N.Y. 1967).

90. *Crylon Steel Co. v. Globus*, 185 F. Supp. 757, 759 (S.D.N.Y. 1960).

91. *Hawkins v. Ringel*, 231 N.Y.S.2d 476, 478 (Sup. Ct. 1962), *rev'd on other grounds*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963).

92. The decisions in New York have consistently held that the place of payment is an important connection with the validating state. In *Crylon Steel v. Globus*, 185 F. Supp. 757, 759 (S.D.N.Y. 1960), the court stated: "The New York law is in accord with the general rule that a transaction may not be attacked as usurious if it is valid under the law of any jurisdiction having appropriate contacts with it. The place of payment of a note is such an appropriate contact." Other cases which have concluded that the place of payment is an important connection with the validating jurisdiction include *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927), and *Hawkins v. Ringel*, 231 N.Y.S. 2d 476 (Sup. Ct. 1962), *rev'd on other grounds*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963).

93. See text accompanying notes 55-59 *supra*.

94. "Substantial relationship" is defined in Comment c to § 203 of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971), as a "normal and natural relationship" to the contract and the parties. The comment explicitly states that a substantial relationship is "unlikely to be based solely upon contacts *purposely* located in the state by the parties in an attempt to gain the benefit of that state's usury statute." *Id.* (emphasis added). The comment also notes that contacts that can be manipulated by the parties will be suspect and of

sion" exception because it did not contain a positive requirement of a "substantial" or "appropriate" connection or contact between the transaction and the jurisdiction whose law was applied. Rather, it stated this requirement negatively by denying the benefit of the validation rule if there was "no normal relation."⁹⁵

The agreements or promissory notes in the decisions discussed above did not contain governing law clauses. However, if the validity of an agreement will be upheld under the laws of any jurisdiction having the required contacts to the transaction even though the agreement did not stipulate the applicability of such law, such agreement would *a fortiori* be found valid if a governing law clause stipulated the applicability of such law. The governing law clause remains important in usury cases if the relationship between the allegedly usurious transaction and the chosen jurisdiction is not "substantial" but meets the presumably less stringent test of reasonableness. It is less clear whether a governing law clause would be upheld if the relation between the allegedly usurious transaction and the chosen jurisdiction is not "reasonable" but meets the possibly less stringent connection test of New York case law. A different question is whether the validation rule would prevail if a governing law clause in an agreement stipulated the applicability of a law under which the agreement would be invalid as being usurious. Would a court still apply the validation rule and disregard the governing law clause?⁹⁶

U.C.C. section 8-106 sets forth a choice-of-law rule regarding

little value, specifically citing the place where the loan is to be paid as a contact that is suspect. *Id.*

95. *Westchester Mortgage Co. v. Grand Rapids & Ionia R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927), follows the same pattern; although the court did not require contacts, it found that existing contacts with Rhode Island were not merely a subterfuge done with the "intent to evade our statute of usury." *Id.* at 198, 158 N.E. at 72. And in *Hawkins v. Ringel*, 231 N.Y.S.2d 476 (Sup. Ct. 1962), *rev'd on other grounds*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963), and in *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. 1964), the court noted that the designation of the validating state as the place of payment was not made with a view toward avoiding the usury laws of another state. None of the other New York or federal decisions applying the validation rule, all of which establish some contact requirements, mention the avoidance exception to the validation rule.

Sheldon v. Haxtun, 91 N.Y. 124, 56 N.Y.S. 37 (1883), *Western Transp. and Coal Co. v. Kilderhouse*, 87 N.Y. 430, 53 N.Y.S. 328 (1882), and *Katz v. Fischel*, 174 Misc. 589, 21 N.Y.S.2d 572 (Sup. Ct. 1940), all of which antedate the validation rule, state the evasion principle (e.g., "the transaction being *bona fide*, and there being no intent thereby to evade the [usury] laws of this State [New York].") *Sheldon v. Haxtun*, 91 N.Y. 124, 128, 56 N.Y.S. 37, 38 (1883)).

96. See Section II D(2) *infra*.

the validity of investment securities:⁹⁷

The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.

Is it the effect of U.C.C. section 8-106 that the law stipulated to govern an investment security does not govern questions of the validity of the security? Is, for instance, the validity of an allegedly usurious bond issue governed by the laws of the state of incorporation of the issuer? A positive answer would mean that U.C.C. section 8-106 supersedes the validation rule. The correct view is that "validity of a security" refers only to those issues of validity which are covered by U.C.C. article 8, as in U.C.C. section 8-202(2), and not to validity in general. This view is supported by the fact that the words in U.C.C. section 8-106 "rights and duties of the issuer with respect to registration of transfer" obviously refer to part 4 of U.C.C. article 8. It cannot be assumed that two references in one statutory provision are intended to have a completely different scope. In addition, it would be inconsistent with the system of the U.C.C. if section 8-106 contained a conflict-of-laws provision which applied not only to the substantive provisions contained in the U.C.C. but also to issues not covered by the U.C.C. Apparently no decision has addressed this question.

D. *Limitations on the Right to Stipulate a Governing Law*

The limitation inherent in every contractual choice of law, namely that there must be a reasonable relationship between the transaction and the jurisdiction whose law has been chosen, has been discussed above.⁹⁸ The following touches on two additional limitations of the parties' autonomy to stipulate the law governing their contract.

1. *Contracts of Adhesion*

Will a governing law clause be given effect if it is contained in a contract that is drafted by the dominant party and then presented on a "take-it-or-leave-it" basis to the weaker party, which has virtually no bargaining power as to its terms? No New York case addresses this question, but a case decided under federal

97. Defined in U.C.C. § 8-102(1)(a).

98. See Section H B *supra*.

law in the Southern District indicates a possible answer. *Fricke v. Isbrandtsen Co.*⁹⁹ was a motion for summary judgment to dismiss plaintiff's claim in an action for injuries sustained while plaintiff was a passenger on defendant's steamship. The steamship ticket contained a contract which stipulated that it was to be governed by United States law and provided that suit had to be brought within one year from the date of injury. This provision was valid under United States law and defendant's motion relied on the contractual limitation. The court did not give effect to the governing law clause, and denied the motion pending proper showing of German law. All the incidents surrounding the sale of the ticket took place in Germany and the plaintiff was not familiar with the English language in which the contract was written: "[p]laintiff, if she considered any law, probably felt that German law controlled."¹⁰⁰ The court said:

A contract of the type in this case is not formulated as a result of the give-and-take of bargaining where the desires of one party are balanced by those of the other. Instead, standard provisions generally common to the trade are submitted to the passenger-contractor on a take-it-or-leave-it basis. . . . While parties should not be precluded from seeking predictability and uniformity by stipulating their choice of law, unilaterally imposed provisions of this nature should not be enforced unless the party urging enforcement provided the other, illiterate in the language of the contract, with knowledge of what was intended.¹⁰¹

The court did not hold that the contractual governing law clause was invalid. A possible rationale for its denial of the motion for summary judgment was that if the protection of parties in plaintiff's position amounts to a strong German national policy, federal conflicts rules should take cognizance of that attitude when the most significant contacts are German. The governing law clause would be recognized only if it did not contravene a strong national

99. 151 F. Supp. 465 (S.D.N.Y. 1957). See also Note, *Determining the Scope of Choice of Law Provisions in Steamship Tickets: Adhesion Contracts and the Conflict of Laws*, 65 YALE L.J. 553 (1956); Note, *Party Autonomy Limited by Strong Public Policy of State of Dominant Interest*, 58 COLUM. L. REV. 274 (1958).

100. 151 F. Supp. at 468.

101. 151 F. Supp. at 467-68.

policy of the state of greatest interest.¹⁰²

Although innovative, the decision does not give much practical guidance for dealing with governing law clauses in adhesion contracts. Guidance may be obtained, however, from the decision of the United States Supreme Court in *The Bremen v. Zapata Off-Shore Co.*,¹⁰³ which upheld a forum selection clause in an international maritime towing contract. In a dictum the court said that forum clauses would be considered binding absent "fraud, undue influence, or overweening bargaining power."¹⁰⁴ The same concept might be applied to governing law clauses.

It could also be argued, following the suggestion of the *Isbrandtsen* case, that governing law clauses in contracts of adhesion may be struck down or limited as being contrary to the public policy of the forum or some other jurisdiction having great interest in the outcome of the litigation.¹⁰⁵ In cases governed by U.C.C. section 1-105(1), section 2-302(1), a provision dealing with unconscionable contracts or clauses, could serve as a corrective in adhesion situations.¹⁰⁶

102. Prebble, *supra* note 3, Part I, at 513-14, takes the position that the court in *Fricke v. Isbrandtsen Co.* simply made its choice-of-law decision as if the governing law clause did not exist. German rules and policies on limitations clauses would apply as part of the *lex contractus*.

103. 407 U.S. 1 (1972).

This decision has been widely recognized as establishing the law relating to forum selection clauses generally. See, e.g., *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); *Fireman's Fund Am. Ins. Co. v. Puerto Rican Forwarding Co.*, 492 F.2d 1294 (1st Cir. 1974); *In-Flight Devices Corp. v. Van Dusen Air, Inc.*, 466 F.2d 220 (6th Cir. 1972) (dictum in note 24); *Cruise v. Castleton, Inc.*, 449 F. Supp. 564 (S.D.N.Y. 1978); *Spatz v. Nascone*, 364 F. Supp. 967, 974, *motion to vacate denied*, 368 F. Supp. 352 (W.D. Pa. 1973); *Gaskin v. Stumm Handel GmbH*, 390 F. Supp. 361, 363 (S.D.N.Y. 1975) (applying New York law in a diversity action and stating: "A forum selection clause contained in an international agreement of the type now before the Court will be enforced according to its terms when the criteria established by the Supreme Court in *The Bremen v. Zapata Off-Shore Co.* . . . have been complied with."); *Roach v. Hapag-Lloyd AG*, 358 F. Supp. 481 (N.D. Cal. 1973).

104. 407 U.S. at 12.

105. Prebble, *supra* note 3, Part I, 516; Yntema, *supra* note 3, at 64. There is a general discussion of contracts of adhesion in Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072 (1953), and in Ehrenzweig, *supra* note 50, at 976. Compare Judge Frank's dissent in *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189 at 204 (2d Cir. 1955) (consumer party to adhesion contract should not be bound by choice-of-law provision). See also RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, Comment b, at 562 (1971).

106. Rheinstein, *supra* note 50, at 137; Weintraub, *supra* note 3, at 411. Nordstrom & Ramerman, *supra* note 50, 1969 DUKE L.J. at 630-33, 3 UCC L.J. at 237-39, suggest that in an adhesion situation one party may not have "agreed" to the governing law, and therefore, one of the statutory elements of U.C.C. § 1-105(1) may not have been fulfilled.

2. Rule of Validation Relating to Governing Law Clauses

Should a governing law clause be disregarded because the whole contract in which it is contained is, or specific provisions of such contract are, invalid under the stipulated law? Some writers suggest this approach, arguing that parties to an agreement always intend and expect their agreement to be valid and that disregarding an invalidating chosen law gives effect to the parties' intention and expectations.¹⁰⁷ However, the case where a stipulated law would invalidate the whole agreement is unlikely. More frequently, certain provisions of an agreement may be invalid under the chosen law; in fact, parties sometimes incorporate into their agreement provisions with the full knowledge that their validity under the chosen law is doubtful.¹⁰⁸ The fear that the invalidity of a provision in a contract would frustrate or defeat the intent and expectations of the parties is not justified in such cases. As a general matter it is not correct to say that validation always serves the interests of the parties: whenever the validity of a contract is at issue in a litigation, one party must have concluded that its interests are not served by the validity of the contract.

A rule of validation which would supersede all governing law clauses is not part of New York law. In *General Electric Credit Corp. v. Beyerlein*¹⁰⁹ the New York Supreme Court upheld a gov-

107. Weintraub, *supra* note 3, at 408, 410; Maw, *Applicable Law and Conflict Avoidance in International Contracts*, 25 N.Y. CITY BAR ASSOC. REC. 365, 374-75 (1970). See generally RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, Comment e, at 565 (1971); Prebble, *supra* note 3, Part I, at 527. Ehrenzweig, who proposes a general rule of validation, believes that the law chosen by the parties should be applied even if it invalidates their contract, Ehrenzweig, *supra* note 3, at 991-92. Sedler, *supra* note 49, at 292, would give effect to an express choice of law, even if it would invalidate a part of the contract, except in the case of mutual mistake by the parties.

108. For instance, Eurodollar loan agreements governed by New York law frequently contain a "judgment currency clause" pursuant to which the borrower promises to indemnify the lender for exchange losses resulting from judgments in a currency other than United States dollars. The enforceability of such clauses has not been determined by a court. Or a loan agreement subject to German law may prohibit prepayment in violation of Section 247 of the German Civil Code. The parties are aware of the doubtful validity of these provisions but the lender thinks the borrower may voluntarily comply or that the law may be settled in favor of the validity of the provisions. At least, the provision may improve the lender's bargaining position should difficulties arise during the life of the contract.

109. 55 Misc. 2d 724, 286 N.Y.S.2d 351 (Sup. Ct. Monroe County 1967), *aff'd*, 30 App. Div. 2d 762, 292 N.Y.S.2d 32 (1968). This was a motion for summary judgment in an action by an assignee of a lease for ten-pin setting machines for the rental payments under the lease. The lease, which expressly stipulated Massachusetts law, permitted the lessor to assign its interests, including payments, under the lease and stated that "the assignee shall not be held responsible for any of the lessor's obligations." *Id.* at 725, 286 N.Y.S.2d at 352. The lessee alleged as a defense that the machines did not function properly. Section 9-

erning law clause, even though the stipulated law invalidated a provision in the contract in dispute. *Painton & Co. v. Bourns, Inc.*¹¹⁰ involved a license agreement between a California licensor and a British licensee expressly governed by California law. The licensee claimed the right to continue to manufacture the licensed product free of the licensor's trade secret and patent claims (and without payment of royalties) after the expiration of the license agreement. The District Court for the Southern District held for licensee, because the stipulation of California law made federal law applicable through the Supremacy Clause of the United States Constitution, and under federal patent law the royalty agreement was unenforceable. In alternative reasoning, the court said that if the contract were governed solely by California law, it would reach the same result by interpreting the language of the contract. Thus, assuming the agreement provided for the alleged royalty payments after expiration, the court in respecting the choice-of-law clause gave effect to the choice of an invalidating law.¹¹¹

Thus, it appears that under New York law a governing law clause would be upheld even if the contract were invalid under the stipulated law. If parties agree on a law to govern their transaction, this law governs for all and not only for some purposes.

III. SCOPE OF CHOICE-OF-LAW CLAUSES

A. Reference to Whole Law or Only to Substantive Law of the

206(1) of the Uniform Commercial Code permits an agreement by a lessee that he will not assert against an assignee any claim or defense which he may have against the lessor "[s]ubject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods." *Id.* The court denied the motion because it found that such a different rule existed in Massachusetts and therefore the clause relieving the assignee from responsibility for the lessor's obligations was unenforceable.

110. 309 F. Supp. 271 (S.D.N.Y. 1970), *rev'd on other grounds*, 442 F.2d 216 (2d Cir. 1971).

111. See the discussion of the *Painton* case in Maw, *supra* note 107, at 369-72 and Prebble, *supra* note 3, Part I, at 528-29. *Accord*, *A.S. Rampell, Inc. v. Hyster Co.*, 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957). In *A.S. Rampell*, the New York Court of Appeals, by denying a motion to dismiss for failure to state a cause of action, gave effect to the governing law clause in a distributorship agreement which provided for Oregon law, although Oregon law invalidated a portion of the written agreement by upholding a subsequent oral modification. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187, at 573 (1971), citing the Record on Appeal, reports that the distributorship agreement contained a provision prohibiting oral changes which was invalidated by the chosen law. The court did not refer to this clause. For further discussion of the *A.S. Rampell* case, see text accompanying notes 23-26 *supra*.

Chosen Jurisdiction

What is the intention of parties to a contract who agree that "New York law shall govern"? Do they intend that New York substantive law alone shall govern or that the whole of New York law shall govern, including its conflict-of-laws rules?

In *Siegelman v. Cunard White Star Ltd.*¹¹² a provision of a contract of carriage of a steamship company provided that all questions under the contract were to be decided according to English law. The Court of Appeals for the Second Circuit, applying federal choice-of-law rules, held that this provision was effective. Turning next to the problem of scope of the provision, the court posed the whole law-substantive law question:

[A]re questions to be decided by the "whole" English law, including its conflicts rules, or just by the substantive English law? That is, are questions to be decided according to the law of England, or instead, as an English court might decide them, applying where appropriate the law of some other country? We think the provision must be read as referring to the substantive law alone, for surely the major purpose of including the provision in the ticket [the contract of carriage] was to assure Cunard of a uniform result in litigation no matter where the ticket was issued or where the litigation arose, and this result might not obtain if the "whole" law of England were referred to.¹¹³

Thus, the court determined that the governing law clause referred to the substantive law of the chosen jurisdiction, and not to the whole body of law including the conflict-of-laws rules of such jurisdiction. The Restatement (Second) of Conflict of Laws is in accord.¹¹⁴ Absent a clear New York decision on the same issue, *Sie-*

112. 221 F.2d 189 (2d Cir. 1955).

113. *Id.* at 194. *Accord*, *Fuller Co. v. Compagnie Des Bauxites De Guinee*, 421 F. Supp. 938, 946 (W.D. Pa. 1976). But *renvoi* was applied in *Mason v. Rose*, 176 F.2d 486 (2d Cir. 1949), a case not involving a governing law clause.

114. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187(3) (1971).

Comment h to subsection (3) of § 187, *id.* at 569, elaborates:

The reference, in the absence of a contrary indication of intention, is to the "local law" of the chosen state and not to that state's "law," which means the totality of its law including its choice-of-law rules. When they choose the state which is to furnish the law governing the validity of their contract, the parties almost certainly have the "local law," rather than the "law," of that state in mind (compare § 186, Comment b). To

gelman v. Cunard White Star Ltd. constitutes strong persuasive authority in New York.

It seems that neither Judge Harlan in the *Siegelman* case nor the Restatement sufficiently clarifies whether a choice-of-law clause refers to the whole law or only to the substantive law of a chosen jurisdiction. It is true that parties to an agreement, who stipulate that the law of a specified jurisdiction shall govern the agreement, nearly always intend that the substantive laws of the chosen jurisdiction shall govern. However, this intention will not be enforced fully. The most important exception is that a court will scrutinize the validity of the contractual choice-of-law clause under the conflict-of-laws rules of the forum jurisdiction,¹¹⁵ and may decide that it is invalid and that the law of another jurisdiction applies. The court will do so regardless of whether the clause stipulates the law of the forum or of some other jurisdiction. The parties to a contract may not change the conflict-of-laws rule relating to the validity of governing law clauses.

When New York is the forum and the chosen jurisdiction, reference in an agreement to New York law is not limited to New York substantive law whenever a rule of New York law (i) refers to the law of another jurisdiction *and* (ii) is an "imperative" rule which cannot be changed by agreement between the parties.¹¹⁶ An example is U.C.C. section 8-106 which provides that the validity of a security is "governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer."¹¹⁷ Even if a

apply the "law" of the chosen state would introduce the uncertainties of choice of law into the proceedings and would serve to defeat the basic objectives, namely those of certainty and predictability, which the choice-of-law provision was designed to achieve.

115. New York courts apparently always determine the effectiveness and scope of governing law clauses according to New York conflict-of-laws rules. Theoretically, of course, it would be possible for the law selected by the parties to determine the effectiveness and scope of their selection. This has been suggested by Yntema, *supra* note 49, at 356, and the suggestion merits serious consideration. The parties to an agreement which contains a governing law clause stipulating Colorado law are likely to have obtained the advice of Colorado counsel or opinions by Colorado counsel to the effect that the agreement — and therefore the governing law clause — is legal, valid and binding. It is less likely that the parties have obtained legal advice concerning the validity of the governing law clause under the laws of all jurisdictions in which one party might in the future bring an action against the other party. The approach suggested by Yntema would promote consistent determinations regardless of where litigation is commenced.

116. See note 49 *supra* and note 130 *infra* and accompanying text. Conceptually, the rule of *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954), insofar as it applies to contracts, is a conflict-of-laws rule which can be modified by party agreement.

117. See text accompanying note 97 *supra*.

trust indenture with a Delaware corporation as issuer provided for New York law, a New York court would have to follow the mandate of U.C.C. section 8-106 and look to Delaware law (including Delaware conflicts rules) if certain issues relating to validity of the bonds issued under the indenture were contested.¹¹⁸ If a foreign (*i.e.*, non-New York) corporation is party to an agreement which stipulates New York law, the question arises whether New York law or the law of the state of incorporation or some other law governs (i) the corporate power and authority of the corporation to enter into and perform the agreement,¹¹⁹ and (ii) the authorization

118. Further examples are contained in U.C.C. §§ 9-103(2)(b), (3)(b) and (5) which refer to the law of specified jurisdictions as including their conflict-of-laws rules.

119. The often stated traditional rule is that the powers of a corporation are governed by the law of the jurisdiction of its incorporation. *McVity v. E.D. Albro Co.*, 90 App. Div. 109, 115, 86 N.Y.S. 144, 148 (1904), *aff'd*, 180 N.Y. 554, 73 N.E. 1126 (1905); *Strodl v. Farish-Stafford Co.*, 145 App. Div. 406, 130 N.Y.S. 35 (1911); *Mason v. Standard Distilling & Distrib. Co.*, 85 App. Div. 520, 83 N.Y.S. 343 (1903); see *Naamloze Vennootschap Suikerfabriek "Wono-Aseh" v. Chase Nat'l Bank*, 111 F. Supp. 833, 843 (S.D.N.Y. 1953) (*dictum*).

RESTATEMENT (SECOND) OF CONFLICT OF LAWS, §§ 301, 302 (1971), takes a different approach and distinguishes between corporate acts "of a sort that can likewise be done by an individual" and acts which are peculiar to corporations. As to the first group, which includes the making of contracts, the same choice-of-laws principles apply as are applicable to non-corporate parties. Thus, the law stipulated in a particular contract would determine whether the corporation had the power to enter into the contract. The second group is governed by the law of the state with the most significant relationship, which usually is the state of incorporation, and includes the "internal affairs" of the corporation, that is, relationships *inter sese* of the corporation, the directors, officers and stockholders. Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958), take the same approach. See Ehrenzweig, *supra* note 3, at 998; Foley, *Incorporation, Multiple Incorporation, and the Conflict of Laws*, 42 HARV. L. REV. 516, 533 (1928-29); Note, *The Powers of Corporations and the Conflict of Laws*, 40 COLUM. L. REV. 1210 (1940).

The N.Y. BUS. CORP. LAW (McKinney 1963) takes yet another approach. Section 1306 provides:

An authorized foreign corporation shall have such powers as are permitted by the laws of the jurisdiction of its incorporation but no greater powers than those of a domestic corporation formed for the business set forth in the application for authority.

See also § 1301(a) (second sentence) of the N.Y. BUS. CORP. LAW (McKinney 1963, Supp. 1979-80). The "powers" referred to in §1306 are the powers which a corporation may exercise in furtherance of its corporate purposes, rather than the powers of corporations with respect to management of their internal affairs. WHITE ON NEW YORK CORPORATIONS (13th ed. 1979) § 1306; see *Report on New York Business Corporation Law*, 33 N.Y. STATE B.J. 435, 443 (1961). See generally Fuld, *Legal Opinions in Business Transactions - An Attempt to Bring Some Order Out of Some Chaos*, 28 BUS. LAW. 915, 927 (1973); Special Committee on Legal Opinions in Commercial Transactions, *Legal Opinions to Third Parties: An Easier Path*, 34 BUS. LAW. 1891, 1912 (1979).

Pursuant to § 1306 an authorized foreign corporation has only such powers as meet a double test: the powers must be such as (1) are permitted by the laws of its jurisdiction of

by all requisite corporate actions of the execution, delivery and performance of the agreement by the corporation, and the due execution and delivery of the agreement by the corporation.¹²⁰ An-

incorporation, and (2) would be permitted to a New York corporation formed for the same purposes. If a corporate act meets the test of § 1306 and, in addition, is not in excess of the powers granted to the corporation by its charter or certificate of incorporation, it is *intra vires*. This Section is based on § 107 of the Model Business Corporation Act. See *Revisers' Notes and Comments on the Business Corporation Law*, Seventh Interim Report to 1963 Session of New York State Legislature, Legislature Document No. 29, JOINT LEGISLATIVE COMMITTEE TO STUDY REVISION OF CORPORATION LAWS (1963).

Although § 1306 only sets the limit of powers permitted to *authorized* foreign corporations, it could be argued, *a fortiori*, that the same rule must apply to unauthorized foreign corporations, at least to unauthorized foreign corporations doing business in New York. It is more likely, however, that the New York legislature did not wish to, or thought that for constitutional reasons it could not, apply § 1306 to foreign corporations which are not authorized in New York. Consequently, by way of *argumentum e contrario*, § 1306 does not apply to unauthorized foreign corporations. Note that §§ 1316, 1317, 1318 and 1319 of the N.Y. BUS. CORP. LAW (McKinney 1963 & Supp. 1979-80) are applicable to "a foreign corporation doing business in this state" whereas § 1306 applies to "an authorized foreign corporation." Thus, the powers of an unauthorized corporation are determined by the law of the state of incorporation if New York follows the above-stated traditional rule, or by the stipulated law if New York follows the RESTATEMENT rule.

An example of a provision which prohibits foreign corporations from exercising certain powers, even if they have them under the laws of their state of incorporation, is § 131(3) of the N.Y. BANKING LAW (McKinney 1971), which prohibits anybody but a New York trust company from having or exercising in New York trust powers. On the other hand, a foreign bank can exercise fiduciary powers at its New York branch only if the bank has such powers under the law of the country of incorporation. The New York State Banking Department requires an opinion of counsel to that effect in connection with an application by a branch of a foreign bank for authorization to exercise fiduciary powers. See §§ 201-b and 202-a N.Y. BANKING LAW (McKinney 1971).

120. It is a question of the "internal affairs" of a corporation whether the appropriate corporate actions were taken to authorize an agreement and whether the proper officers signed the agreement on behalf of the corporation. The law of the jurisdiction of incorporation governs these questions. *Chalmers v. Nederlandsch Amerikaansche Stoomvaart Maatschappij, Holland Amerika Lijn*, 36 N.Y.S.2d 717 (N.Y. City Ct. 1942); *Diamond v. Oreamuno*, 24 N.Y.2d 494, 503, 248 N.E.2d 910, 915, 301 N.Y.S.2d 78, 85 (1969); *Russian Reinsurance Co. v. Stoddard*, 240 N.Y. 149, 147 N.E. 703 (1925).

In *Hausman v. Buckley*, 299 F.2d 696 (2d Cir.), *cert. denied*, 369 U.S. 885 (1962), the court, applying New York law in a diversity action, found after a detailed analysis of New York cases, that New York follows the "internal affairs" choice-of-law rule and that that principle had not been modified by *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954). The question before the court was whether the rights of a stockholder of a foreign corporation to participate in its management, *i.e.*, to bring a lawsuit on the corporation's behalf, was governed by the law of the forum or by the law of the corporation's place of incorporation, *Venezuela*. In *Gildenhorn v. Lum's Inc.*, 335 F. Supp. 329 (S.D.N.Y. 1971), *rev'd on other grounds sub nom. Schein v. Chasen*, 478 F.2d 817 (2d Cir. 1973), *vacated sub nom. Lehman Bros. v. Schein*, 416 U.S. 383 (1974), the court, applying New York law in a diversity action, held that New York follows the general choice-of-law principle that the law of the state of incorporation governs the existence and extent of corporate fiduciary obligations. The court said that it would reach the same result by applying the "grouping of contacts" approach and the "governmental interest" theory. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 302

swers to these questions must be found in the rules of New York conflict-of-laws.

If New York as the forum is confronted with a governing law clause referring to the law of a jurisdiction other than New York, which under the New York conflict-of-laws rules is effective, then New York will (i) not investigate whether the chosen jurisdiction, under its own choice-of-laws rules, would give effect to the governing law clause, and (ii) apply only the substantive law of the chosen jurisdiction and not its whole law. This is the teaching of *Siegelman v. Cunard White Star Ltd.*¹²¹ The scope of the second portion of the rule is not clear. It is correct that a New York court, if confronted with a valid governing law clause providing for California law, would not apply the California conflict-of-laws rule laid down in the California equivalent of *Auten v. Auten* to the contract in question. But if an agreement by a German corporation

(1971) and Reese & Kaufman, *supra* note 119, would probably classify due authorization and execution as an act which is peculiar to a corporation and apply the law of the state of incorporation. The "internal affairs" doctrine has been modified by Article 13 of the N.Y. Bus. CORP. LAW (McKinney 1963 & Supp. 1979-80), which subjects foreign corporations having specified contacts with New York to certain provisions of that law. See Baraf, *The Foreign Corporation - A Problem in Choice-of-Law Doctrine*, 33 BROOKLYN L. REV. 219 (1967); Note, *Domestic Regulation of Foreign Corporations*, 47 CORNELL L.Q. 273 (1962).

The "automatic application" of the "internal affairs" choice-of-law rule was rejected in *Greenspun v. Lindley*, 36 N.Y.2d 473, 330 N.E.2d 79, 369 N.Y.S.2d 123 (1975). The issue there was whether holders of shares of beneficial interest in a Massachusetts real estate investment trust had to make a demand on the trustees before commencing the equivalent of a stockholders' derivative suit against the trustees. The court held that the law of Massachusetts governed the issue, but expressly stated that it would apply New York law if the trust had significant contacts with New York. In spite of *Greenspun*, it is very difficult to imagine that a state, other than the state of incorporation, would ever have a strong interest in applying its law to the question of whether a corporate act has been duly authorized by all requisite corporate action and of whether an agreement has been duly executed and delivered by a corporation.

To the contrary is *Scientific Holding Co. v. Plessey Inc.*, 510 F.2d 15, 23 n. 5 (2d Cir. 1974), where the court stated in a dictum that it believed a New York court would rule that the choice-of-law clause in an agreement stipulating New York law was sufficiently broad to cover the authority of officers of the parties (a Barbados corporation and an English corporation, which prior to the closing of the contract assigned its rights to a Delaware subsidiary) to execute and perform the agreement. The court cited no authority in support of this statement except RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 291 (1971) which deals with the law applicable to the principal-agent relationship. This reference is curious in light of the fact that the court also held that under New York law a corporate officer is not an "agent" for purposes of the Statute of Frauds.

121. 221 F.2d 189 (2d Cir. 1955). In effect, the court rejected the doctrine of *renvoi*. For a discussion of *renvoi*, see Prebble, *supra* note 3, Part II, at 692.

In *Folk v. York-Shipley, Inc.*, 239 A.2d 236, 240 (1968), the Delaware Supreme Court, without any further explanation stated in a dictum that § 1-105 of the Uniform Commercial Code provides for a limited *renvoi* and that *renvoi* is to be followed in suits subject to the Uniform Commercial Code.

and a New York corporation stipulated English law, would a New York court apply English law to the issue of the power and authorization of the German corporation, or would it apply German law if the English conflict-of-laws rules would do so? It is likely that the New York court would do the latter. If English law had an equivalent to U.C.C. section 8-106, would the New York court follow the express reference to the law of a third country?

The court in *Siegelman* claimed that its approach would lead to uniform results no matter where litigation arose. Obviously, the *Siegelman* rule does not create uniform results in litigation, unless all jurisdictions follow that rule. But even in that case, results might differ, if there were a difference in the rules of the various jurisdictions in which litigation could arise relating to the validity of choice-of-law clauses. In addition, the *Siegelman* rule could lead to the application of a different law to the same contract, depending on whether suit were commenced in the chosen or in another jurisdiction. If the *Siegelman* litigation had not been commenced in New York but in England, the chosen jurisdiction, England not only would have applied its own choice-of-laws rules to determine the validity of the governing law clause but, had the clause been valid, could also have applied its whole law, including its conflict-of-laws rules, to the contract in question.

The court in *Reger v. Nat'l Ass'n of Bedding Manufacturers Group Insurance Trust Fund*¹²² saw some but not all of the issues correctly. After determining that the stipulated law, that of Illinois, applied, it recognized that if Illinois were the forum state, it would reject the choice-of-law provision and apply the law of the jurisdiction most favorable to the insured. The court then went on to apply the second part of the *Siegelman* rule:

In the court's opinion the parties to the group policy obviously intended only Illinois internal law to apply. To look to the whole law of Illinois would serve to introduce uncertainty (Restatement, Conflict of Laws 2d, § 187, comment h, p 569) and, hence renvoi should not be utilized. . . .¹²³

However, the court, as if afraid of its own courage, made a complete turnabout by adding:

122. 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. 1975). For further discussion of this case, see notes 27-30 and accompanying text *supra*.

123. *Id.* at 544, 372 N.Y.S.2d at 118.

[B]ut, if I understand Illinois law in point, Illinois would apply New York law under the present facts (not through renvoi, but by rejection of the stipulated law provision), then we are back to square one and the specter of inconsistent determinations under the same group policy where, for example, a New York insured brings suit in Illinois.¹²⁴

The court then found a way out by considering the applicable laws of both states which, fortunately, did not lead to different results.

The court committed a conceptual error in not recognizing that the Illinois law dealing with the validity of the stipulated law provision is a rule of Illinois conflict-of-laws. Under the rule of *Siegelman v. Cunard White Star Ltd.*, the court should not have asked whether Illinois would accept or reject the governing law clause. However, the court did correctly state the second part of the *Siegelman* rule. The court also quite correctly recognized that the outcome of the litigation would differ depending on whether the action were brought in New York or in the stipulated jurisdiction, even though it could not accept this fact. Nevertheless, the possibility of inconsistent results is unavoidable under the approach of the *Siegelman* case. This possibility appears to be the lesser evil, if one compares it with the uncertainty to which the parties would be exposed if a forum were generally to apply the conflict-of-laws rules of the jurisdiction chosen by a governing law clause and then apply the laws of the jurisdiction selected by these rules as the substantive law of the agreement. Furthermore, under that approach the court would always have the added burden of determining the validity of a governing law clause under two legal systems, its own and that of the chosen jurisdiction.

B. The Stipulated Law Governs the Validity and the Interpretation of the Contract

The Court of Appeals for the Second Circuit, applying federal conflict-of-laws rules in *Siegelman v. Cunard White Star Ltd.*,¹²⁵ stated in a dictum that there is "much doubt" whether parties can

124. *Id.* (citation omitted).

125. 221 F.2d 189 (2d Cir. 1955). But the District Court for the Southern District of New York, discussing the federal choice-of-law rule, said in dictum in *Mulvihill v. Furness, Withy & Co.*, 136 F. Supp. 201, 205-06 (S.D.N.Y. 1955), that the language of the governing law clause under consideration in that case embraced "all questions" arising under the contract which indicated to the court that "the validity as well as the interpretation of the contract" was governed by the stipulated law.

stipulate the law which should govern the *validity* of their contract.¹²⁶ However, *A.S. Rampell, Inc. v. Hyster Co.*¹²⁷ has made it clear that New York does not have a prohibition against parties choosing the law by which to determine the validity of their contract. Moreover, in a subsequent case decided by the District Court for the Southern District of New York¹²⁸ the court indicated that the New York conflict-of-laws rule (as best as it could determine) is to give effect to the parties' intention regarding the law applicable to the contract even as to matters of validity. In this case, the court had to decide whether an issue of material fact was raised which would preclude a motion by the defendant for summary judgment. The court held that a dispute as to a material fact was presented by the plaintiff's claim that plaintiff and defendant had agreed orally that Saudi Arabian law would govern their finder's contract. Under such law, an oral agreement as to commissions was valid, while the New York Statute of Frauds precluded enforcement of such oral agreements. The court indicated that such a dispute was indeed as to a material fact, since a New York court would honor the parties' choice of law even as to the validity of their contract.¹²⁹

Thus, under New York law a governing law clause makes applicable to the contract the "mandatory" or "imperative" provisions of the stipulated law, *i.e.*, provisions which the parties could not alter or modify by agreement within a particular legal system, as well as the "facultative" or "pliable" provision of the stipulated law, *i.e.*, provisions which the parties could alter or modify by agreement within a particular legal system.¹³⁰ Examples of mandatory rules are questions of formalities, as the statute of frauds, of validity, as illegality, and the need for consideration. At the same time, a governing law clause excluded "mandatory" as well as "facultative" rules of the laws of all other jurisdictions.

126. 221 F.2d at 195.

127. 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957). See note 111 *supra*.

128. *Nakhleh v. Chem. Constr. Corp.*, 359 F. Supp. 357 (S.D.N.Y. 1973), applying New York conflict-of-laws rules.

129. U.C.C. § 1-105 is intended to include issues of validity as well as of construction. Weintraub, *supra* note 3, at 407. Section 7-1.10 of the N.Y. EST. POWERS & TRUST LAW (McKinney 1967) expressly provides that governing law clauses covered by that provision determine the validity of trust agreements. The court stated that the stipulated law governed questions of validity in *Hal Roach Studios, Inc. v. Film Classics, Inc.*, 156 F.2d 596 (2d Cir. 1946), and in *Boyd v. Curran*, 166 F. Supp. 193, 196 (S.D.N.Y. 1958) ("[The stipulated New York law] is limited to questions involving the validity, interpretation, construction or performance of the agreement as between the parties.").

130. See notes 49 and 116 *supra*.

C. *Governing Law Clauses and Rights of Third Parties*

Generally speaking, a governing law clause binds only the parties to the agreement and does not affect third parties. The District Court for the Southern District of New York, applying New York law, has held that the stipulation of New York law in an agreement and declaration of trust effectuating a union pension and welfare plan was limited to questions involving the validity, interpretation, construction and performance of the agreement as between the parties, but was not controlling with regard to the rights of a California-domiciled widow of a California-domiciled union member to recover one-half of the death benefits payable under the plan as her share of community property.¹³¹

The principle that a stipulated law cannot affect the rights of certain third parties underlines an older decision by the same court. In *Maguire v. Gorbaty Bros.*¹³² chattels sold under a conditional sales contract, which provided that the contract should be construed according to the laws of New York, were moved to buyer's residence in Connecticut where they remained thereafter.

131. *Boyd v. Curran*, 166 F. Supp. 193 (S.D.N.Y. 1958). This was an action by the legal widow of a drowned seaman against the trustees of a union pension and welfare fund to recover death benefits concededly due to the proper beneficiary of the decedent. The decedent had named another woman, not his legal wife, as his beneficiary. Plaintiff claimed that under the California community property laws she was entitled to one-half of the death benefits notwithstanding the designation of another beneficiary. The court determined that the validity of the governing law clause had to be determined under New York law and that under such law it had to be given effect because there were "pertinent contacts" with New York. *Id.* at 196. The agreement and declaration of trust were executed in New York, the officers of the trustees were in New York and the fund was administered there. Furthermore, 1930 N.Y. LAWS ch. 849, as amended, 1933 N.Y. LAWS ch. 573, codified as § 12-a N.Y. PERS. PROP. LAW (now § 7-1.10, N.Y. EST. POWERS & TRUST LAW (McKinney 1967)), provided that where there was such a stipulation, the validity and effect of the trust agreement should be determined by the laws of New York. However, in spite of the valid governing law clause stipulating New York law, the court applied California law to plaintiff's claim with the following reasoning. The benefits claimed by plaintiff are in the nature of a property right arising out of the declaration of trust. Since the situs of the property right to which plaintiff asserts a claim is in New York, New York law will govern as to any such claims. This is so not because of the stipulation of New York law, but because the parties to the declaration of trust cannot by agreement between themselves dictate what law shall govern the claims of a third party to a property right arising from the trust. If New York law is applied because of the situs of property within New York, the whole New York law, including its conflicts rules, will apply and not the substantive law alone. The rule in New York is that interests of a spouse in personal property acquired by the other during marriage are determined by the law of the domicile of the parties when the property was acquired. On this theory the court applied California law to the claim. The court stated that it was presented with a case of first impression and cited no cases in support of its limiting interpretation of the governing law clause.

132. 133 F.2d 675 (2d Cir. 1943).

The contract was not properly recorded in accordance with Connecticut law. The court held that the right of the vendor and of buyer's creditors were controlled by Connecticut law and the vendor was not entitled to possession of the chattels as against the buyer's trustee in bankruptcy.

The philosophy of this decision is today reflected in U.C.C. section 9-103 which limits the right of contracting parties to choose the applicable law with respect to perfection of security interests in order to protect third parties, because third parties must have sure ways to find out whether and where to file and where to look for possible existing filings.¹³³ At the same time, U.C.C. section 1-105(1) expressly states that the *parties* may agree as to the law which will govern *their* rights and duties. The areas which U.C.C. section 1-105(2) excludes from the party autonomy of section 1-105(1) are those in which a third party is likely to become involved.

D. "Freezing" of the Stipulated Law at the Date of the Agreement

Is a stipulation of a particular law a stipulation of such law as is in effect at the time the contract was entered into or of such law as it may change from time to time? If a contract contains no governing law clause and a New York court applies New York law in accordance with the general rules of law, the court will apply New York law as in effect at the time of the court's decision. If the contract under consideration specifically declares New York law to be the governing law, the result cannot be different. The stipulation does not "freeze" New York law at the date of execution and delivery of the contract. There is no reason why the result should be different if the parties stipulate German, rather than New York, law: the stipulated law is the law at the time of decision. It is a separate question, which must be determined under the stipulated substantive law, whether, and to what extent, decisions rendered or statutes adopted after the date of a contract affect the rights and obligations of the parties to such contract. This result, in most cases, is justified by the expectation of the parties who have no particular rules of the stipulated law in mind.

The New York Court of Appeals has applied foreign post-contract law to contracts governed by foreign law in two instances. In

133. U.C.C. § 1-105, Official Comment 5. See Coogan, *supra* note 50, at 530. See Tuckler, *supra* note 50, at 202 n. 63.

*Dougherty v. Equitable Life Assurance Soc'y*¹³⁴ a Russian citizen purchased a life insurance policy in Russia from a New York insurance company. The contract itself, as well as a Russian statute, provided for the application of Russian law. The court gave effect to a Soviet decree cancelling all contracts of life insurance, although the decree was issued subsequent to the policy, and held that the obligation of the insurer had ended. The court in *Kleve v. Basler Lebens-Versicherungs-Gesellschaft*¹³⁵ took the same position with respect to a life insurance policy written by defendant, a Swiss company, in Germany for the benefit of plaintiffs, former German nationals. Plaintiffs sued to recover the cash surrender value of the policies. Although the policies did not contain a governing law clause, the court determined that the parties intended German law to govern. The German government, pursuant to German law, had seized from the defendant life insurance company's Berlin branch a sum of money representing the cash surrender value of the policies after the plaintiffs had left Germany to reside abroad permanently. The German government also declared the obligation of the defendant on the policies discharged. The court recognized the force of the German law with respect to assets of the parties in Germany.¹³⁶

Presumably a Russian court and a German court would have held that under Russian law and German law, respectively, the

134. 266 N.Y. 71, 193 N.E. 897 (1934).

135. 182 Misc. 776, 45 N.Y.S.2d 882 (Sup. Ct. 1943). See also *French v. Banco Nacional de Cuba*, 23 N.Y.2d 46, 59, 295 N.Y.S.2d 433, 446 (1968).

136. The New York Court of Appeals applied post-contract United States federal law to an agreement governed by New York law because a subsequently enacted federal law announced a public policy and was intended by Congress to apply to prior contracts. *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*, 269 N.Y. 22, 198 N.E. 617, *remittitur amended*, 269 N.Y. 602, 199 N.E. 691 (1935), *cert. denied*, 297 U.S. 705 (1936). The court stated that absent such factors the substantive law applicable to a contract is that existing at the time the contract is entered into. *Accord*, *Battaglia v. General Motors Corp.*, 169 F.2d 254 (2d Cir. 1948), *cert. denied*, 335 U.S. 887 (1949); *Brown v. Utica Mut. Ins. Co.*, 184 Misc. 693, 53 N.Y.S.2d 760 (Sup. Ct. Erie County 1945).

Compare *Goodman v. Deutsch-Atlantische Telegraphen Gesellschaft*, 166 Misc. 509, 2 N.Y.S.2d 80 (Sup. Ct. Kings County 1938), which is an example of a case where the parties "froze" the law applicable to their agreement not by virtue of a governing law clause but by virtue of a waiver of defenses based on present or future law. In that case the court applied New York law because it found that certain references in the agreement to German law did not amount to a general governing law clause. *But see* *De Sayve v. De la Valdene*, 124 N.Y.S.2d 143 (Sup. Ct. N.Y. County 1953), *aff'd*, 383 App. Div. 918, 130 N.Y.S. 2d 865 (1954), where the court did not give effect to a French currency regulation statute which was enacted after the contract was made and which affected the amount payable under the contract, although French courts would give effect to such subsequent statute. The contract did not contain a governing law clause, but the court found that French law applied.

post-contract decrees effectively discharged the contractual rights. Thus, the New York court did what the parties wanted it to do: it applied the foreign law.¹³⁷

Parties to an agreement sometimes specifically agree on a law in existence at the time of the contract. New York courts have not passed on the question of whether such intention must be honored. The governing law clause in *Painton & Co. v. Bourns, Inc.*¹³⁸ stipulated California law "in effect on execution" of the agreement. The Federal District Court nevertheless applied federal law, part of California law by virtue of the Supremacy Clause of the United States Constitution, as it was interpreted in a United States Supreme Court decision rendered seven years after the contract was entered into and one year after its expiration. The court did not discuss its disregard of the "freezing provision" in the governing law clause.¹³⁹

E. Public Policy of the Forum

The effect of an otherwise valid choice-of-law clause stipulating a foreign law may be limited by the public policy of New York if New York is the forum state.¹⁴⁰ However, the public policy which prevents the enforcement in New York of a contract or of a provision in a contract which is valid under the stipulated foreign law must be of special importance to New York.¹⁴¹ It is not clear which

137. Nevertheless, if under the stipulated foreign law, including its constitutional law, a post-contract decree could not validly abrogate vested rights of the parties to a contract, a New York court should not give effect to such decree.

138. 309 F. Supp. 271, 273 n.5 (S.D.N.Y. 1970), *rev'd on other grounds*, 442 F.2d 216 (2d Cir. 1971).

139. It is conceivable that the court understood the applicable rule of federal law as a mandatory rule of public policy which overrode the otherwise applicable choice-of-law rules. See Prebble, *supra* note 3, Part I, at 529 n. 446.

140. See, e.g., *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 851 (E.D.N.Y.), *aff'd without opinion*, 614 F.2d 1289 (2d Cir. 1979); *Dougherty v. Equitable Life Assurance Soc'y*, 266 N.Y. 71, 90, 193 N.E. 897, 903 (1934); *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 541, 372 N.Y.S.2d 97, 116 (Sup. Ct. 1975). See also Paulsen & Sovern, "Public Policy" in the Conflict of Laws, 56 COLUM. L. REV. 969 (1956). In *Fricke v. Isbrandtsen Co.*, 151 F. Supp. 465 (S.D.N.Y. 1957), the court looked to the public policy of the state having the dominant interest in the transaction, which was not the forum state. See text accompanying notes 99-102 *supra*; RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187(2)(b) (1971).

The finding that a provision in an agreement, which stipulates a law other than the forum law, violates a public policy of the forum, does not lead to the invalidity of the governing law clause; it only restricts its effect with respect to the issue as to which the public policy prevails.

141. See, e.g., *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 851 (E.D.N.Y.) ("strong countervailing public policy"), *aff'd without opinion*,

public policies of New York are so important that they not only apply to domestic transactions but also to agreements governed by a foreign law and override an otherwise valid choice of law. The mere fact that a stipulated foreign law has a "very obnoxious and offensive character" or is "bad law" does not render the otherwise governing foreign law non-controlling.¹⁴² The contract must be such that its judicial enforcement "would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense."¹⁴³

Although the public policy limitation of governing law clauses has frequently been mentioned, there are only a few cases which actually denied enforcement of a contract which was subject to a foreign law on the basis that the contract violated a strong New York public policy. A case where public policy was strong enough to override a stipulated law is *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*.¹⁴⁴ The plaintiff,

614 F.2d 1289 (2d Cir. 1979); *Sears, Roebuck & Co. v. Enco Assoc.*, 83 Misc. 2d 552, 562, 370 N.Y.S.2d 338, 348 (Sup. Ct. 1975) ("strong public policy"), *aff'd*, 54 App. Div. 2d 13, 385 N.Y.S.2d 613 (1976), *modified*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977).

142. *Kleve v. Basler Lebens-Versicherungs-Gesellschaft*, 182 Misc. 776, 782, 45 N.Y.S.2d 882, 887 (Sup. Ct. 1943) ("This is not a case of enforcing German law here but rather of necessarily recognizing the force of German law in Germany". *Id.* at 782, 45 N.Y.S.2d at 887). See *Dougherty v. Equitable Life Assurance Soc'y*, 266 N.Y. 71, 90, 193 N.E. 897, 903 (1934) ("However, it cannot be against the public policy of this State to hold nationals to the contract which they have made in their own country to be performed there according to the laws of that country"). See also *French v. Banco Nacional de Cuba*, 23 N.Y.2d 46, 56, 295 N.Y.S.2d 433, 443 (1968).

Another example of a case in which the parties' choice of law was not found to violate a public policy is *Nakhleh v. Chem. Constr. Corp.*, 359 F. Supp. 357 (S.D.N.Y. 1973). There the District Court for the Southern District held that the New York Statute of Frauds did not represent such a fundamental policy of New York that a New York court would not apply the parties' choice of law to the question of the validity of an oral finder's contract.

143. *Intercontinental Hotels Corp. (Puerto Rico) v. Golden*, 15 N.Y.2d 9, 13, 203 N.E.2d 210, 212, 254 N.Y.S.2d 527, 529 (1964) (action to recover a gambling obligation incurred by defendant in Puerto Rico; the court held that the public policy of New York should not deny a party seeking to recover for gambling debts, obligations entered into in Puerto Rico and enforceable under Puerto Rican law, access to its courts); *accord*, *Pioneer Credit Corp. v. Catalano*, 51 Misc. 2d 407, 411, 273 N.Y.S.2d 310, 315 (Sup. Ct. 1966), *aff'd*, 282 N.Y.S.2d 214 (App. Div. 1967) (interest rate on a note and mortgage to which Massachusetts law applied violated the New York usury law; the court held that the public policy of New York did not prevent enforcement of the note in New York). *Cf. Dym v. Gordon*, 16 N.Y.2d 120, 128, 209 N.E.2d 792, 796, 262 N.Y.S.2d 463, 469 (1965) ("The courts . . . do not close their doors unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal.") (*citing Loucks v. Standard Oil Co.*, 224 N.Y. 99, 111, 120 N.E. 198, 202 (1918) (Cardozo, J.)), *overruled*, *Tooker v. Lopez*, 24 N.Y.2d 569, 249 N.E.2d 394, 301 N.Y.S.2d 519 (1969).

144. 269 N.Y. 22, 198 N.E. 617, *remititur amended*, 269 N.Y. 602, 199 N.E. 691 (1935), *cert. denied*, 297 U.S. 705 (1936).

a Colombian corporation, sued a Finnish bank under a bond purchase agreement containing a gold clause to recover the equivalent in dollars of the value in gold coin of the amount at which the bonds had been called. The court held that the joint resolution of Congress¹⁴⁵ which nullified clauses requiring payment in gold applied to a foreign bond containing such a requirement where it had been issued and was payable in the United States, even though both issuer (debtor) and holder (creditor) were non-residents of the United States. Although the court found that the parties intended New York law to apply to the agreement (which did not contain a governing law clause) it stressed that its holding would have been the same had the bonds been governed by some foreign law. The court stated:

The joint resolution has thus revealed clearly the intention of the Congress to regulate the kind and amount of the currency wherewith the obligation may be discharged, as a matter of public policy in this jurisdiction. The parties to a contract may not by their intention, however expressed, override the laws of the country in which suit is brought when a matter of public policy of that country is involved. . . . Consequently, it becomes immaterial whether the obligations of these bonds would otherwise be governed by some foreign law.¹⁴⁶

In *F.A. Straus and Co. v. Canadian Pacific Railway Co.*¹⁴⁷ the court held unenforceable, as in violation of New York public policy, two clauses contained in a bill of lading issued by a common carrier at a foreign port for the delivery of goods to a citizen within the State of New York, even though the contract of carriage stated that it was governed by the law of Great Britain, under which the clauses were valid. The first clause absolutely exempted the carrier from liability for negligence and the second clause limited the carrier's liability without consideration therefor and without choice of rates.¹⁴⁸

145. *Id.* (citing 48 Stat. 112).

146. *Id.* at 31-32, 198 N.E. at 621.

147. 254 N.Y. 407, 173 N.E. 564 (1930).

148. The opinion contains an interesting discussion about changes in public policy in the light of changed conditions. *Antinora v. Nationwide Life Ins. Co.*, 76 Misc. 2d 599, 350 N.Y.S.2d 863 (Sup. Ct. 1973), held that a New York statute requiring notice of conversion privilege to be given to holders of accident and health group insurance upon termination of the group coverage reflected a public policy of the State of New York which must prevail if the insured resides in New York, even though a governing law clause in the group insurance

The public policy which may override an otherwise effective governing law clause apparently need not be the public policy of the forum. Two diversity decisions of the District Court for the Southern District of New York disregarded governing law clauses in franchise agreements where the state in which the franchisee was located had franchise statutes which protected franchisees. The court held that the statutes expressed a fundamental public policy¹⁴⁹ and cited in support Restatement (Second) of Conflict of Laws section 187(2)(b).¹⁵⁰ No New York court has yet ruled on that issue.

policy provided for the application of Ohio law. For a contrary opinion, see *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 542, 372 N.Y.S.2d 97, 116 (Sup. Ct. 1975). See note 32 *supra*.

149. *Southern Int'l Sales Co. v. Potter & Brumfield Div. of AMF Inc.*, 410 F. Supp. 1339 (S.D.N.Y. 1976), was a suit by a manufacturer's representative against the manufacturer for wrongful termination of a contract for exclusive sales representation. The court denied the manufacturer's motion for summary judgment. The agreement stipulated Indiana law; the representative was a Puerto Rican corporation and its territory was Puerto Rico and adjacent United States islands. The agreement provided for termination without cause, but the Puerto Rican Dealers' Contracts Act permitted termination only for just cause. The court held that Puerto Rican law applied despite the fact that the contract bore a reasonable relation to Indiana. (The manufacturer had its headquarters and facilities there, and it shipped, processed and did the paper work there on the representative's orders for merchandise.) The court held that the Dealers' Contracts Act was the expression of a fundamental policy of Puerto Rico which could not be circumvented by the stipulation of the law of another state.

Business Incentives Co. v. Sony Corp. of Am., 397 F. Supp. 63 (S.D.N.Y. 1975), arose out of a similar fact situation. The sales territory of plaintiff, an independent salesman, was New Jersey, and the agreement between the manufacturer and the salesman provided for the application of New York law. The court found that "New Jersey has a strong public policy — enunciated both by its courts and its legislature — in favor of protecting the relatively powerless consumer or small businessman from more powerful commercial giants . . .," and applied New Jersey law, despite the parties' agreement to the contrary. *Id.* at 67. Curiously, the court then held that the New Jersey Franchise Practices Act, on which the complaint largely relied, by its terms did not apply to the relationship between plaintiff and defendant and that the plaintiff could not rely on the very cases which the court had cited as expressing the New Jersey public policy. The court's conclusion shows that New Jersey did not have "a materially greater interest than the chosen state in the determination of the particular issue" as required by *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 187(2)(b) (1971) and that the court misapplied the rule of § 187(2)(b). It appears that in order to overcome a governing law clause, a public policy must be more specific than a policy to protect the weak. The court can hardly deny that New York has the same public policy.

Also in *Fricke v. Isbrandtsen Co.*, 151 F. Supp. 465 (S.D.N.Y. 1957), the court possibly looked to the public policy of the state which had the dominant interest in the transaction, but which was not the forum state. See text accompanying notes 99-102 *supra*. See also *RESTATEMENT (SECOND) OF CONFLICT OF LAWS*, § 187 (2)(b) (1971). Apparently no New York court has held that the public policy of a state other than the forum state should be considered. Obviously, the approach suggested by *Southern Int'l Sales Co.* and *Business Incentives Co.* adds an element of uncertainty to governing law clauses.

150. Note 49 *supra*.

U.C.C. section 1-105 does not mention public policy of the forum as a limitation to party autonomy to choose a governing law. Presumably the general conflict-of-laws rule as to public policy would also apply with respect to a governing law clause upheld under U.C.C. section 1-105(1).¹⁵¹

IV. CONCLUSION

Writers on conflict-of-laws questions involving contracts traditionally have prefaced their papers with the statement that such questions concern "the most confused subject in the conflict of laws."¹⁵² Such a statement would no longer be appropriate in the case of New York insofar as the law selected by the parties to a contract is concerned. These rules are fairly clear and consistent. As Ernst Rabel, a noted authority, said:

The practice allowing parties to a contract to determine the law applicable to their contractual relation . . . for centuries has been applied by courts throughout the world with slight dissent.¹⁵³

New York has clearly joined the majority.

The only area of concern is the uncertainty created by *Haag v. Barnes*.¹⁵⁴ The approach suggested in that case would destroy the utility of governing law clauses. If a state wishes its citizens to participate in interstate and international commerce and to risk their money and effort in ventures which cross territorial boundaries, it must provide legal rules which enable these individuals to ascertain which law applies to such transactions. If there are no simple mechanical rules as to applicable law, the parties to an agreement must have the right to agree on the applicable law. Businessmen should not be asked to bear not only economic risk but the risk of a court determining in hindsight which law governs their transaction.

Hopefully New York courts will be generous in their interpre-

151. Prebble, *supra* note 3, Part I, at 534, refers to U.C.C. § 2-302(1). However, the concept of that section would not be helpful in cases like *Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*, 269 N.Y. 22, 198 N.E. 617, *remitter amended*, 269 N.Y. 602, 199 N.E. 691 (1935), *cert. denied*, 297 U.S. 705 (1936).

152. Ehrenzweig, *supra* note 3, at 973; Oliver, *Standardization of Choice-of-Law Rules for International Contracts: Should There Be a New Beginning?* 53 AM. J. INT'L L. 385 (1959).

153. Rabel, 1 THE CONFLICT OF LAWS 90 (1958).

154. 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961); see text accompanying notes 15-21 *supra*.

tation of the requirement of a "reasonable relationship" between the transaction and the jurisdiction whose laws were chosen. Some New York courts have already suggested that a "reasonable basis" for the parties' choice, as suggested by the Restatement (Second) of Conflict of Laws, should be sufficient.¹⁵⁵ Every day international transactions involving millions of dollars are entered into, in New York and elsewhere, which stipulate New York law. The reason for this choice is New York's role as an international business center and the fact that many businessmen have a high regard for New York law, New York judges, and New York lawyers. This demonstration of confidence should encourage the New York courts to support New York's role as a financial and commercial center.

155. See notes 49 and 79 *supra*.

