

# Governing Law Clauses Excluding Principles of Conflict of Laws

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With increasing frequency, international and interstate agreements contain choice of law clauses (governing law clauses) that select a specific law but exclude the portions of those laws containing principles or rules of conflict of laws.

Part I of this article will discuss how a court in the jurisdiction of the stipulated law might deal with a clause selecting the law of the forum excluding its conflict of laws rules. For example, litigation may arise in New York involving the clause “*This Agreement shall be governed by and construed in accordance with the law of the State of New York without giving effect to any conflict of laws principles of such State.*” Part II of this article will discuss how a court might deal with a clause selecting the law of another jurisdiction excluding that jurisdiction’s conflict of laws rules. For example, litigation may arise in New York involving the clause “*This Agreement shall be governed by and construed in accordance with German law without giving effect to any conflict of laws principles of Germany,*” or litigation under the clause stipulating New York law other than its conflict of laws principles may arise in a jurisdiction other than New York.

## I. Governing Law Clauses Stipulating the Law of the Forum

### A. EXCLUSION OF OBJECTIVE CONFLICT OF LAWS RULES

If the parties to an agreement fail to select a law to govern the agreement, courts will apply various tests using objective criteria to determine the applicable law. New York courts, for instance, would determine the applicable law using either the center of gravity doctrine<sup>1</sup> or the governmental interest doctrine.<sup>2</sup> If the parties have chosen the forum law as the law governing their agreement and if under the forum’s conflict of laws rules such choice is valid and will be upheld, courts in the forum jurisdiction will apply the chosen law rather

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1. See *Auten v. Auten*, 124 N.E.2d 99, 101–02 (N.Y. 1954).

2. See *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 248 N.E.2d 576, 582 (N.Y. 1969). See generally EUGENE F. SCOLES ET AL., *CONFLICT OF LAWS* 884–95 (3d ed. 2000).

than search for the applicable law using the objective tests.<sup>3</sup> It is unlikely that any court in the forum jurisdiction would first hold the parties' contractual choice of the forum law as valid and then ignore this choice by selecting the law pursuant to the objective standards. Such an action would be illogical. If a court in the jurisdiction of the governing law selects the applicable law using the objective standards, it has rejected the choice of law clause for one of two reasons: (1) the court is of the opinion that the parties generally or under the particular circumstances of the case do not have the autonomy to choose the law of the contract, or (2) the choice does not meet certain requirements of the forum jurisdiction's conflict of laws rules. This deficiency may consist of a lack of a reasonable relation between the jurisdiction of the chosen law and the transaction.<sup>4</sup>

Some proponents of governing law clauses that exclude conflict of laws principles have argued that such clauses prevent a court in the forum jurisdiction from applying its objective rules of choice of law despite the governing law clause.<sup>5</sup> This concern is absurd, however, because once a court has held that the governing law clause is effective and must be recognized, that court cannot apply the rules that would be applicable if no effective choice of law clause existed. For the court to apply the objective choice of law principles, it must have held that the choice of law clause is ineffective. On the other hand, if a governing law clause is ineffective under the forum's conflict of laws rules, its effectiveness cannot be created by an exclusion of conflict of laws principles. To illustrate, in New York if the choice of law clause is not given effect because the transaction amount does not meet the minimum requirements set forth in New York General Obligations Law § 5-1401<sup>6</sup> and does not have a reasonable relationship with New York,<sup>7</sup> the effectiveness cannot be created by excluding the two aforementioned conflict of laws rules.

#### B. EXCLUSION OF THE RULES THAT DETERMINE THE VALIDITY OF THE GOVERNING LAW CLAUSE

The courts of substantially all countries, and of all states of the United States, including New York, determine under their own conflict of laws rules whether and to what extent a governing law clause will be recognized and given effect, regardless of whether it stipulates the forum law or a foreign law.<sup>8</sup> Thus, a New York court will determine under New York's

3. See Michael Gruson, *Governing Law Clauses in Commercial Agreements—New York's Approach*, 18 COLUM. J. TRANSNAT'L L. 323, 329-40 (1979) (citing New York cases); *Gen. Ins. Co. of Am. v. Fort Lauderdale P'ship*, 740 F. Supp. 1483, 1490-91 (W.D. Wash. 1990) (parties selected Washington law; court rejected the argument that under Washington's (objective) rules of conflict of laws, New York law should be applied); *Economu v. Borg-Warner Corp.*, 652 F. Supp. 1242, 1246-47 (D. Conn. 1987), *aff'd*, 829 F.2d 311 (2d Cir. 1987); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(3) cmt. h (1971, rev. 1989) [hereinafter RESTATEMENT].

4. See Gruson, *supra* note 3, at 329-40.

5. If the forum applies a foreign law because the governing law clause is invalid or because mandatory rules of conflict of laws require the forum to do so, no issue of *renvoi* is involved. Some practitioners, however, erroneously state that the exclusion of conflict of laws principles is necessary to prevent the courts of the jurisdiction of the governing law from applying *renvoi*. For a discussion on the doctrine of *renvoi*, see Michael Gruson, *International Agreements—The Application of a Law Other than the Law Stipulated in the Agreement*, in COMMERCIAL CONTRACTS: STRATEGIES FOR DRAFTING AND NEGOTIATING, § 6.09 (Martin Moskin ed., 2003).

6. N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 2001).

7. See Gruson, *supra* note 3, at 329-40; N.Y. U.C.C. LAW § 1-105 (McKinney 2003).

8. See MICHAEL GRUSON ET AL., LEGAL OPINIONS IN INTERNATIONAL TRANSACTIONS (Report of the Subcommittee on Legal Opinions of the Committee on Banking Law of the Section on Business Law of the International Bar Association) ch. 9, XIV (Reporters' annotation (3)), at 164 (4th ed. 2003) [hereinafter IBA

conflict of laws rules whether a choice of law clause stipulating that New York law or a foreign law shall govern an agreement is effective.

The clause excluding the application of conflict of laws rules appears to also exclude the conflict of laws rules that permit the parties to select a law to govern their agreement. For example, if the law of New York, yet excluding New York's conflict of laws rules, is chosen, New York General Obligations Law § 5-1401 or Uniform Commercial Code § 1-105, the very bases for the effectiveness of the governing law clause, would be excluded.<sup>9</sup> This is an absurd, and probably unintended, result. The parties to an agreement containing a clause selecting the forum's law exclusive of its conflict of laws rules as the governing law will probably argue that they did not intend to exclude the forum's conflict of laws rules pursuant to which the validity and effectiveness of the choice of law clause is determined.

The effectiveness of a governing law clause under the rules of conflict of laws must be distinguished from the contractual validity of the governing law clause, which must be determined, like the validity of the whole contract, according to the chosen law (which may or may not be the law of the forum).<sup>10</sup>

The rule that the effectiveness and scope of a governing law clause is determined by the forum is a mandatory rule of conflict of laws and cannot be abrogated by party agreement.

### C. EXCLUSIONS OF MANDATORY CONFLICT OF LAWS RULES REFERRING TO A FOREIGN LAW

The drafters of a governing law clause stipulating the law of the forum, yet excluding its conflict of laws rules, may have intended to circumvent the consequences of the forum's mandatory conflict of laws rules that mandate the application of a law other than the chosen law, despite a contractual choice of law clause.<sup>11</sup> Examples of such mandatory conflict of laws rules are:

1. *The internal affairs doctrine.* This doctrine provides that issues such as the corporate power of a corporation to enter into and to perform the agreement in question, the authorization

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Opinion Report]; Gruson, *supra* note 5, § 6.02. For U.S. cases, see, e.g., Valley Juice Ltd., Inc. v. Evian Waters of France, Inc., 87 F.3d 604, 607-09 (2d Cir. 1996); Woodling v. Garrett Corp., 813 F.2d 543, 551 (2d Cir. 1987); Maltz v. Union Carbide Chems. & Plastics Co., 992 F. Supp. 286, 295-97 (S.D.N.Y. 1998); Associated Metals & Minerals Corp. v. Sharon Steel Corp., 590 F. Supp. 18, 20 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1431 (2d Cir. 1983); Haag v. Barnes, 175 N.E.2d 441 (N.Y. 1961); Caton v. Leach Corp., 896 F.2d 939, 942-43 (5th Cir. 1990); Equifax Servs., Inc. v. Hitz, 905 F.2d 1355, 1360 (10th Cir. 1990). The issue that governing law clauses must be effective under the forum's choice of law rules should be distinguished from the issue that, in cases in the United States based on diversity jurisdiction, a federal court follows the substantive law, including the choice of law rules, of the state in which the federal district court sits. See *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941). If a case is transferred from one federal jurisdiction to another pursuant to 28 U.S.C. § 1404(a), a federal court follows the substantive law, including the choice of law rules, of the jurisdiction in which the action was originally filed. See, e.g., *Valley Juice Ltd., Inc.*, 87 F.3d 604, 607; *Maltz*, 992 F. Supp. 286, 295.

9. See N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 2001); N.Y. U.C.C. LAW § 1-105 (McKinney 2002). If the parties agreed on New York law to govern their agreement, and the governing law clause does not meet the conditions of section 5-1401, for example, because the transaction does not cover the threshold amount of \$250,000, then the validity of the governing law clause will be determined under the reasonable relationship rule, *supra* note 4. The exclusion of New York's conflict of laws rules would also exclude the reasonable relationship rule.

10. See Gruson, *supra* note 5, n.12 and accompanying text; IBA Opinion Report, *supra* note 8, at 164.

11. See Gruson, *supra* note 5 (discussion of the mandatory conflict of laws rules that require the application of a law other than the law stipulated in the agreement).

by all required corporate actions of the execution, delivery, and performance of the agreement in question, and the execution and delivery of the agreement by properly appointed or elected and authorized officers of the corporation, are governed by the law of the jurisdiction of incorporation and not by the stipulated law, be it a foreign law or the forum law.<sup>12</sup>

2. *Public policy of a third country as a limitation on choice of law clauses.* Many states limit the scope of a choice of law clause if a rule of the stipulated law—be it a foreign law or the forum law—or a term of the agreement in question violates a fundamental public policy of a jurisdiction other than the forum.<sup>13</sup>
3. *Foreign bankruptcy proceedings.* A foreign bankruptcy proceeding relating to a party to the agreement in question may modify the contractual relationship irrespective of the governing law clause stipulating a law of a jurisdiction other than the jurisdiction of the bankruptcy proceeding, and the jurisdiction of the governing law may recognize such modification.<sup>14</sup>
4. *The act of state doctrine.* U.S. courts may be required under the act of state doctrine to apply a law of a jurisdiction other than the jurisdiction of the stipulated law. If the act of state doctrine is applied to contracts, the issue is properly one of applicable law—whether the stipulated law of the contract governs the issue in question, or whether the foreign law or decree promulgated by a foreign country after the contract has been executed modifies the contractual obligation. Courts have held that whether or not the foreign act of state will be given effect depends on the location or *situs* of the obligation; if the contract is “located” in the foreign country, the foreign act of state will prevail over the stipulated law. But, if the contract is “located” in the United States, the foreign act of state will not be given effect.<sup>15</sup>

12. See *Edgar v. MITE Corp.*, 457 U.S. 624, 645–46 (1982); Gruson, *supra* note 5, § 6.03; RESTATEMENT, *supra* note 3, § 302. The Restatement, in § 301, takes a more differentiated view regarding corporate power and states that the law selected by the parties to govern their contract determines whether *ultra vires* is a defense against the enforcement of the contract. RESTATEMENT, *supra* note 3, § 301; see Gruson, *supra* note 5, § 6.03[B]. Thus, under the approach of the Restatement, the *ultra vires* defense is not part of the mandatory internal affairs doctrine.

13. See RESTATEMENT, *supra* note 3, § 187(2)(b); Gruson, *supra* note 5, § 6.05. See *Winer Motors, Inc. v. Jaguar Rover Triumph, Inc.*, 506 A.2d 817, 820–21 (N.J. Super. Ct. App. Div. 1986) (stating that although the franchise agreement stipulated New Jersey law and that generally a contractual choice of law provision refers to the local law and not to the forum’s conflict of laws rules, Restatement § 187(2)(b), which refers to another state’s fundamental public policy, is an exception to this rule). *But see* *Supply & Building. Co. v. Estee Lauder Int’l, Inc.*, 2000 WL 223838, at \*2–3 (S.D.N.Y. 2000) (denying motion for reconsideration of the Court’s 1999 ruling and holding that N.Y. GEN. OBLIG. LAW § 5–1401 precludes the consideration of another country’s public policy with respect to agreements governed by New York law). See Gruson, *supra* note 5, § 6.05[B] (discussing the *Estee Lauder* case).

Article 7(1) of the Convention on the law applicable to contractual obligations, which opened for signature on June 19, 1980, provides that a country may give effect to the mandatory rules of law of another country with which the transaction has a close connection “if and insofar as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract.” 80/934/EEC, E.C. O.J. L 266 (1980) [hereinafter Rome Convention]. Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Portugal, Sweden, and the United Kingdom have adopted the Rome Convention; however, not all of these countries have adopted article 7(1).

14. See *Canada S. Ry. Co. v. Gebhard*, 109 U.S. 527, 537–38 (1883) (deeming the creditor to have consented to foreign bankruptcy laws by virtue of the creditor’s entry into a contract with a corporation incorporated in a foreign country); *Second Russian Ins. Co. v. Miller*, 268 U.S. 552 (1925) (stating that the bankruptcy exception to governing law clauses is related to the internal affairs exception to governing law clauses); Gruson, *supra* note 5, § 6.06.

15. See Michael Gruson, *The Act of State Doctrine in Contract Cases as a Conflict-of-Laws Rule*, 1988 U. ILL. L. REV. 519, 529 *et seq.*; Gruson, *supra* note 5, § 6.07. The act of state doctrine is a federal conflict of laws rule. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 424–27 (1964).

5. *Lex monetae*. Otherwise known as the 'law of the money,' this rule deals with which currency is the legal tender for the discharge of the nominal amount of an obligation, and in the case of a currency alteration, how sums expressed in the former currency are to be converted into the new one. The courts of many countries apply the law of the country that issued the currency to determine what constitutes legal tender and the currency's nominal value, regardless of the contractual choice of another law.<sup>16</sup> Because this aspect of the rule *lex monetae* deals with the question which law the forum must apply to determine certain issues relating to a foreign currency in which the contract is to be performed, it is a rule of conflict of laws.<sup>17</sup> If the law chosen by the parties is not the law of the country of the contract currency, the court must determine whether the rule of *lex monetae* is a mandatory rule of conflict of laws of the forum. U.S. courts have not had the opportunity to decide whether *lex monetae* is a mandatory rule of conflict of laws in the United States because, in most decided cases, the law of the contract was identical with the law of the currency.<sup>18</sup> In cases in which the law of the contract was not the law of the country of the currency, some U.S. courts have reached the same result that they would have reached through the application of *lex monetae* by interpreting the governing law clause in the agreement. In those cases courts have held that the parties when agreeing on a foreign currency for the performance of the agreement also agreed on the application of the currency law of the country of the contract currency and thereby limited the scope of the choice of law clause.<sup>19</sup> The conflict of laws rule that permits the parties to apply the laws of different countries to an agreement (*dépeçage*) is a dispositive rule of conflict of laws.
6. *Statutory mandatory conflict of laws rules*. The statutory law of most jurisdictions contains mandatory conflict of laws rules requiring the application of foreign law in certain cases.<sup>20</sup>

16. See F. A. MANN, *THE LEGAL ASPECT OF MONEY*, 266–67, 271–79 (5th ed. 1992). See also Peter Hay, *Fremdwährungsansprüche und -urteile nach dem US-amerikanischen Uniform Act*, 1995 RECHT DER INTERNATIONALEN WIRTSCHAFT 113.

17. See Michael Gruson, *The Scope of Lex Monetae in International Transactions: A United States Perspective*, in *INTERNATIONAL MONETARY LAW—ISSUES FOR THE NEW MILLENNIUM* 433 (Mario Giovanoli ed., 2000); Gruson, *supra* note 5, § 6.08. If the parties to an agreement validly select as the law governing the agreement the law of the country of the contract currency, a court sitting in a third country must apply the selected country's law determining such currency as part of the law governing the agreement. Thus, the law of the chosen country would be applied along with the monetary laws of the chosen country, including the regulations governing the replacement of an old currency with a new one and rules determining the conversion rate between both currencies. In that case, the court does not reach the issue of *lex monetae*.

18. See, e.g., *Dougherty v. Equitable Life Assurance Soc'y*, 193 N.E. 897 (N.Y. 1934); *Trinh v. Citibank, N.A.*, 623 F. Supp. 1526, 1536–38 (E.D. Mich. 1985), *aff'd*, 850 F.2d 1164 (6th Cir. 1988). See Gruson, *supra* note 17, at 438–45.

19. See *Sternberg v. West Coast Life Ins. Co.*, 16 Cal. Rptr. 546 (Cal. Dist. Ct. App. 1961) (holding that a plaintiff suing for the payment of a life insurance policy payable in California, but denominated in no longer existing Chinese currency at the time of payment, could only recover in the current Chinese currency determined as of the date of payment because by agreement on payment in a foreign currency the parties had also agreed to be subject to the currency laws of the country of issue); *Johansen v. Confederation Life Ass'n*, 447 F.2d 175 (2d Cir. 1971); Gruson, *supra* note 17, at 451–55.

20. See, e.g., N.Y. U.C.C. LAW §§ 9–103(2)(b), 9–103(3)(b), 9–103(5) (1972 & 1977 versions of article 9 of the U.C.C., 1977 N.Y. Laws ch. 866, as amended); N.Y. U.C.C. LAW §§ 9–301, 9–302, 9–303(c), 9–304(a), 9–305(a), & 9–306(a) (McKinney 2002) (2000 version, adopted in New York in 2001) (foreign law applicable to the perfection of security interest in certain collateral); N.Y. U.C.C. LAW § 4–102(2) (McKinney 2001) (referring with respect to the liability of a bank for items handled by it to the law of the place where the bank is located); N.Y. U.C.C. LAW § 8–110 (McKinney 2002) (referring to the local law of the jurisdiction of the issuer or of the jurisdiction of the securities intermediary). See also N.Y. U.C.C. LAW § 1–105(2) (McKinney 2002) (listing other U.C.C. provisions); Gruson, *supra* note 5, § 6.09[B].

Mandatory rules of law cannot be changed by agreement. The parties to an agreement cannot by their agreement exclude mandatory conflict of laws rules, and their intention to do so would invalidate their choice of law. They will have to argue that contrary to the language of the clause excluding conflict of laws rules, they did not intend it to cover mandatory rules of conflict of laws.

The rules that are referred to as mandatory conflict of laws rules could also be understood as conflict of laws rules that are outside the permitted scope of a contractual governing law clause and are not subject to disposition by the parties. A choice of law clause is limited to issues that are characterized as contractual matters.<sup>21</sup> The court determines the law applicable to issues that are outside the scope of contractual matters by application of objective conflict of laws rules of the forum. Thus, the applicable law has to be determined for some issues irrespective of the law otherwise governing the contract. The conflict of laws rules that apply to those issues regardless of the parties' choice of law are mandatory. Some U.S. courts have reached this result by holding that some rules of conflict of laws that refer to the law of another jurisdiction deal with matters that affect the rights of third parties are not subject to disposition by agreement of the parties to an agreement, and are excluded from the scope of the choice of law clauses. Examples for such provisions are the rules of conflict of laws that refer to the rules of another jurisdiction relating to the perfection of a security interest (*lex rei sitae* rule).<sup>22</sup>

Even if the parties are able to persuade a court in the jurisdiction of the governing law that they did not intend to exclude mandatory conflict of laws rules referring to the law of a foreign jurisdiction, the exclusion of certain nonmandatory rules of conflict of laws referring to a foreign law may surprise the parties that excluded conflict of laws rules from the governing law clause. For example, the obligor under an agreement that is governed by New York law without its conflict of laws rules but performable in Japanese Yen may be found to have excluded the rule of *lex monetae* (which in the United States is a nonmandatory rule of conflict of laws).<sup>23</sup> The parties may be surprised that they excluded the internal affairs doctrine (to the extent that it is a nonmandatory rule of conflict of laws).<sup>24</sup>

If the parties to an agreement governed by the law of the forum without the forum's conflict of laws rules do not wish to or are not able to, and therefore presumably do not intend to, exclude the conflict of laws rules that determine the validity of the choice of law clause or the mandatory conflict of laws rules referring to a foreign law, and if by agreeing on a choice of law clause they have already chosen to exclude the objective conflict of laws rules of the forum that are applicable in the absence of a choice of law clause, the intention of the drafter of an exclusion clause remains a mystery. At best, the exclusion clause, if

21. See SCOLES, *supra* note 2, at 119, § 3.3 (discussing characterization as a fundamental problem in conflict of laws).

22. See, e.g., *Vintero Corp. v. Corporacion Venezolana De Fomento*, 1980 WL 98409 (Bankr. S.D.N.Y. 1980), *rev'd on other grounds*, 675 F.2d 513 (2d Cir. 1982). See also *Maguire v. Gorbaty Bros.*, 133 F.2d 675 (2d Cir. 1943) (involving pre-U.C.C. perfection of a security interest); *Boyd v. Curran*, 166 F. Supp. 193, 196 (S.D.N.Y. 1958) (holding that parties to a declaration of trust cannot by agreement dictate which law shall govern the claims of a third party to the property right arising from the trust). See N.Y. U.C.C. LAW § 1-105(1) (McKinney 2002) (providing that parties may agree to the law that will govern *their* rights and duties) (emphasis added); N.Y. U.C.C. LAW § 1-105 cmt. 5; Gruson, *supra* note 5, § 6.09[B]; Gruson, *supra* note 3, at 371-72.

23. See *supra* note 19 and accompanying text.

24. See *supra* note 12.

properly interpreted, states the obvious. The clause, however, creates an uncertainty and unpredictability of interpretation, a risk that far outweighs the imagined risk it seeks to prevent.

Some governing law clauses do not expressly exclude the conflict of laws rules of the stipulated New York law but state that the chosen New York law should be applied “*as applicable to contracts to be performed entirely within the State of New York.*” Such clause does not exclude New York’s conflict of laws rules that determine the validity of the governing law clause, but is likely intended to exclude New York’s mandatory rules of conflict of laws that require the application of a law other than the chosen New York law. The place of performance is not in all cases relevant for the application of a law other than the stipulated law. Even if an agreement is to be performed only in New York, the internal affairs doctrine applies to a foreign corporate party to the agreement. The place of performance is irrelevant in cases involving a modification of the agreement by a foreign bankruptcy proceeding relating to a contract party or cases involving the application of *lex monetae* to contracts that are performable in a foreign currency. The place of performance, however, may be a relevant factor in determining the *situs* of the agreement for purposes of the act of state doctrine or for the question whether the governing law clause is limited by the public policy of another jurisdiction. The drafters of the above clause may have intended to exclude the application of a foreign act of state or the limitation of the governing law clause by the public policy of another jurisdiction. As stated above, the parties cannot exclude mandatory conflict of laws rules. It is unlikely that a court would follow a self-servicing fiction stated in the agreement and ignore the legal consequences of a performance, in whole or in part, of the agreement outside of New York. The application of statutory mandatory conflict of laws rules would not be affected by a contractual fiction. For example, if collateral is located outside of New York, and under the Uniform Commercial Code perfection of a security interest in that collateral is governed by the law of the place where the collateral is located, the contractual fiction cannot change that result.

#### D. GOVERNING LAW CLAUSES EXCLUDING CONFLICT OF LAWS RULES IN U.S. COURTS

U.S. courts have, without squarely facing the issue, in fact ignored the exclusionary language of governing law clauses stipulating the law of a U.S. state. Though the clause excludes the application of the conflict of laws rules on the basis of which the validity of the governing law clause must be determined, courts have nevertheless continued to determine the validity of governing law clauses under the conflict of laws rules of the forum.<sup>25</sup>

Once a court concludes under the conflict of laws rules of the forum that the governing law clause is valid, it applies the mandatory rules of conflict of laws of the forum despite the exclusion of the conflict of laws rules. In *SG Cowen Securities Corp. v. Messih*,<sup>26</sup> the Federal

25. Cases where the law of the forum, excluding its conflict of laws rules, was stipulated but nevertheless the court determined the validity of the governing law clause under the conflict of laws rules of the forum: *SG Cowen Sec. Corp. v. Messih*, 2000 U.S. Dist. LEXIS 6697, at \*7-8 (S.D.N.Y. 2000), *aff’d*, 224 F.3d 79 (2d Cir. 2000); 600 Grant St. Assocs. Ltd. P’ship v. Leon-Dielmann Inv. P’ship, 681 F. Supp. 1062, 1064 (S.D.N.Y. 1988).

26. *SG Cowen*, 2000 U.S. Dist. LEXIS 6697. *SG Cowen* represents good law in spite of *Estee Lauder*, because *SG Cowen* involved an employment agreement, which is excluded from N.Y. GEN. OBLIG. LAW § 5-1401. Compare *SG Cowen*, 2000 U.S. Dist. LEXIS 6697, with *Supply & Building Co. v. Estee Lauder Int’l, Inc.*, 2000 WL 223838 (S.D.N.Y. 2000). Therefore, in *SG Cowen*, the validity of the governing law clause in the em-

District Court for the Southern District of New York applied, in the face of an exclusion clause, the conflict of laws rule of Restatement § 187(2)(b) to an employment agreement governed by New York law and decided that California law governed the contract issue in question.<sup>27</sup> The plaintiff in *In re Uno Broadcasting Corp.* argued that the choice of law clause in a stock pledge agreement referred only to the local law of Arizona and did not include the conflict of laws provisions of Arizona.<sup>28</sup> A federal court in Arizona nevertheless applied the internal affairs doctrine of Arizona conflict of laws and in accordance therewith applied Illinois law as the law of the state of incorporation. Under Illinois law the court determined the irrevocability of a proxy that was part of the stock pledge agreement.

How would a U.S. court interpret the purpose of a governing law clause that excluded the conflict of laws rules of the stipulated law? *Keene Corp. v. Bogan*<sup>29</sup> indicates the interpretation that a court might give to such a clause. The governing law clause in *Keene* provided for the application of New York law “including those [rules] relating to conflicts of law [sic].”<sup>30</sup> The court held that this clause either (1) led to the absurd result that the parties did not wish the forum to apply the stipulated law, and instead wished the court to apply the objective conflict of laws rules that apply in the absence of a governing law clause<sup>31</sup> or (2) restated the self-evident rule that, despite a governing law clause, a court will apply foreign law if required by mandatory conflict of laws rules.<sup>32</sup> The court decided that the clause simply restated the law that even in the case of a valid stipulation of New York law, in a limited number of cases New York conflict of laws rules require the application of a foreign law. The court rejected the absurd result and selected the self-evident interpretation, effectively ignoring the inclusion language. A court confronted with an *exclusion clause* would likely engage in the same analysis as the court in *Keene*. It would probably reject the absurd result that the parties did not wish the governing law clause to be upheld on the basis of the rules of conflict of laws of the forum or that they intended a clause that violated mandatory law resulting in its invalidation. The court would probably read the clause as restating the self-evident rule that the forum would not (1) uphold the validity of the governing law clause and apply the governing forum law as stipulated and (2) hold that the forum law includes the objective choice of law rules—the center of gravity and governmental interest doctrines—that apply in the absence of a valid governing law clause, and in application of such doctrines apply the law of another jurisdiction.<sup>33</sup> No court in the United States has taken the absurd position to give effect to a choice of law clause in order to ignore it.

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ployment agreement was determined under the reasonable relationship rule. In *Estee Lauder*, the court held that section 5-1401, which permits parties to significant contracts to agree on New York law in the absence of a reasonable relation between the transaction and New York state, precludes the consideration of another county's or state's public policy pursuant to Restatement § 187(2)(b). RESTATEMENT, *supra* note 3, § 187(2)(b). This case only applies to agreements governed by New York law, not to agreements governed by a foreign law. See *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 144 (S.D.N.Y. 2000) (applying Restatement § 187(2)(b) to a guaranty governed by Delaware law). For a discussion of Restatement § 187(2)(b), see Gruson, *supra* note 5, § 6.05 [B]. The reasonable relationship rule is discussed in Gruson, *supra* note 3, at 329–52, and Michael Gruson, *International Opinions, in LEGAL OPINION LETTERS, A COMPREHENSIVE GUIDE TO OPINION LETTER PRACTICE*, § 11.9 [A] (M. John Sterba, Jr., ed., 3d ed. 2003).

27. *SG Cowen*, 2000 U.S. Dist. LEXIS 6697, at \*8–9. See RESTATEMENT, *supra* note 3, § 187(2)(b).

28. *In re Uno Broad. Corp.*, 167 B.R. 189, 197–98 (Bankr. D. Ariz. 1994).

29. *Keene Corp. v. Bogan*, 1990 WL 1864 (S.D.N.Y. 1990).

30. *Id.* at \*2.

31. *Id.* The court called this interpretation an “anomaly” that “defies common sense.” *Id.* at \*\*3–4.

32. *Id.* at \*3.



Although a governing law clause stipulating New York law yet excluding its conflict of laws rules would be void under New York law if taken literally, a New York court is likely to ignore the exclusion language since, as a court said, it “defies common sense.”<sup>34</sup> A court’s position will likely be based on the interpretation that the parties did not intend an invalid clause because it purports to exclude mandatory law, but intended to instruct the court not to apply the objective conflict of laws rules of the forum law that determines the law of the contract in the absence of a governing law clause. Because courts will not do this anyway, the clause deals with an imaginary concern. A court would likely uphold the validity of the clause by interpreting the clause as stating a rule that would apply even in the absence of the exclusion language. It is curious that lawyers draft a clause that on its face is invalid and deals with an imaginary concern.<sup>35</sup>

## II. Governing Law Clauses Stipulating a Foreign Law

### A. CLAUSE DOES NOT EXCLUDE THE FORUM’S CONFLICT OF LAWS RULES

A governing law clause selecting a law other than the law of the forum and excluding the conflict of laws rules of the stipulated foreign law does not exclude the conflict of laws rules of the forum.<sup>36</sup> Thus, the conflict of laws rules of the forum pursuant to which the forum will determine the validity and effectiveness of a choice of law clause stipulating a foreign law are not affected by such a clause.<sup>37</sup>

Furthermore, mandatory conflict of laws rules of the forum requiring the forum to apply the law of the forum or the law of a third country or state to certain issues under the agreement irrespective of the choice of law by the parties (*renvoi*) are not affected by a clause excluding the conflict of laws rules of the stipulated foreign law. For example:

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33. The court in *600 Grant St. Assocs. Ltd. P’ship v. Leon-Dielmann Inv. P’ship* did not understand or ignored the party’s argument that the court should, in accordance with the governing law clause, apply the law of the forum, which includes the rules of objective choice of law that apply in the absence of a governing law clause and in application of such objective rules apply the law of another state. 681 F. Supp. 1062 (S.D.N.Y. 1988).

34. *Keene Corp. v. Bogan*, 1990 WL 1864, at \*3.

35. See Gruson, *supra* note 26, § 11.21[B] (discussing whether New York counsel can render an opinion that an agreement with a governing law clause stipulating New York law, but excluding its conflict of laws rules, is legal, valid, binding, and enforceable). Gruson concludes that the New York lawyer could properly reach the opinion that an agreement containing such a clause is legal, valid, binding, and enforceable because a New York court is likely to ignore the exclusion language. The TriBar Report reaches the same result when it states that a governing law clause with or without an exclusion of conflict of laws principles clause “means the same thing.” Opinion Committee, *Third-Party Closing Opinions*, 53 BUS. LAW. 591, 633 n.89 (1998). See Michael Gruson, *The Remedies Opinion in International Transactions*, 27 INT’L L. 911 (1993) (discussing the legal, valid, binding, and enforceable opinion in cross-border transactions).

36. The following are cases in which a foreign law, excluding its conflict of laws principles, was stipulated and the forum determined the validity of the governing law clause in accordance with its conflict of laws principles: *Maltz v. Union Carbide Chems. & Plastics Co.*, 992 F. Supp. 286, 295–98 (S.D.N.Y. 1998); *Frutico, S.A. de C.V. v. Bankers Trust Co.*, 833 F. Supp. 288 (S.D.N.Y. 1993), *aff’d*, 23 F.3d 396 (2d Cir. 1994) (analyzing the validity of a governing law clause, stipulating New York law without recourse to New York choice of law or conflict of laws principles, under Texas conflict of laws rules; the cases having been transferred from a Texas federal district court to a New York federal district court pursuant to 28 U.S.C. § 1404(a) (2000)); *Key Motorsports, Inc. v. Speedvision Network, L.L.C.*, 40 F. Supp. 2d 344 (M.D.N.C. 1999) (addressing an agreement stipulating the internal laws of New York).

37. See Gruson, *supra* note 5, § 6.02.

1. The *internal affairs doctrine*, discussed above, may require the forum to apply the law of the jurisdiction of incorporation of a corporate party to the agreement despite a governing law clause selecting a foreign law (other than the law of the jurisdiction of incorporation) as governing law.<sup>38</sup>
2. *Public policy of the forum as a limitation on choice of law clauses*. New York, like most other jurisdictions, limits the scope of a choice of law clause stipulating a foreign law if the application of a rule of the stipulated law or a term of the agreement in question violates a fundamental public policy of New York.<sup>39</sup> The violation of the New York public policy does not invalidate the choice of the governing law; it merely limits its effect on the issues that are inconsistent with the public policy. A New York court will apply New York law with respect to those issues in spite of an otherwise valid choice of a foreign governing law.
3. Under the conflict of laws rules of the forum, the *public policy of a third country*, as discussed above may lead to the application of the law other than the stipulated foreign law.<sup>40</sup>
4. The forum may determine that an agreement, although governed by a stipulated foreign law, has been modified by the *bankruptcy laws* of a third country.<sup>41</sup>
5. U.S. courts would apply a foreign law under the *act of state doctrine* in spite of a governing law clause selecting the law of a country other than the country that has issued the act of state as governing law.<sup>42</sup>
6. The rule of *lex monetae*, discussed above, could lead to the application by the forum of a law other than the stipulated foreign law.<sup>43</sup>
7. *Statutory mandatory conflict of laws rules* of the forum are not affected by a governing law clause selecting a foreign law but excluding the conflict of laws rules of the selected foreign law.<sup>44</sup>

## B. RENVOI IS A CONFLICT OF LAWS RULE OF THE FORUM

The drafters of an agreement that contains a governing law clause excluding the conflict of laws principles of the stipulated foreign law frequently argue that they wish to exclude the doctrine of *renvoi*. *Renvoi* means that a court in a jurisdiction other than the jurisdiction of the chosen governing law does not apply the substantive law of the stipulated jurisdiction but its conflict of laws rules and such conflict of laws rules refer either back to the forum (*remission*) or to the law of a third country or state (*transmission*).<sup>45</sup> For example, if the parties agree on English law, a New York court applying the doctrine of *renvoi* would not look to English substantive law but rather to the whole English law, which includes the English conflict of laws rules that refer to the law of another country, and would apply the foreign law that the English court would apply. Such English conflict of laws rules could be rules

38. See *Rosenmiller v. Bordes*, 607 A.2d 465 (Del. Ch. 1991) (stating that the internal affairs doctrine requires application by Delaware Court of Delaware law, notwithstanding express choice by parties of New Jersey law excluding its conflict of laws provisions). See *supra* note 12 and accompanying text.

39. See Gruson, *supra* note 3, at 374-78; Gruson, *supra* note 26, § 11.10[A]; Gruson, *supra* note 5, § 6.04. *Finucane v. Interior Constr. Corp.*, 264 A.D.2d 618, 620 (N.Y. App. Div. 1999) (discussing, but rejecting under the facts of the case, the existence of a fundamental public policy in New York that would override the stipulation of Oklahoma law excluding its rules regarding conflict of laws).

40. See *supra* note 13 and accompanying text.

41. See *supra* note 14 and accompanying text.

42. See *supra* note 15 and accompanying text.

43. See *supra* notes 16-19 and accompanying text.

44. See, e.g., for New York, N.Y. U.C.C. Law § 4-102(2) (McKinney 2001); N.Y. U.C.C. Law §§ 8-110, 9-301, 9-302, 9-303(c), 9-304(a), 9-305(a), & 9-306(a) (McKinney 2002). See *supra* note 20.

45. See SCOLAS, *supra* note 2, § 3.13, at 134.

that apply in the absence of a valid choice of law clause or rules that refer to a foreign law irrespective of the existence of a valid choice of law clause.

If the forum, like New York, follows the nearly universal rule that the validity and effectiveness of a choice of law clause, even if stipulating a foreign law, is determined under the conflict of laws rules of the forum,<sup>46</sup> it would be strange indeed and contradictory if the forum would determine under the conflict of laws rules of the forum that the clause is valid and therefore would apply the stipulated foreign law and then decide that the validity of the choice of law clause is determined in a second analysis under the conflict of laws rules of the jurisdiction of the governing law. Under this approach which no court has taken, the parties' choice of law would have to fulfill the requirements of two sets of conflict of laws rules.

Furthermore, the forum might take the position that *renvoi* is an issue of conflict of laws, that the forum law determines conflict of laws issues under its own rules and that therefore the law of the forum determines whether or not the forum must apply *renvoi*. The governing law clause excluding conflict of laws rules of the chosen foreign law does not have any effect on the conflict of laws rules, including the rules of *renvoi*, of the forum. For example, if a governing law clause stipulates English law except England's conflict of laws rules, the question whether by application of *renvoi* a referral by English law to a third-country law must be followed by a New York court, remains a question of New York's conflict of laws. Thus, the clause excluding foreign conflict of laws rules is meaningless insofar as the application of *renvoi* by a New York court is concerned. In addition, if the conflict of laws rule of the jurisdiction of the forum has mandatory statutory or court-developed provisions requiring *renvoi*, the courts of the forum clearly must apply such mandatory *renvoi*.<sup>47</sup>

### C. RENVOI AND THE SUBSTANTIVE LAW OR WHOLE LAW ISSUE

The parties that stipulate a foreign law to govern their agreement intend that the substantive or local law of the jurisdiction of the governing law shall apply. In *Siegelman v. Cunard White Star Ltd.*,<sup>48</sup> 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

46. See *supra* note 8 and accompanying text.

47. Examples for prior New York statutory *renvoi* provisions are N.Y. U.C.C. Law §§ 9-103(2)(b), 9-103(3)(b), & 9-103(5), which refer with respect to the perfection of security interests in certain collateral to the law of a specified jurisdiction "including the conflict of laws rules." N.Y. U.C.C. Law §§ 9-103(2)(b), 9-103(3)(b), & 9-103(5) (1972 & 1977 version of article 9 of the U.C.C., 1977 N.Y. Laws ch. 866, as amended). Note that older versions of the N.Y. U.C.C. Law contained more *renvoi* provisions than more recent versions. Compare N.Y. U.C.C. Law § 8-106 (1978 version, adopted in New York in 1982, 1983 N.Y. Laws, ch. 928 of 1982) (validity of securities; see Gruson, *supra* note 3, at 357-58) (referring to the law of the jurisdiction of organization of the issuer including the conflict of laws rules), with N.Y. U.C.C. Law § 8-110 (1994 version, adopted in New York 1997) (referring to the local law, i.e., the law of the jurisdiction other than its conflict of laws rules); see N.Y. U.C.C. Law 8-110, cmt. 1 (McKinney 2002); compare N.Y. U.C.C. Law §§ 9-103(2)(b), 9-103(3)(b), & 9-103(5) (1972 & 1977 version, *supra*) (referring to a foreign law including its conflict of laws rules), with N.Y. U.C.C. Law §§ 9-301, 9-302, 9-303(c), 9-304(a), 9-305(a), & 9-306(a) (2000 version, adopted in New York in 2001, 2001 N.Y. Laws ch. 84) (McKinney 2002) (referring to the local law, i.e., the law of the jurisdiction other than its conflict of laws rules). However, N.Y. U.C.C. Law § 1-105(2) provides: "Where one of the following provisions of this Act specifies the applicable 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. . . ." N.Y. U.C.C. Law § 1-105(2) (McKinney 2002).

48. *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189 (2d Cir. 1955).

Appeals for the Second Circuit, applying federal choice of law rules, held that this provision was effective. Turning next to the issue of the 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.<sup>49</sup>

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 is in accord.<sup>50</sup> Absent a clear New York decision on the same issue,<sup>51</sup> *Siegelman v. Cunard White Star Ltd.* constitutes strong persuasive authority in New York. The above-quoted statement from *Siegelman* reflects common sense: parties to an agreement, who stipulate that the law of a specified jurisdiction shall govern their agreement, probably always intend that the substantive rules of the chosen jurisdiction shall apply. However, the extent to which this intention will be carried out requires further analysis.

The conclusion that the parties chose the substantive law of the jurisdiction of the governing law does not mean that the chosen substantive law also applies when the forum's mandatory conflict of laws rules refer to a third country's or state's law. The chosen substantive law also does not apply to issues that are not subject to disposition by the parties. In addition, the forum may determine that the chosen foreign governing substantive law does not apply in cases in which mandatory rules of the foreign governing law refer to a third country's or state's law. The forum may ask itself why it should not follow mandatory conflict of laws rules of the governing law that, despite a valid governing law clause, refer

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49. *Id.* at 194. *Accord* Fuller Co. v. Compagnie Des Bauxites De Guinee, 421 F. Supp. 938, 946 (W.D. Pa. 1976) (regarding a contract clause referring to New York law interpreted as a reference to the substantive law of New York). But *renvoi* was applied in *Mason v. Rose*, a case in which the agreement did not contain a governing law clause and the governing law was determined in accordance with the objective conflict of laws rules. 176 F.2d 486 (2d Cir. 1949).

50. RESTATEMENT, *supra* note 3, § 187(3). Comment h to § 187(3) elaborates:

The reference [in a governing law clause to the law of a chosen state], 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 . . . . To 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.

See also *Economu v. Borg-Warner Corp.*, 652 F. Supp. 1242, 1246-47 (D. Conn. 1987), *aff'd*, 829 F.2d 311 (2d Cir. 1987) (rejecting the argument that New York law requires the court to apply whole New York law, including its (objective) conflict of laws rules which in this case would refer to Connecticut law); *McGill v. Hill*, 644 P.2d 680, 683 (Wash. Ct. App. 1982).

51. There is no clear New York decision on point, but see *Reger v. Nat'l Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 372 N.Y.S.2d 97, 118 (N.Y. Sup. Ct. 1975). See also *Gruson*, *supra* note 3, at 367-69.

to a third country's laws or back to the forum if the courts in the country of the governing law would also follow such referral. The above issues were not before the court in *Siegelman*, and the statement that not the whole law but only the substantive law is referred to in a contractual governing law clause does not address these issues. U.S. courts have not addressed the question how they would decide when faced with a mandatory provision of the stipulated foreign law referring to a third-country law. It is likely, however, that U.S. courts would be guided by the following principles.

1. A court in the United States would probably not apply the stipulated foreign substantive law to the internal affairs of a corporate party to the agreement that is incorporated under the laws of another jurisdiction, but would follow a referral by the conflict of laws rules of the jurisdiction of the stipulated law to the law of the jurisdiction of incorporation. In other words, a court would probably follow the "internal affairs" doctrine of the law of the stipulated jurisdiction.<sup>52</sup>
2. A bankruptcy proceeding in the home country of a foreign corporate party to the agreement may have modified a contractual relationship irrespective of the otherwise governing law. It is likely that a court in the United States would not apply the stipulated foreign substantive law to the contractual relationship but would follow the deference by the conflict of laws rules of the jurisdiction of the stipulated law to modifications made to the agreement in the bankruptcy proceedings in the foreign corporate party's home country. In other words, a U.S. court would probably follow the stipulated jurisdiction's "home country bankruptcy doctrine."<sup>53</sup>
3. When the stipulated foreign law's conflict of laws rules mandate referral to another jurisdiction's law, such as in the cases of the act of state doctrine,<sup>54</sup> U.C.C. §§ 9-301-9-306, § 4-102, or § 8-110,<sup>55</sup> or a mandatory rule of *lex monetae*,<sup>56</sup> it is unclear to what extent a U.S. court might follow such referral. The logic of following such mandatory conflict of laws rules of the stipulated law cannot be denied, especially where the foreign jurisdiction itself would apply such rules to contracts which expressly stipulate the law of such foreign jurisdiction. Following such rules would promote uniform results irrespective of the chosen forum.

The above issues were not before the court in *Siegelman*, and thus the holding that only the substantive law and not the whole law was referred to by a contractual governing law clause, does not address these issues.

In most cases, it makes no difference whether the forum applies to an issue (1) its own rules of mandatory conflict of laws that refer to the law of another jurisdiction or (2) the mandatory rules of conflict of laws of the governing law that refer to the law of the other jurisdiction. In other words, the result would likely be the same whether New York applies its own internal affairs doctrine or that of the jurisdiction of the governing law: in both cases the law of the jurisdiction of incorporation would be applied to the internal affairs of a corporation.

A New York court confronted with a clause selecting a foreign law, but excluding the conflict of laws rules of the chosen law, would not interpret such a clause as excluding

52. See *supra* note 12 and accompanying text.

53. See *supra* note 14 and accompanying text.

54. See *supra* note 15 and accompanying text.

55. See *supra* note 20.

56. See *supra* notes 16-19 and accompanying text. According to Mann, *lex monetae* in many countries is a mandatory rule of law. MANN, *supra* note 16, at 271-79.

mandatory New York choice of laws rules that expressly instruct the court to apply a foreign law other than the stipulated foreign law. Examples for such rules, such as the internal affairs doctrine, the act of state doctrine, and statutory rules of conflict of law are discussed above. Furthermore, a New York court would not interpret such clause as excluding mandatory New York choice of laws rules that expressly instruct the court to apply foreign conflict of laws rules. N.Y. U.C.C. § 1-105(2)<sup>57</sup> is an example of such rule. Exclusion of such mandatory rules would result in the invalidity of the governing law clause.

Even if the parties to an agreement that is governed by a foreign law were able to exclude the application of *renvoi* by the forum, the question remains whether the exclusion of *renvoi* leads to the same result that the parties intended when they excluded the conflict of laws provisions from the chosen governing law.<sup>58</sup>

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57. N.Y. U.C.C. Law § 1-105(2) (McKinney 2002).

58. See Gruson, *supra* note 26, § 11.21 [C] (discussing whether New York counsel can give a conflict of laws opinion with respect to the validity of the governing law clause contained in an agreement governed by a foreign law that excludes the conflict of laws rules of such foreign law). Gruson concludes that New York counsel probably cannot give such opinion because the party's intentions are unclear and it is unclear how a New York court would interpret such a clause.