

# Modern Law for Global Commerce

Congress to celebrate the fortieth annual session of UNCITRAL  
Vienna, 9-12 July 2007

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## **Choice of law, Contract Terms and Uniform Law in Practice**

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There are three subjects embedded in my topic of “choice of law, contract terms and uniform law in practice.” These are: 1. does choice of law really matter to commercial parties, 2. are these concerns reflected in the contract terms of the commercial agreements, and 3. to the extent that they are, are the legal choices reflected in the choosing of uniform laws. In the brief time I have today, I would like to summarize what we know about these three questions in the actual practice of commercial transactions.

Before looking at these specific questions, it is important to remember that various uniform laws, both internationally and domestically, have been some of the most important achievements in private law in recent times. For example, internationally, the United Nations Convention on the International Sale of Goods (CISG) has effectively become the universal standard in international sales contracts.

From my own jurisdiction, one of the most effective unifications of domestic law is the American Uniform Commercial Code, which is now the law in all fifty states in the United States of America and has effectively unified on the national level the commercial law. There seems to be little doubt that the unification of laws throughout the world has increased certainty, transparency, efficiency and fairness in the law.<sup>1</sup>

My comments, although they are generally applicable to choice of law provisions that concern domestic uniform laws, are primarily directed to uniform laws created for primary use in international transactions. For our purposes today, the question is not whether uniform international laws create part of the commercial background of international transactions as default provisions, which they clearly do, but whether parties choose to use these uniform laws.

Thus, for example, I am not addressing such instruments as the Cape Town Convention, which although greatly increases and facilitates international commerce and finance, are not essentially part of the subject of choice of law. These international commercial laws will generally govern the transactions despite party choice.

Moreover, there is no way to determine how often parties intend for the application of uniform laws, but leave no record of that choice because the law is the law anyway by default. For example, parties might be quite willing to choose the CISG to govern their contract, but do not do so expressly because the CISG already applies to the transaction anyway.

As for the first question: whether choice of law matters to parties, we have to work our way through several layers of other considerations. First, we need to distinguish the concerns of the business

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<sup>1</sup> For an examination of the economic efficiencies brought about by unification of commercial laws, see Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 JOURNAL OF LEGAL STUDIES 131 (1996).

people from those of the lawyers. It is always important (and sobering to the lawyers) to remember that the business people; the folks that actually put together international transactions, have little if any concern for questions of choice of law.

To the extent that legal questions are likely to concern commercial parties, the concerns will be ameliorated by those terms that virtually all legal systems allow through freedom of contract to be resolved by the parties themselves.

Thus, for example, in a sales contract, these include such terms as price, delivery, risk of loss, payment time and method, and the quality of performance.<sup>2</sup> If the seller does not deliver the goods, the bank does not pay on the letter of credit, or the carrier causes loss to the cargo, the harmed party will either be compensated, the parties will settle the dispute without resort to questions of law, or the aggrieved party will sue the party that caused the harm.

Choice of law will have little bearing on the outcome of any of these resolutions. To the extent that there are issues in dispute, the issues are usually factual issues that do not raise legal questions that will be answered by a choice of law provision.

There are two legal questions that the commercial parties are often quite concerned about.

First, there is the question of choice of forum. If there is a legal dispute, where will the dispute be resolved? In the case of court litigation, most parties, for obvious reasons, choose the forum in their own jurisdiction.

The second question is whether to choose arbitration over the otherwise available judicial process. For many reasons, in international disputes parties will often choose arbitration.

Questions of both choice of forum as well as the choice of arbitration both impact on the question of enforcement- an issue of great importance. But neither of these two concerns specifically addresses the question of choice of law as it applies to the substantive aspect of the transaction.

Moving to the concerns that lawyers have in the structuring of an international transaction, unlike the actual commercial parties that the lawyers represent; the concerns that more likely reflect the interests of those in this room today, we can look at choice of law provisions.

Thus, as to this first question: does choice of law matter to parties, it seems we can give a qualified yes. There are some areas where parties have traditionally found the differences in the law matter.

This, for example has been the case of for warranties and other obligations imposed on sellers of goods. It is also the case in some areas of banking and finance law. But choice of law rarely tends to be the primary point of concern of the parties.

This brings us to the second question: do parties add choice of law provisions to their agreements? It is generally thought that the concept of freedom of contract or party autonomy provides open ended choice for parties to choose the underlying law that will govern their transactions.<sup>3</sup> To a large extent, that is so, but it is subject to many important limitations.<sup>4</sup> Although the question of the legal restrictions on choice of law provisions is beyond the scope of my remarks today- it is important to note that they do exist, and to the extent that these restrictions do exist- they inhibit the ability of parties to choose uniform laws or any specific laws for that matter. Thus, we must note that the option to choose

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<sup>2</sup> In areas of the law that are still undeveloped parties may feel a particularly need to contract around otherwise applicable law. This has been the case in the area of software licenses when the parties have been uncomfortable with existing legal rules. See e.g., Raymond T. Nimmer, *An Essay on Article 2's Irrelevance to Licensing Agreements*, 40 LOYOLA OF LOS ANGELES LAW REVIEW 235 (2006).

<sup>3</sup> The presumption in favor of the validity and enforcement of choice of law clauses is particularly strong in international cases. See e.g. *Roby v. Corporation of Lloyd's* 996 F.2d 1353 (Federal Court of Appeals for the Ninth Circuit, 1993).

<sup>4</sup> For a detailed examination of the problem courts have in the enforcement of choice of law provisions under conflict of laws rules, see Kermit Roosevelt III, *The Myth of Choice of Law: Rethinking Conflicts*, 97 MICHIGAN LAW REVIEW 2448 (1999).

uniform laws may be limited, and this limitation will have an impact on whether parties provide for choice of law in their agreement.

In addition, it is clear from many cases, particularly the CISG cases, that parties do not bother to put in any choice of law provisions and only discover the applicability of a specific set of rules when litigation arises. Unfortunately, we have no clear data on how prevalent choice of law provisions are or how often they are absent from an agreement.

However, there is strong evidence to suggest that choice of law clauses are often put in agreements with no particular thought of the effect or outcome of the provisions. Thus, for example, it is not uncommon for the parties to provide for the law of a specific domestic jurisdiction only to discover later in litigation that their agreement is bound by the CISG because, unknown to the parties, that was the applicable domestic law by treaty.<sup>5</sup>

Thus, to the second question: do parties make use of choice of law provisions: we can say, sometimes, and not always thoughtfully.

This brings us to our third question: do parties, when providing a choice of law provision, choose uniform international laws in an international transactions?

If we mean international uniform laws in international contracts, the answer is not usually. The evidence suggests that in international contracts, when the parties consciously choose the law, they choose domestic laws.<sup>6</sup> In other words, in international transactions, parties more often opt out as opposed to opt in to international uniform laws.<sup>7</sup> Moreover, the evidence suggests that often when parties expressly specify international norms, they refer to “international legal principles and practices” or “general international commercial practices” and this is done not to supplant, but to supplement domestic law.<sup>8</sup>

What I have just said may be subject to some qualification because the evidence we have on the substance of choice of law provisions is based on studies by major international arbitral centers. It may be unfair to generalize about the whole world of international commercial law from the cases that end up in major arbitral institutions.

It is important to remember that uniform law is really more of an aspiration than a reality in the world today. First, many of the transactions that concern international commerce are not subject to uniform laws. This is changing quite a bit, and there is substantial development of recent and future projects. Thus, the UNIDROIT Cape Town Convention on Secured Financing of Movables as well as the UNICTRAL Accounts Receivable Convention are welcome additions to uniform laws that govern financing of sales and other transactions. But there are still substantial areas of private international law that are not governed by uniform laws or customs.

It is also important to remember that beyond all of the academic theory of the benefits of uniform law to parties, particularly in international transactions, the parties themselves, and the lawyers representing those parties, do not really care much for uniform law in the abstract. What the parties are

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<sup>5</sup> See e.g., *Vlero Mkt. & Supply Co. v. Greeni Oy & Greeni Trading Oy*, 373 F.Supp.2d 475 (District of New Jersey 2005). Conversely, sloppy drafting can also result in a court not fully appreciating the import of a choice of law provision. Thus, for example, in an American case, the United States District Court for the District of Rhode Island concluded that the law of the state of Rhode Island governed an agreement when the contract had a choice of law clause which read: that the agreement “shall be construed and enforced in accordance with the laws of the state of Rhode Island.” *American Biophysics Corp. v. Dubois Marine Specialties*, 411 F.Supp.2d 61, 63 (District of Rhode Island 2006). In this case, the parties were both from countries that are parties to the CISG: the United States and Canada. The court apparently did not consider the fact the CISG is the law of Rhode Island in this type case.

<sup>6</sup> One study indicated that parties chose domestic law in 79 percent of the cases. *2005 Statistical Report ICC INTERNATIONAL COURT ARBITRATION BULLETIN*, Spring 2006, p. 11. There are two obvious reasons for this. First, there is the perception that a party’s own domestic law might be more favorable. Second, and more intuitive, is that parties (or the lawyers representing the parties) will choose the law most familiar. This is usually the domestic law of the respective party.

<sup>7</sup> See Peter M. Haver, *Adopting European Sales Conditions for Sales into the United States*, 38 *BUSINESS LAW INTERNATIONAL* 38 (2007); Franco Ferrari, Remarks on the UNCITRAL Digest’s Comments on Article 6 CISG, 25 *JOURNAL OF LAW AND COMMERCE* 13 (2005).

<sup>8</sup> Christopher R. Drahozal, *Contracting Out of Natural Law: An Empirical Look at the New Law Merchant*, 80 *NOTRE DAME LAW REVIEW* 523 (2005).

interested in is law that favors their particular interests. If it is uniform, so much the better (or just as likely, so much more the indifference).

Because uniform law reduces transaction costs by providing known default rules, this is often reason enough to choose a uniform legal regime. (Certainly, this has long been the justification for the massive, time consuming and expensive uniform law projects both at domestic as well as international levels). Moreover, uniform laws are often chosen because the parties are familiar with them and therefore have the comfort that they will not be surprised with unfamiliar rules.<sup>9</sup>

As it turns out, however, particularly in domestic formulations of uniform law, often (but not universally) the uniform laws favor the parties with the strongest bargaining positions as it is the representatives of these parties who have been most active in the processes of formulating uniform law. It is these parties who have the most to gain by uniform laws and tend to have the bargaining position to insure that these laws will be the chosen sources of laws in their respective transactions.

In addition, those parties that opt to choose a uniform law instrument by a choice of law provision are often sophisticated enough to provide specific terms that contract around many of the default provisions otherwise provided by the uniform law instrument.<sup>10</sup> In this respect, the ultimate law that governs the underlying transaction may be somewhat irrelevant because those terms that might be different among the various possible sets of legal rules that are of importance to the parties (or at least to the party with the strongest bargaining position) will be replaced with specific terms that reflect party choice.<sup>11</sup> Such is the effect of party autonomy.

It is also worth considering in the discussion of uniform laws, the differences in hard laws and soft laws. Parties often are provided the possibility of choosing soft law uniform law instruments such as the UNIDROIT Principles of International Commercial Law to govern the underlying contract, the International Chamber of Commerce INCOTERMS to govern the shipping agreement, or the International Chamber of Commerce UCP for the payment by letters of credit.

In some circumstances, such as the UCP for letters of credit and the INCOTERMS for shipment contracts, these rules may govern without express party choice by well known custom and usage. To that extent, these instruments are no different than hard law instruments, and they become part of the agreement either by express party choice or implied by custom and trade usage.

For our purposes here, the question is how often parties specifically choose these soft law instruments. Unfortunately, we have no basis to determine this, as, in the case of most transactions, there is no public record of usage.

In conclusion, despite the widespread application of international uniform laws in international transactions, it appears that when it comes to express party choice, several factors inhibit more widespread use. First, often parties simply do not make any express choice of law to govern their transactions, and therefore the transactions are governed by the applicable law under conflict of law rules. Second, to the extent that parties do make an express choice of law decision, there is a strong tendency toward the adoption of the familiar, and this is often domestic law.

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<sup>9</sup> I am assuming that the parties have consciously made a choice to use one or another uniform law. The more paradigmatic situation is when the underlying transaction is governed by uniform laws and the parties have made no conscious decision as to which law may govern the transaction. This is the case, for example, in the majority of cases where the CISG applies.

<sup>10</sup> Thus, for example, it has been suggested that a party might choose to have a transaction governed by the UNIDROIT Principles of International Commercial Law instead of the domestic American Uniform Commercial Code because the UNIDROIT Principles have neither a writing requirement nor a parol evidence rule. SARAH HOWARD JENKINS, *Contracting Out of Article 2: Minimizing the Obligation of Performance & Liability for Breach*, 40 *Loyola of Los Angeles Law Review* 401, 402-05 (2006). However it would seem odd that a party that was astute enough to choose the Principles over the domestic law would somehow still be worried about form requirements that could be easily met.

<sup>11</sup> This includes those areas that may vary depending upon the underlying law, such as standards of performance, the basis for acceptance or rejection of performance, damages, and the method of dispute resolution.

To increase the use of international uniform law, a desire that should be self evident to this body, there appears to be two avenues to pursue. First, there should be conscious effort on the part of bodies such as this to educate parties to the existence of these instruments. Second, it is incumbent upon bodies such as UNCITRAL to insure that these instruments reflect a fair balance between the competing domestic legal traditions such that the use of these instruments encourages international trade and facilitates predictable and fair resolution of disputes that will inevitably arise. Events such as this Congress should help achieve both of these goals.

Thank you.