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THE RULES OF CONSTRUCTION IN CHOICE-OF-LAW CASES IN NEW YORK

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I. INTRODUCTION

It is essential in contract actions to ascertain the reasonable expectations of the parties to an agreement.[1] Commercial agreements, such as insurance and reinsurance contracts, are carefully drafted in order to achieve certain specific economic objectives.[2] The rights and obligations of the parties to such contracts are invariably affected by the substantive law of the various jurisdictions. When disputes arise and the laws of the states or nations connected with the contract differ, the court must choose which law to apply.[3] Since, however, the prevailing conflict of law rules are, for the most part, ambiguous and unpredictable,[4] contracting parties have increasingly opted to insert choice-of-law clauses into their agreements, thus ensuring predictable and desirable results. Given New York's status as one of the world's major financial,

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[1] *See* Skandia Am. Reins. Corp. v. Schenck, 441 F. Supp. 715, 723-24 (S.D.N.Y. 1977); Miller v. Miller, 22 N.Y.2d 12, 27, 237 N.E.2d 877, 886, 290 N.Y.S.2d 734, 747, *remittitur denied*, 22 N.Y.2d 722, 239 N.E.2d 204, 292 N.Y.S.2d 107 (1968); Insurance Co. of N. Am. v. United States Fire Ins. Co., 67 Misc. 2d 7, 10, 322 N.Y.S.2d 520, 523 (Sup. Ct. N.Y. County 1971), *aff'd*, 42 App. Div. 2d 1056, 348 N.Y.S.2d 122 (2d Dep't 1973).

[2] Gruson, *Governing Law Clauses in Commercial Agreements—New York's Approach*, 18 COLUM. J. TRANSNAT'L L. 323 (1980).

[3] Note, *Effectiveness of Choice-of-Law Clauses in Contract Conflicts of Law: Party Autonomy or Objective Determination*, 82 COLUM. L. REV. 1659 (1982).

[4] Gruson, *Governing-Law Clauses in International and Interstate Loan Agreements—New York's Approach*, 1982 ILL. L. REV. 207. Reese has observed that "[c]onflict of laws in the United States is presently in a state of flux and chaos. . . . [T]here is dispute over whether there should be rules at all." Reese, *Choice of Law in Torts and Contracts and Directions for the Future*, 16 COLUM. J. TRANSNAT'L L. 1, 1 (1977).

The current rules, although unpredictable and uncertain, afford the jurisdiction with the greatest interest in the litigation the opportunity to control the legal issues and assert its policy considerations. *See, e.g., infra* notes 25-27 and accompanying text (discussing policy considerations).

commercial, and insurance centers,[5] its developed commercial law, and the belief that New York judges are both competent and nonparochial,[6] parties engaged in multi-jurisdictional transactions frequently stipulate that New York law will govern their contract.[7]

Recognizing this status, in 1984 the New York Legislature added section 5-1401 to the New York General Obligations Law.[8] That statute provides for enforcement of the choice of New York law as the governing law in non-consumer contractual obligations involving at least $250,000, even if the obligation does not bear a "reasonable relationship" to the state. However, despite this legislation, New York courts continue to adhere to pre-1984 principles in interpreting governing law clauses,[9] thus effectively causing the policy goals of the statute to remain unfulfilled.[10] As a result, liti-

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[5] *See* Memorandum of Assemblyman Siegel, *reprinted in* [1984] N.Y. LEGIS. ANN. 156, 157.

[6] *See* Gruson, *supra* note 2, at 325.

[7] Typical language from a governing law clause states: "This Agreement shall be governed by, and construed in accordance with, the law of the State of New York." *See* Gruson, *supra* note 2, at 324 n.3. Initially, courts were slow in giving effect to choice-of-law clauses because they were "impeded by the theoretical and erroneous notion that to permit the parties to choose their law would in effect place them in the role of legislators." Reese, *supra* note 4, at 19 (footnote omitted).

[8] N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney Supp. 1988). The new statute provides that:

> 1. The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state. This section shall not apply to any contract, agreement or undertaking (a) for labor or personal services, (b) relating to any transaction for personal, family or household services, or (c) to the extent provided to the contrary in subsection two of section 1-105 of the Uniform Commercial Code.
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> 2. Nothing contained in this section shall be construed to limit or deny the enforcement of any provision respecting choice of law in any other contract, agreement, or undertaking.

Id.

[9] *See infra* notes 144-157 and accompanying text.

[10] In addition to General Obligations Law section 5-1401, the New York Legislature adopted a companion provision to provide for the enforcement of choice-of-forum clauses. Section 5-1402 provides that:

> 1. Notwithstanding any act which limits or affects the right of a person to maintain an action or proceeding, including, but not limited to, paragraph (b) of section thirteen hundred fourteen of the business corporation law and subdivision two of section two hundred-b of the banking law, any person may maintain an action or proceeding against a foreign corporation, non-resident, or foreign state

gants continue to face uncertainty as to whether courts will uphold governing law clauses.

This Article will discuss and analyze the rules of construction employed by the New York courts in determining whether the parties' choice of law will govern their contractual obligations.

II. Effectiveness of Choice-of-Law Clauses

Perhaps no legal subject has caused more bewilderment among the bench and bar than choice of law.[11] There are several choice of law theories currently used by the courts,[12] thus leaving judges to wrestle with often irreconcilable and incomprehensive precedents.[13] This is particularly disturbing because the choice of law decision is frequently outcome determinative.[14]

New York courts employ standard rules of construction in in-

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where the action or proceeding arises out of or relates to any contract, agreement or undertaking for which a choice of New York law has been made in whole or in part pursuant to section 5-1401 and which (a) is a contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate, not less than one million dollars, and (b) which contains a provision or provisions whereby such foreign corporation or non-resident agrees to submit to the jurisdiction of the courts of this state.

2. Nothing contained in this section shall be construed to affect the enforcement of any provision respecting choice of forum in any other contract, agreement or undertaking.

N.Y. Gen. Oblig. Law § 5-1402 (McKinney Supp. 1988). The enforceability of forum selection clauses is beyond the scope of this paper. For a broad overview of forum selection clauses, see Stewart Org., Inc. v. Ricoh Corp., No. 86-1908, slip op. (U.S. June 20, 1988); Scherk v. Alberto-Culver Co., 417 U.S. 506, 515-20 (1974); Bremen v. Zapata Offshore Co., 407 U.S. 1, 8-20 (1972); Gruson, *Forum Selection Clauses in International and Interstate Agreements*, 1982 Ill. L. Rev. 133.

[11] *See* Smith, *Choice of Law in the United States*, 38 Hastings L.J. 1041, 1041 (1987).

[12] *See* W.H. Barber Co. v. Hughes, 223 Ind. 570, 586-87, 63 N.E.2d 417, 423 (1945) (center of gravity approach); Foster v. Leggett, 484 S.W.2d 827, 829 (Ky. 1972) ("lex fori" approach); Neumeier v. Kuehner, 31 N.Y.2d 121, 128, 286 N.E.2d 454, 457-58, 335 N.Y.S.2d 64, 70 (1972) (Fuld's rules); D. Cavers, The Choice-of-Law Process (1965) (Cavers' rules); B. Currie, Selected Essays on the Conflict of Laws 231, 267, 716 (1963) (interest analysis approach); Restatement of Conflict of Laws § 311 (1934) ("lex loci contractus/solutionis" approach); Restatement (Second) of Conflict of Laws § 188 (1969) (most significant relationship test); Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. Rev. 267, 282 (1966) (Leflar's approach). For a brief discussion of the various theories, see Smith, *supra* note 11, at 1043-50.

[13] *See* Smith, *supra* note 11, at 1041. This confusion is compounded not only by the fact that courts do not consistently adhere to a single rule, but also that such courts may at times cite one rule when they are in fact applying the rationale of another in reaching their decision. *See* Reese, *supra* note 4, at 18.

[14] *See* Smith, *supra* note 11, at 1042.

terpreting insurance and reinsurance contracts.[15] In absence of a choice-of-law clause in an insurance contract, courts will either apply a "paramount interest" analysis[16] or a "grouping of contacts" test[17] to determine the applicable law. If an insurance contract does contain a choice-of-law clause, the court will either apply a "reasonable relationship" test,[18] a "paramount interest" analysis,[19] or a "grouping of contacts" test.[20]

A. No Choice-of-Law Clause

The traditional rules regarding choice of law, as expressed in the first *Restatement of Conflict of Laws*, provided that the laws of the place of making and place of performance governed various aspects of the contract.[21] In *Auten v. Auten*,[22] the New York Court of Appeals expressly departed from the first Restatement view and adopted the "grouping of contacts" approach.[23] This approach demands that courts apply the law of the jurisdiction "which has the

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[15] Sullivan County Gas Serv. v. Phoenix Mut. Life Ins. Co., 111 App. Div. 2d 542, 543, 489 N.Y.S.2d 415, 416 (3d Dep't 1985). For example, in the case of ambiguous language in a contract of insurance, doubt or uncertainty will be resolved in the insured's favor. United States Lines Co. v. Eastburn Marine Chem. Co., 221 F. Supp. 881, 883 (S.D.N.Y. 1963). Terms of an insurance contract which are clear and unambiguous, however, must be given their plain and ordinary meaning; such policies must be enforced as written, and the court is not free to modify terms by judicial construction. *See* Breed v. Insurance Co. of N. Am., 46 N.Y.2d 351, 355, 385 N.E.2d 1280, 1282, 413 N.Y.S.2d 352, 355 (1978).

[16] Krauss v. Manhattan Life Ins. Co., 643 F.2d 98, 101 (2d Cir. 1981); Index Fund, Inc. v. Insurance Co. of N. Am., 580 F.2d 1158, 1162 (2d Cir. 1978); Jefferson Ins. Co. v. Fortress Re, Inc., 616 F. Supp. 874, 877 (S.D.N.Y. 1984); *see* Intercontinental Planning, Ltd. v. Daystrom, Inc., 24 N.Y.2d 372, 382, 248 N.E.2d 576, 582, 300 N.Y.S.2d 817, 825 (1969).

[17] *See* Auten v. Auten, 308 N.Y. 155, 160, 124 N.E.2d 99, 101-02 (1954); American Home Assur. Co. v. Employers Mut., 77 App. Div. 2d 421, 424-25, 434 N.Y.S.2d 7, 9 (1st Dep't 1980), *aff'd*, 54 N.Y.2d 874, 429 N.E.2d 424, 444 N.Y.S.2d 917 (1981).

[18] A.S. Rampell, Inc. v. Hyster Co., 3 N.Y.2d 369, 381, 144 N.E.2d 371, 379, 165 N.Y.S.2d 475, 486 (1957); *see* Associated Metals & Minerals Corp. v. Sharon Steel Corp., 590 F. Supp. 18, 20 (S.D.N.Y), *aff'd*, 742 F.2d 1431 (2d Cir. 1983).

[19] Zanfardino v. E-Systems, Inc., 652 F. Supp. 637, 639 (S.D.N.Y. 1987).

[20] Haag v. Barnes, 9 N.Y.2d 554, 560-61, 175 N.E.2d 441, 443, 216 N.Y.S.2d 65, 69 (1961); *see* Keystone Leasing Corp. v. Peoples Protective Life Ins. Co., 514 F. Supp. 841, 847-48 (E.D.N.Y. 1981).

[21] RESTATEMENT OF CONFLICT OF LAWS §§ 332, 358 (1934). The First Restatement evinced the "vested rights rule;" the law of the place of making governed the validity and the effect of a contract ("*lex loci contractus*"), *id.* § 332, while issues concerning the breach or performance of a contract were governed by the law of the place of performance ("*lex loci solutionis*"). *Id.* § 358. The First Restatement left no room for parties to choose the law governing their contract. *See* Gruson, *supra* note 2, at 339 n.48.

[22] 308 N.Y. 155, 124 N.E.2d 99 (1954).

[23] *Id.* at 160, 124 N.E.2d at 102.

most significant contacts with the matter in dispute."[24]

A second theory applied by New York courts is the "paramount interest analysis."[25] In *Intercontinental Planning, Ltd. v. Daystrom, Inc.*,[26] the New York Court of Appeals applied the substantive law of the jurisdiction which had the greatest interest in the disputed issue. The jurisdiction's "interest" was determined by analyzing the purpose of the particular law in conflict.[27]

Under both theories, courts generally employ a three-step analysis.[28] The first step is to identify the issue involved. The paramount interest analysis starts with the consideration of the different governmental interests involved, which may vary among issues.[29] Although courts utilizing the grouping of contacts test apparently turn first to the relevant contacts, they must necessarily look to the issue involved in order to decipher the importance of each contact.[30]

The second step is the identification of the purposes of the conflicting state laws to determine whether a genuine conflict exists.[31] Under the paramount interest analysis, this step is expressly articulated.[32] On the other hand, although courts employing the

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[24] *Id.* (quoting Rubin v. Irving Trust Co., 305 N.Y. 288, 305, 133 N.E.2d 424, 431 (1953)); *see* American Home Assur. Co. v. Employers Mut., 77 App. Div. 2d 421, 425, 434 N.Y.S.2d 7, 9 (1st Dep't 1980), *aff'd*, 54 N.Y.2d 874, 429 N.E.2d 424, 444 N.Y.S.2d 917 (1981). Prior to *Auten*, it was clear that New York courts never followed the first *Restatement* rule in its pure form. *Id.*; *see* Hal Roach Studios v. Film Classics, Inc., 156 F.2d 596, 598 (2d Cir. 1946); Compania de Inversiones Internacionales v. Industrial Mortgage Bank, 269 N.Y. 22, 26, 198 N.E. 617, 618, *remittitur amended*, 269 N.Y. 602, 199 N.E. 69 (1935), *cert. denied*, 297 U.S. 705 (1936); Kleve v. Basler Lebens, 182 Misc. 776, 780, 45 N.Y.S.2d 882, 885 (Sup. Ct. N.Y. County 1943); Chincilla v. Foreign Tankship Corp., 195 Misc. 895, 901, 91 N.Y.S.2d 213, 218 (N.Y.C. City Ct. N.Y. County 1949), *modified on other grounds*, 197 Misc. 1058, 97 N.Y.S.2d 835 (Sup. Ct. N.Y. County 1950), *aff'd*, 278 App. Div. 556, 102 N.Y.S.2d 438 (1st Dep't 1951).

[25] *See* Gruson, *supra* note 4, at 210.

[26] 24 N.Y.2d 372, 248 N.E.2d 576, 300 N.Y.S.2d 817 (1969).

[27] *Id.* at 382, 248 N.E.2d at 582, 300 N.Y.S.2d at 825-26.

[28] Krauss v. Manhattan Life Ins. Co., 643 F.2d 98, 100 (2d Cir. 1981); Dym v. Gordon, 16 N.Y.2d 120, 124, 209 N.E.2d 792, 794, 262 N.Y.S.2d 463, 466 (1965); *see Auten*, 308 N.Y. at 161, 124 N.E.2d at 102.

[29] *Daystrom*, 24 N.Y.2d at 384, 248 N.E.2d at 582, 300 N.Y.S.2d at 827; *see* Fort Howard Paper Co. v. William D. Witter, Inc., 787 F.2d 784, 789-90 (2d Cir. 1986); All State Vehicles v. Allstate Ins. Co., 620 F. Supp. 444, 446 n.4 (S.D.N.Y. 1985).

[30] *See* Reese, *Choice of Law: Rules of Approach*, 57 CORNELL L. REV. 315, 316 (1972); Note, *supra* note 3, at 1679.

[31] *Dym*, 16 N.Y.2d at 124, 209 N.E.2d at 794, 262 N.Y.S.2d at 466; *see* Jefferson Ins. Co. v. Fortress Re, Inc., 616 F. Supp. 874, 877 (S.D.N.Y. 1984).

[32] *See Daystrom*, 24 N.Y.2d at 382, 248 N.E.2d at 582, 300 N.Y.S.2d at 825-26; Hart v. General Motors Corp., 129 App. Div. 2d 179, 185, 517 N.Y.S.2d 490, 493-94 (1st Dep't),

grouping of contacts test normally do not analyze the policies involved,[33] consideration of these policies is implicit in their analysis; contacts are not merely grouped together, but are evaluated within the context of a particular issue.[34]

The third step is the examination of the contacts of the competing jurisdictions in order to ascertain which has the closer connection with the case and thus has the superior interest in seeing its law applied.[35] This step is emphasized in the grouping of contacts approach,[36] but is also implicit in the paramount interest analysis.[37]

In sum, although the analyses undertaken for the grouping of contacts and paramount interest tests are not identical, the differences are largely in emphasis.[38]

B. Choice-of-Law Clauses

A New York court faced with deciding whether a choice-of-law clause is enforceable has three options: (1) give determinative effect to the clause; (2) ignore the clause; or (3) treat the clause as a pertinent but not determinative factor.[39] In reaching this decision, the courts employ one of three different approaches: (1) the reasonable relationship test; (2) the grouping of contacts test; or (3) the paramount interest analysis test.

1. Reasonable Relationship

The most common approach utilized by New York courts is

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appeal denied, 70 N.Y.2d 608, 515 N.E.2d 910, 521 N.Y.S.2d 235 (1987).

[33] *See, e.g.*, American Special Risk Ins. Co. v. Delta Am. Reins. Co., 634 F. Supp. 112, 118-19 (S.D.N.Y. 1986).

[34] Note, *supra* note 3, at 1679; *see Jefferson Ins.*, 616 F. Supp. at 877; *Auten*, 308 N.Y. at 161-62, 124 N.E.2d at 102.

[35] *See Daystrom*, 24 N.Y.2d at 382, 248 N.E.2d at 583, 300 N.Y.S.2d at 825-26; *Dym*, 16 N.Y.2d at 124, 209 N.E.2d at 794, 262 N.Y.S.2d at 466; *Auten*, 308 N.Y. at 161-62, 124 N.E.2d at 102.

[36] *Auten*, 308 N.Y. at 161-62, 124 N.E.2d at 102; *see American Special*, 634 F. Supp. at 118-19.

[37] Note, *supra* note 3, at 1680; *see Daystrom*, 24 N.Y.2d at 382, 248 N.E.2d at 583, 300 N.Y.S.2d at 825-26.

[38] *See* Note, *supra* note 3, at 1680. It has been suggested, however, that the "paramount interest" analysis developed through the merger of the "grouping of contracts" and the "weighing of interests" analysis which preceded it. *See id.* This position was espoused by the New York Court of Appeals in Babcock v. Jackson, 12 N.Y.2d 473, 481, 191 N.E.2d 279, 283, 240 N.Y.S.2d 743, 749 (1963).

[39] *See* Note, *supra* note 3, at 1661.

the reasonable relationship test. This approach was first adopted by the New York Court of Appeals in *A.S. Rampell, Inc. v. Hyster Co.*,[40] in which the court held that a choice of law clause would be enforced so long as the transaction was "reasonably related" to the jurisdiction whose law was selected by the parties.[41]

Demonstrating the resiliency of choice of law clauses in complex circumstances, two New York cases applied the reasonable relationship test in group insurance contract disputes.[42] In *Reger v. National Association of Bedding Manufacturers*,[43] the court was faced with the issue of whether New York or Illinois law should apply in determining the manner of termination of a group life insurance policy which contained a choice-of-law clause stipulating that Illinois law would govern.[44] When the employer ceased doing business, the insurance terminated, since the insured decedent was not notified of his statutory right to convert the group policy into individual coverage. Under Illinois law, however, the defendant was not required to provide the insured with affirmative notice of conversion rights. The insured's widow and the beneficiary under the group policy thereafter sued the group policy sponsor under a theory of negligence.[45] Both the insured and his widow were domiciled in New York, the former employer of the insured was located in New York, and the certificate of insurance was delivered in New York.[46] Although the court recognized that "the paramount interests in this litigation weigh heavily in favor of the beneficiary and support application of New York law,"[47] the court upheld the choice of Illinois law, stating that:

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[40] 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957).

[41] *Id.* at 381, 144 N.E.2d at 379, 165 N.Y.S.2d at 485-86; *see also* Woodling v. Garrett Corp., 813 F.2d 543, 551 (2d Cir. 1987) (choice of Connecticut law upheld); Zerman v. Ball, 735 F.2d 15, 19-20 (2d Cir. 1984) (choice of New York law upheld); Associated Metals & Minerals Corp. v. Sharon Steel Corp., 590 F. Supp. 18, 20 (S.D.N.Y.), *aff'd*, 742 F.2d 1431 (2d Cir. 1983) (choice of Pennsylvania law upheld); Walter E. Heller & Co. v. Chopp-Wincraft Printing Specialties, 587 F. Supp. 557, 560 (S.D.N.Y. 1982) (choice of Illinois law upheld).

[42] *See, e.g.*, Reger v. National Ass'n of Bedding Mfrs., 83 Misc. 2d 527, 539, 372 N.Y.S.2d 97, 114 (Sup. Ct. Westchester County 1975); Kahn v. Great-West Assurance Co., 61 Misc. 2d 918, 923, 307 N.Y.S.2d 238, 244 (Sup. Ct. Richmond County 1970).

[43] 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. Westchester County 1975).

[44] *Id.* at 538, 372 N.Y.S.2d at 112-13; *see* Gruson, *supra* note 2, at 330.

[45] *Reger*, 83 Misc. 2d at 528, 372 N.Y.S.2d at 104; *see* Gruson, *supra* note 2, at 330-31.

[46] *Reger*, 83 Misc. 2d at 542 n.10, 372 N.Y.S.2d at 116 n.10; *see* Gruson, *supra* note 2, at 331.

[47] *Reger*, 83 Misc. 2d at 542, 372 N.Y.S.2d at 116 (footnote omitted); *see* Gruson, *supra* note 2, at 331.

> 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 . . . .
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> . . . .
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> Even our [paramount interest analysis] 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.[48]

In *Kahn v. Great-West Life Assurance Co.*,[49] a similar action was brought by the beneficiary of a group life insurance policy against a Canadian insurer, contesting coverage on grounds that the insured, a New York domiciliary, had made fraudulent misrepresentations in the application.[50] The group policy and the certificate provided that Illinois law would govern.[51] Under Illinois law, the insurer had a complete defense based on the misrepresentation.[52] Under New York law, however, the insurer could not assert such a defense.[53] The New York court held that the choice of Illinois law was enforceable.[54]

The thread of principle in *Reger* and *Kahn* underscores the need for enforcing choice-of-law provisions in group insurance cases, as it is not "practical to have such [policies] governed by different laws depending on the persons insured."[55]

In sum, it appears that New York courts applying the reasonable relationship test tend to enforce choice-of-law clauses. These

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[48] *Reger*, 83 Misc. 2d at 539, 543, 372 N.Y.S.2d at 114, 117 (citation omitted); *see* Gruson, *supra* note 2, at 331.

[49] 61 Misc. 2d 918, 307 N.Y.S.2d 238 (Sup. Ct. Richmond County 1970).

[50] *Id.* at 919, 307 N.Y.S.2d at 240.

[51] *Id.* at 920, 307 N.Y.S.2d at 241.

[52] *Id.* at 919-20, 307 N.Y.S.2d at 240.

[53] *Id.* at 919, 307 N.Y.S.2d at 240.

[54] *Id.* at 918, 307 N.Y.S.2d at 240.

[55] Gruson, *supra* note 2, at 332 n.32; *cf.* Zanfardino v. E-System, 652 F. Supp. 637, 639 (S.D.N.Y. 1987) (employment contract scenario). *But see* Antinora v. Nationwide Life Ins. Co., 76 Misc. 2d 599, 350 N.Y.S.2d 863 (Monroe County Ct. 1973) (Choice of Ohio law in governing law clause not upheld in group insurance dispute involving conversion rights). However, *Antinora* is distinguishable because the insurer, who was also the employer, withheld a premium from the insured's paycheck after the termination of employment, but within the 31-day grace period, and the claim arose during that period. *See id.* at 600, 350 N.Y.S.2d at 865.

courts are inclined to respect the parties' autonomy,[56] exercise a minimum level of scrutiny, and refuse to conduct extended "grouping of contacts" or "paramount interest" analyses.[57]

2. Grouping of Contacts

Courts following the grouping of contacts approach in interpreting choice-of-law clauses apply a heightened level of scrutiny in conducting their choice-of-law analysis. These cases treat the clause as a relevant but not determinative factor.

In *Haag v. Barnes*,[58] the New York Court of Appeals applied the grouping of contacts approach to an agreement which contained a choice-of-law clause. Although decided four years after *A.S. Rampell, Inc.*, the court of appeals in *Haag* did not distinguish its precedent as it determined the enforceability of a stipulation that Illinois law would govern the terms of a child support agreement between a putative father in Chicago and a mother who resided in New York.[59] The provision in the agreement which provided for the waiver of all causes of action of the mother against the father in exchange for certain support payments was valid

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[56] *See, e.g.*, Warnaco, Inc. v. Farkas, 664 F. Supp. 738, 741 (S.D.N.Y. 1987) (guarantors' liability determined under Connecticut law); Avant Petroleum, Inc. v. Banque Paribus, 652 F. Supp. 542, 545-46 (S.D.N.Y. 1987) (law of England used to determine secured creditor's rights to impleaded fund); Alco Standard Corp. v. Schmidt Bros., 647 F. Supp. 4, 7 (S.D.N.Y. 1986) (New York law used to determine right to terminate contract without exercising good faith); Sprung v. Coutin, 637 F. Supp. 191, 192-93 (S.D.N.Y. 1986) (New York law governs former husband's duty to pay alimony to ex-wife cohabiting with man in California); Mon-Shore Management v. Family Media, Inc., 584 F. Supp. 186, 193 (S.D.N.Y. 1984) (New York law determined rights of franchises against publisher and franchisor).

[57] *See, e.g.*, Woodling v. Garrett Corp., 813 F.2d 543, 551 (2d Cir. 1987) (Connecticut law used to determine validity and enforceability of release in wrongful death action); Gray v. American Express Co., 743 F.2d 10, 16-17 (D.C. Cir. 1984) (right to notice of cancellation of credit card decided under New York law); Zerman v. Ball, 735 F.2d 15, 19-20 (2d Cir. 1984) (securities purchaser waived right to use any law except New York law to determine legal rate of interest on margin account); First Commodity Traders v. Heinold Commodities, 591 F. Supp. 812, 815 (N.D. Ill. 1984), *aff'd*, 766 F.2d 1007 (7th Cir. 1985) (Illinois law governed right to terminate contract without clear termination date); Walter E. Heller & Co. v. Chopp-Wincraft Printing Specialties, 587 F. Supp. 557, 560 (S.D.N.Y. 1982) (Illinois law validated contract that would be void in New York due to usury); General Pub. Util. Corp. v. Babcock & Wilcox Co., 547 F. Supp. 842, 843 n.1 (S.D.N.Y. 1982) (Pennsylvania law applies to question of strict liability limitations on contract to purchase nuclear power plant); R-T Leasing Corp. v. Ethyl Corp., 494 F. Supp. 1128, 1131 (S.D.N.Y. 1980) (Virginia law determined meaning of "usual wear and tear" in contract dispute alleging misuse of leased railroad cars).

[58] 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961).

[59] *Id.* at 557-58, 175 N.E.2d at 442, 216 N.Y.S.2d at 66-67.

under Illinois law.[60] New York law, however, mandated judicial review of the agreement for fairness.[61] The mother brought suit in New York seeking increased support payments.[62] In upholding the father's motion to dismiss and applying Illinois law, the Court of Appeals concluded that:

> The traditional view was that the law governing a contract is to be determined by the intention of the parties. 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.
>
> The agreement, in so many words, recites that it "shall in all respects be interpreted, construed and governed by the laws of the State of Illinois" and, since it was also drawn and signed by the complainant in Illinois, the traditional conflicts rule would, without doubt, treat these factors as conclusive and result in applying Illinois law. 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.' " And, when these important factors are taken together with other of the "significant contacts" in the case, they likewise point to Illinois law.[63]

Therefore, a court will apply the substantive law of the jurisdiction which has the most significant contacts with the transaction if it adheres to the grouping of contracts test in a case involving a choice-of-law clause. Furthermore, under this approach, the intent of the parties is a factor considered, although not dispositive of the issue per se.[64]

Although the *Haag* court upheld the parties' choice of law, New York courts have since utilized its reasoning to defeat gov-

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[60] *Id.* at 558, 175 N.E.2d at 443, 216 N.Y.S.2d at 68; *see* Gruson, *supra* note 2, at 328.

[61] *Haag*, 9 N.Y.2d at 558-59, 175 N.E.2d at 443, 216 N.Y.S.2d at 68; *see* Gruson, *supra* note 2, at 328.

[62] *Haag*, 9 N.Y.2d at 558, 175 N.E.2d at 443, 216 N.Y.S.2d at 68.

[63] *Id.* at 559-60, 175 N.E.2d at 443-44, 216 N.Y.S.2d at 68-69 (citations omitted) (quoting Auten v. Auten, 308 N.Y. 155, 160, 124 N.E.2d 99, 102 (1954)); *see* Gruson, *supra* note 2, at 328.

[64] Gruson, *supra* note 2, at 329; *see also* Burger King Corp. v. Rudzewicz, 471 U.S. 462, 481-82 (1985) (choice of law could be considered in determining personal jurisdiction).

erning law clauses.[65] For example, in *Keystone Leasing Corp. v. Peoples Protective Life Insurance Co.*,[66] a federal diversity action was brought to enforce a guaranty contract. The contract provided that New York law would govern.[67] However, the defendant insurer alleged that the guaranty was unenforceable since Tennessee law governed the contract.[68] Under the applicable Tennessee insurance and corporation statutes,[69] the agreement was unenforceable.[70] The Eastern District of New York reached the conclusion that Tennessee substantive law governed the issue of whether the guaranty should be enforced[71] by applying New York's conflict of law rules.[72]

Another leading case in which a New York court refused to

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[65] For examples of other New York cases that have upheld the validity of choice-of-law clauses based on the grouping of contacts approach evinced in *Haag v. Barnes*, see Hawes Office Sys. v. Wang Laboratories, 537 F. Supp. 939, 941-42 (E.D.N.Y. 1982) (choice of Massachusetts law upheld); La Beach v. Beatrice Foods Co., 461 F. Supp. 152, 155-56 (S.D.N.Y. 1978) (choice of Illinois law upheld). *See also* Walter E. Heller & Co. v. Video Innovations, Inc., 730 F.2d 50, 52-53 (2d Cir. 1984) (although parties' contract provided for Illinois law, court sustained stipulation that New York should govern since there was no material difference in regard to issue in question).

[66] 514 F. Supp. 841 (E.D.N.Y. 1981).

[67] *Id.* at 847.

[68] *Id.* The plaintiff was a New York-based corporation and the defendant insurer was incorporated in Tennessee. *Id.* at 843.

[69] Section 48-1-403 of the Tennessee Code provided: "A corporation shall have power to guarantee obligations of any other entity and to secure such guarantees by mortgage, pledge or otherwise by vote of a majority of the entire board, unless such power is reserved to the shareholders or members in the charter." TENN. CODE ANN. § 48-1-403 (1984) (repealed 1988 and replaced by § 48-13-102(6), effective January 1, 1988).

Tennessee Code section 56-3-103 provided that:

> No director or other officer of any domestic insurance company organized under the laws of Tennessee . . . shall accept, or be the beneficiary of, either directly or remotely, any fee, brokerage, commission, gift, or other consideration for or on account of any loan, deposit, purchase, sale, payment, or exchange made by or in behalf of such company, or be pecuniarily interested in any such purchase, sale, or loan, either as borrower, principal, co-principal, agent, or beneficiary . . . .

TENN. CODE ANN. § 56-3-103 (1984).

[70] *See Keystone*, 514 F. Supp. at 848. Under section 48-1-403, the requisite board action was not accomplished. *Id.*

[71] *Id.* One commentator has argued that the *Keystone* court "should have applied New York [substantive] law in accordance with the governing-law clause in the guaranty." Gruson, *supra* note 4, at 213 n.27.

[72] The *Keystone* court was a federal district court sitting by reason of diversity jurisdiction. Since 1941, federal courts presented with a conflict of laws issue in diversity cases have applied the conflicts rule of the state in which they sit. *See* Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496 (1941). Because the *Keystone* court was sitting in New York, the court applied New York's conflict of laws rule (i.e., the grouping of contacts test evinced in *Haag v. Barnes*).

enforce a choice-of-law clause by applying a grouping of contacts approach was *Harmonay, Inc. v. Binks Manufacturing Co.*[73] In *Harmonay*, a subcontractor brought suit against a contractor to recover damages for delay. The parties' subcontract provided for Illinois law, the state of defendant's principal place of business, to apply.[74] Although the contract was executed in Michigan, the place of performance was New York.[75] All negotiations for extra work took place in New York and the prime contract was governed by New York law.[76] Moreover, the plaintiff was incorporated under New York law and maintained its principal place of business in New York.[77] Citing *Haag v. Barnes*,[78] the court declined to uphold the choice of Illinois law and held that New York law governed.[79] In so doing, the court concluded that although the choice-of-law clause was a relevant factor, it was not determinative.[80]

As progeny of *Haag v. Barnes*, the *Keystone* and *Harmonay* cases indicate that a growing number of New York courts have declined to follow the lower-scrutiny approach of the reasonable relationship test evinced by the court of appeals in *A.S. Rampell, Inc. v. Hyster Co.*[81] In so doing, these courts have applied a grouping of contacts analysis similar to that applied in cases without a choice-of-law clause.[82]

3. Paramount Interest Analysis

The New York Court of Appeals has never applied the paramount interest analysis approach to a contract dispute involving a

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[73] 597 F. Supp. 1014, 1024-25 (S.D.N.Y. 1984), *aff'd*, 762 F.2d 990 (2d Cir. 1985).

[74] *Id.* at 1025.

[75] *Id.*

[76] *Id.*

[77] *Id.*

[78] 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961).

[79] *Harmonay*, 597 F. Supp. at 1025.

[80] *Id.*

[81] 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957).

[82] *See, e.g.*, Carlos v. Philips Business Sys., 556 F. Supp. 769, 774 n.4 (E.D.N.Y.), *aff'd*, 742 F.2d 1432 (2d Cir. 1983) (declining to enforce parties' choice of New York law, court applied laws of New Jersey, Connecticut, and Ohio, which were states in which parties who stood "to lose the most" did business); Guaranty Mortgage Co. v. Z.I.D. Assocs., 506 F. Supp. 101, 107-08 (S.D.N.Y. 1980) (declining to enforce choice of Tennessee law, court applied New York law because "substantial proportion" of relevant contacts were in New York, and because enforcement of contract would be contrary to New York public policy); H.B. Fuller Co. v. Hagen, 363 F. Supp. 1325, 1331 (W.D.N.Y. 1973) ("[c]onsidering all of the contacts . . . the law of New York is controlling" and not parties' choice of Minnesota law).

choice-of-law clause. Recently, however, two New York-based federal district courts during diversity actions have employed the paramount interest analysis to set aside the parties' choice of law.[83]

In *Triad Financial Establishment v. Tumpane Co.*,[84] a marketing consultant organization brought an action against a subcontractor based on a military contract seeking commissions allegedly owed when the organization obtained subcontracts for the defendant. The plaintiff was a Liechtenstein entity and the defendant, although incorporated in New York, maintained its principal office in Vancouver, Washington.[85] Although the parties' marketing agreement expressly provided that New York law should govern, the defendant contended Saudi Arabian law applied.[86] In its conflict of laws analysis, the court considered several factors: (1) defendant maintained only two employees in New York but employed 3,750 in Saudi Arabia; (2) the parties' relevant agreements were neither executed nor performed in New York; (3) the plaintiff, though organized in Liechtenstein, characterized itself as a "Saudi sales agent;" and (4) the subcontracts were negotiated and performed in Saudi Arabia.[87] Based on these factors, the court concluded that it was not bound by the parties' choice of law since that choice "would override the policies of a state with a materially greater interest in the controversy."[88] Applying the paramount interest analysis, the court found that Saudi Arabia had a "compelling interest" in having its law applied,[89] since in 1975 it had adopted by decree an anticorruption measure prohibiting the payment of agent's fees on contracts for arms and related services.[90]

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[83] *See* Triad Fin. Establishment v. Tumpare Co., 611 F. Supp. 157, 162-64 (N.D.N.Y. 1985); Southern Int'l Sales Co. v. Potter & Brumfield, 410 F. Supp. 1339, 1341-43 (S.D.N.Y. 1976).

[84] 611 F. Supp. 157 (N.D.N.Y. 1985).

[85] *Id.* at 159.

[86] *Id.* at 163.

[87] *Id.*

[88] *Id.* at 162.

[89] *Id.* at 163.

[90] *Id.* In relevant part, the decree provided that:

> 1. No firm holding a contract with the Saudi Government for the supply of arms or equipment required by the Saudi Government may pay any sum as a commission to any intermediary, sales agent, representative, or broker. This prohibition shall apply regardless of the nationality of the firm or the nationality of the intermediary, sales agent, representative, or broker. It shall apply also whether the contract was concluded directly between the Saudi Government and the firm or through a third-party state. No recognition is accorded to any commission agreement previously concluded by any such firm with any party, and such agreement

The court recognized that had it enforced the parties' choice of New York law, the "strong policy" behind that decree would have been rendered "meaningless."[91] Furthermore, since New York had no substantial stake in the litigation, with little or no interest in upholding the plaintiff's claim, the court concluded that Saudi Arabian law should govern.[92]

A similar rationale was employed by the Southern District of New York in *Southern International Sales Co. v. Potter & Brumfield*.[93] In that case, a Puerto Rico dealer sued an Indiana manufacturer for wrongful termination of an exclusive sales representation contract. The parties' contract provided that Indiana law should govern.[94] However, Puerto Rico had enacted the Dealers Contract Act, which prohibited unilateral terminations absent just cause.[95] Although the court found that the dispute was "reasonably related" to Indiana, the court held that Puerto Rico had a paramount interest in having its law applied in determining the validity of the manufacturer's termination of the representation agreement.[96] In comparison, Indiana's interest in having its law govern the dispute was deemed to be minor.[97]

Thus the *Triad* and *Southern* cases demonstrate that New York courts are willing to apply foreign law despite the parties' choice of law if the foreign jurisdiction is deemed to have a paramount interest in the dispute.[98] In such cases, the parties' intent

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shall have no validity *vis-a-vis* the Saudi Government.

2. If among the foreign firms mentioned in paragraph 1 above there are any that are obligated by commission agreements that they have made, they are to stop payment of the commissions due after having been warned by this decision . . . .

Id.

[91] *Id.*

[92] *Id.* at 163-64. Under the conflict-of-laws concept of "depacage," however, the court only applied Saudi Arabian law for fees claimed after September 17, 1975, the date on which the Saudi decree was adopted. *Id.* at 164. New York law governed fee claims which arose prior to that date. *Id.* "Depacage" has been defined as "applying the rules of different states to determine different issues." Reese, *Depacage: A Common Phenomenon in Choice of Law*, 73 COLUM. L. REV. 58, 58 (1973). After the relevant factors are weighed, "[t]he court determines which law should apply with respect to each particular *issue*." *Triad Financial Establishment*, 611 F. Supp. at 164 n.6.

[93] 410 F. Supp. 1339 (S.D.N.Y. 1976).

[94] *Id.* at 1341.

[95] *Id.* at 1340-41.

[96] *Id.* at 1341-43.

[97] *Id.* at 1342.

[98] *Accord* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971); Prebble, *Choice of Law to Determine the Validity and Effect of Contracts: A Comparison of English and American Approaches to the Conflict of Laws*, 58 CORNELL L. REV. 433, 512-14 (1973)

will not determine the scope of the legislative jurisdiction of states which have not delegated that power to them.[99] However, judicial willingness to intervene has produced confusion and unpredictability. As a result, it is clear that courts have often denied parties the "use of the only practical device for bringing certainty and predictability into multistate contracts"—a choice-of-law provision.[100]

III. CONTRACTUAL LIMITATIONS ON CHOICE OF LAW

The parties' autonomy to stipulate a choice of governing law in their contract has far-reaching qualifications in New York. As discussed above, some courts require that the chosen law have a reasonable relationship to the contract.[101] On the other hand, courts employing the grouping of contacts test require the chosen law to have substantial contacts with the disputed issue.[102] Moreover, courts that apply the paramount interest analysis go further in requiring that the chosen law be tied to the state whose governmental interest has the highest stake in determining the issue.[103] This section discusses three additional restraints that may exist in deciding whether or not to enforce the parties' freedom to agree on the law governing their contract.

A. *Adhesion Contracts*

Although the New York Court of Appeals has not spoken on the issue, it is probable that a New York court will not enforce a choice-of-law provision in a contract which is not the product of an

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(discussing public policy of jurisdictions other than forum's); Sedler, *The Contracts Provision of the Restatement (Second): An Analysis and a Critique*, 72 COLUM. L. REV. 279, 294-98 (1972) (discussing conflicting governmental policy).

[99] *See* Note, *supra* note 3, at 1667-68. It has been observed that:

> One might expect that such a question, involving, as it does, the scope of the states' legislative power vis-a-vis one another, would be decided by the Supreme Court. But, although the Court flirted with the possibility of constitutionalizing interstate choice of law over a generation ago, *Allstate Insurance Co. v. Hague* confirmed and extended the subsequent trend in Supreme Court decisions widening the area of freedom that states enjoy in deciding choice-of-law issues.

Id. at 1662-63 (footnotes omitted); *see also id.* at 1163 n.20 (discussing due process and full faith and credit clauses with respect to conflicts).

[100] Reese, *Power of Parties to Choose Law Governing their Contract*, 1960 PROC. AM. SOC. INT'L L. 49, 51; *see* Note, *supra* note 3, at 1661.

[101] *See supra* notes 40-57 and accompanying text.

[102] *See supra* notes 58-82 and accompanying text.

[103] *See supra* notes 83-100 and accompanying text.

arm's length negotiation.[104] Should the court find any indicia of "fraud, undue influence, or overweening bargaining power" against the party who challenges the validity of the clause, it may label the agreement as an adhesion contract and refuse to uphold the provision.[105]

The time-honored precedent which evinced this principle is the seminal decision of *Fricke v. Isbrandtsen Co.*[106] In *Fricke*, the defendant steamship owner, on a summary judgment motion, moved to dismiss the plaintiff passenger's suit for personal injuries.[107] The contract of passage, which was printed in English, provided that the law of the United States governed, and reduced the statute of limitations to one year from the date of injury.[108] The plaintiff, who failed to bring suit within the prescribed time period, was a German national, entirely nonconversant in the English language.[109] Moreover, the contract of passage was purchased in Germany for a round trip to the United States.[110] As a result, the plaintiff challenged the choice-of-law clause and argued that German law be applied.[111]

In denying defendant's motion to dismiss, the court found that the contract of passage was "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."[112] Rather, the terms and conditions were offered by the defendant on a "take-it-or-leave-it basis."[113] Because the plaintiff purchased the tickets in Germany, the court stated that he "probably felt that German law controlled."[114] The court concluded that because the defendant did not provide the illiterate plaintiff with a translation, or other knowledge of what

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[104] *See* Gruson, *supra* note 2, at 358-60; *see also* Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12-13, 17 (1972) (choice of forum upheld in arm's length transaction).

[105] *Bremen*, 407 U.S. at 12; *cf.* Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) (discussion of adhesion contracts in connection with forum-selection clauses); Gaskin v. Stumm Handel GmbH, 390 F. Supp. 361, 363 (S.D.N.Y. 1975) (forum selection clause enforced when criteria of *Bremen* court satisfied).

[106] 151 F. Supp. 465 (S.D.N.Y. 1957).

[107] *Id.* at 466.

[108] *Id.*

[109] *Id.*

[110] *Id.*

[111] *Id.* at 467. Plaintiff's action would have been barred under the law of the United States. *Id.* at 466.

[112] *Id.* at 467.

[113] *Id.*

[114] *Id.* at 468.

the contract included, the choice-of-law clause was not binding.[115] As a result, the court held that German law governed the statute of limitations question.[116]

B. *Validation Rule*

Although not common, parties may occasionally stipulate a governing law in their contract which renders the agreement invalid, either in whole or in part.[117] Some commentators have argued that a governing law clause should be disregarded if it points to the law of a jurisdiction which would invalidate the contract.[118] However, "[a] rule of validation which would supersede all governing law clauses is not part of New York law,"[119] except in cases involving usury.[120]

In *General Electric Credit Corp. v. Beyerlein*,[121] an equipment lease permitted the lessor to assign its interests under the lease, and provided further that the assignee would not be responsible for the lessor's obligations.[122] Under section 9-206(1) of New York's Uniform Commercial Code ("U.C.C."), this clause was binding upon the lessee, subject only to "any statute or decision which establishes a different rule for buyers or lessees of consumer goods."[123] However, the lease contained a choice-of-law clause stip-

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[115] *Id.*

[116] *Id.*; *accord* Harmonay, Inc. v. Binks Mfg. Co., 597 F. Supp. 1014, 1025 (S.D.N.Y. 1984) (refusing to enforce parties' choice of Illinois law because of contract's substantial contacts with New York, court noted that choice-of-law clause was found in the defendant's "standard printed form"), *aff'd*, 762 F.2d 990 (2d Cir. 1985). Some commentators have argued that choice-of-law clauses in adhesion contracts may be stricken or limited as violative of the forum's public policy. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 comment b, at 562 (1971); Gruson, *supra* note 2, at 360.

[117] *See* Gruson, *supra* note 2, at 361-62.

[118] *See, e.g.*, Weintraub, *Choice of Law in Contract*, 54 IOWA L. REV. 399, 408, 410 (1968) ("stipulation of invalidating law should be disregarded as an obvious error and the proper law chosen by some other means"); *see also* Prebble, *supra* note 98, at 527 ("any stipulation of otherwise inapplicable law that clearly frustrates the intent of the parties should be disregarded") (quoting Maw, *Applicable Law and Conflict Avoidance in International Contracts*, 25 N.Y.C.B.A. RECORD 365, 374-75 (1970)).

[119] Gruson, *supra* note 2, at 361.

[120] *See, e.g.*, Walter E. Heller & Co. v. Chopp-Wincraft Printing Specialties, 587 F. Supp. 557, 560 (S.D.N.Y. 1982) ("the forum state chooses the state whose usury statute would sustain the contract in full or else impose the lightest penalty for usury from the set of all states that have a substantial relationship to the contract").

[121] 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 (4th Dep't 1968).

[122] *Id.* at 725, 286 N.Y.S.2d at 352.

[123] N.Y. U.C.C. § 9-206(1) (McKinney 1964).

ulating Massachusetts law.[124] After the assignee sued the lessee for overdue payments, the lessee interposed a defense that the equipment did not function properly.[125] Denying the assignee's motion for summary judgment, the court held that the lease's exculpatory clause was unenforceable under Massachusetts law.[126]

C. *Public Policy*

1. Choice of Foreign Law

A New York court may limit the enforceability of a choice-of-law clause which stipulates that a particular foreign law govern the contract if it finds that the law is violative of the public policy of New York.[127] However, the public policy violated must be deemed particularly important before the choice-of-law clause will be invalidated.[128] Such a clause will not be ignored merely on grounds that the chosen law is "obnoxious and offensive."[129] The test for invalidating the foreign law is whether its application would result in "approval of a transaction which is inherently vicious, wicked or

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[124] *Beyerlein*, 55 Misc. 2d at 725, 286 N.Y.S.2d at 352.

[125] *Id.*

[126] *Id.* at 727, 286 N.Y.S.2d at 353-54; *accord* A.S. Rampell, Inc. v. Hyster Co., 3 N.Y.2d 369, 381, 144 N.E.2d 371, 379, 165 N.Y.S.2d 475, 486 (1957); *see* Painton & Co. v. Bourns, Inc., 309 F. Supp. 271, 277 (S.D.N.Y. 1970), *rev'd on other grounds*, 442 F.2d 216 (2d Cir. 1971).

[127] Gruson, *supra* note 4, at 220-21; *see, e.g.*, Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp., 466 F. Supp. 846, 851 (E.D.N.Y.) (New York law applied, absent contrary public policy), *aff'd*, 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) (enforcement of insurance provision requiring dispute be resolved under Russian law not violative of public policy); Reger v. National Ass'n of Bedding Mfrs., 83 Misc. 2d 527, 541, 372 N.Y.S.2d 97, 115-16 (Sup. Ct. Westchester County 1975) ("[t]he rule to be applied is simple: in group insurance policies a choice of law provision should be given effect unless it contravenes [New York] public policy"); *cf.* Business Incentives Co. v. Sony Corp., 397 F. Supp. 63, 67 (S.D.N.Y. 1975) (court considered not only New York public policy, but policy of any "state which has a materially greater interest than the chosen state in the determination").

[128] Gruson, *supra* note 4, at 221; *see, e.g.*, B.M. Heede, Inc. v. West India Mach. & Supply Co., 272 F. Supp. 236, 241 (S.D.N.Y. 1967) (choice-of-law clause enforced provided "fundamental public policy of the forum [state] is not vitiated"); Sears, Roebuck & Co. v. Enco Assocs., 83 Misc. 2d 552, 562, 370 N.Y.S.2d 338, 348 (Sup. Ct. Westchester County 1975) (Michigan law not offensive to "strong public policy"), *aff'd*, 54 App. Div. 2d 13, 385 N.Y.S.2d 613 (2d Dep't 1976), *modified*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977).

[129] Gruson, *supra* note 4, at 221 (quoting Kleve v. Basler Lebens-Versicherungs-Gesellschaft, 182 Misc. 776, 782, 45 N.Y.S.2d 882, 887 (Sup. Ct. N.Y. County 1943)); *see* French v. Banco Nacional de Cuba, 23 N.Y.2d 46, 56, 242 N.E.2d 704, 711, 295 N.Y.S.2d 433, 443 (1968).

immoral, and shocking to the prevailing moral sense."[130]

Only a few New York courts have denied enforcement of a choice of foreign law clause because the foreign law violated New York public policy. For example, in *F.A. Straus & Co. v. Canadian Pacific Railway Co.*,[131] a provision in a bill of lading exempted the carrier from any liability for negligence and further provided that the contract should be governed by English law.[132] Under English law, the clause was valid,[133] but the New York Court of Appeals held the exculpatory clause void because it contravened New York public policy.[134]

In *Antinora v. Nationwide Life Insurance Co.*,[135] the court held that a New York statute requiring that affirmative notice of conversion rights be given to the holder of a group insurance policy upon termination of employment reflected the public policy of New York. Because the policy holder was domiciled in New York, the court concluded that New York's public policy prevailed over the insurance contract's choice-of-law clause stipulating that Ohio law govern.[136]

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[130] Intercontinental Hotels Corp. v. Golden, 15 N.Y.2d 9, 13, 203 N.E.2d 210, 212, 254 N.Y.S.2d 527, 529 (1964) (New York public policy did not preclude judicial enforcement in New York of gambling debts validly incurred in Puerto Rico); *see also* Mitchell v. New York Hosp., 61 N.Y.2d 208, 214, 461 N.E.2d 285, 288, 473 N.Y.S.2d 148, 151 (1984) (stipulation waiving New York statute concerning protection of non-settling tortfeasor not violative of public policy); Tuthill Fin. v. Cartaya, 133 App. Div. 2d 343, 344, 519 N.Y.S.2d 243, 244 (2d Dep't 1987) (mem.) (because note was governed by and valid under Connecticut law, it was not usurious under New York law); Towne Funding Co. v. Macchia, 120 App. Div. 2d 519, 519, 501 N.Y.S.2d 717, 717 (2d Dep't 1986) (mem.) (Connecticut law governed mortgage-secured loan allegedly usurious under New York law); Pioneer Credit Corp. v. Catalano, 51 Misc. 2d 407, 411, 273 N.Y.S.2d 310, 315 (Columbia County Ct. 1966) (public policy did not preclude enforcement of a note which was usurious under New York law, but was validly issued in Massachusetts), *aff'd*, 28 App. Div. 2d 595, 282 N.Y.S.2d 214 (3d Dep't 1967).

[131] 254 N.Y. 407, 173 N.E. 564 (1930).

[132] *Id.* at 410-11, 414, 173 N.E. at 565, 567.

[133] *Id.* at 414, 173 N.E. at 567.

[134] *Id.* at 416, 173 N.E. at 568; *see also* Kilberg v. Northeast Airlines, 9 N.Y.2d 34, 39-40, 172 N.E.2d 526, 528, 211 N.Y.S.2d 133, 135-36 (1961) (Massachusetts' limitation of wrongful death damages violative of New York Constitution); Mertz v. Mertz, 271 N.Y. 466, 472-74, 3 N.E.2d 597, 598-99 (1936) (Connecticut law violative of New York spousal tort immunity policy); Compania de Inversiones Internacionales v. Industrial Mortgage Bank of Finland, 269 N.Y. 22, 31-32, 198 N.E. 617, 621 (1935) (clause in contract which required payment in gold was invalidated as violative of public policy), *cert. denied*, 297 U.S. 705 (1936).

[135] 76 Misc. 2d 599, 350 N.Y.S.2d 863 (Monroe County Ct. 1973).

[136] *Id.* at 605, 350 N.Y.S.2d at 870; *accord* Oakley v. National W. Life Ins. Co., 294 F. Supp. 504, 508 (S.D.N.Y. 1968). *But see supra* notes 43-55 and accompanying text.

In *Guaranty Mortgage Co. v. Z.I.D. Associates*,[137] a bank brought suit against a corporation and its president for brokerage fees earned on loans it had brokered on the defendants' behalf. The parties' agreement provided that Tennessee law should govern.[138] Plaintiff contended that under Tennessee law, it was not required to obtain a broker's license.[139] Under New York law, however, plaintiff was required to obtain a broker's license, which it never did.[140] After determining that New York was the forum which had the most substantial contacts with the dispute,[141] the court held that enforcement of the choice-of-law clause would violate New York public policy against unlicensed brokers.[142] As a result, the court applied New York law and accordingly dismissed the complaint.[143]

2. Choice of New York Law

The New York Court of Appeals has yet to rule on whether the public policy of another jurisdiction may override an otherwise valid choice of New York law in the parties' contract.[144] However, since the enactment of General Obligations Law section 5-1401[145] in 1984, it appears that the public policy of New York would mandate enforcement of such clauses.[146]

Interestingly, in *Triad Financial Establishment v. Tumpane Co.*,[147] the court did not refer to General Obligations Law section 5-1401. Had it done so, it would have been faced with the conflicting public policies of New York and Saudi Arabia. On the one hand, it was New York public policy, as evinced by Section 5-1401,

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[137] 506 F. Supp. 101 (S.D.N.Y. 1980).

[138] *Id.* at 107.

[139] *Id.* at 102, 108.

[140] *Id.* at 103. New York law requires licensing of real estate brokers under section 440-a of the Real Property Law. N.Y. REAL PROP. LAW § 440-a (McKinney Supp. 1988).

[141] *See Guaranty Mortgage*, 506 F. Supp. at 107.

[142] *See id.* at 107-08.

[143] *See id.* at 108.

[144] *See* Gruson, *supra* note 4, at 222.

[145] N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 1984); *see supra* notes 8 and 10 and accompanying text.

[146] *See, e.g.*, Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 128 Misc. 2d 564, 568-69, 490 N.Y.S.2d 670, 674-76 (Sup. Ct. N.Y. County 1985) (§§ 5-1401 and 5-1402 embody policy enforcing choice-of-law clause "absent a strong showing that it should be set aside"); *see also supra* note 10 (test of § 5-1401).

[147] 611 F. Supp. 157 (N.D.N.Y. 1985); *see supra* notes 84-92 and accompanying text (discussion of facts of *Triad*).

to enforce choice-of-law clauses providing that New York law govern.[148] On the other hand, Saudi Arabia's public policy outlawed the parties' contract.[149]

By reason of the New York statute, resolution of this dispute should have been determined by enforcing the choice-of-law clause. The due process clause of the United States Constitution[150] may be used to prevent a state from unreasonably invoking its own law,[151] and the full faith and credit clause[152] may be used to compel a state to apply another state's law.[153] However, only principles of comity encourage a state to apply the law of a foreign nation.[154] When foreign legislation conflicts with New York public policy, the court of appeals has stated that New York law should prevail.[155] According to the legislative memoranda which accompanied the passage of section 5-1401, New York State has a strong interest in enforcing parties' choice of New York law to govern their contrac-

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[148] N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 1984 & Supp. 1988). The statute exempts contracts "for labor or personal services." *Id.* The parties' contract was a brokerage agreement whereby the plaintiff agreed to obtain military contracts for the defendant with an American contractor doing business in Saudi Arabia. *See Triad*, 611 F. Supp. at 159. It is unclear whether the brokerage agreement came within the purview of this statutory exemption. It appears that the exemption may have been intended to deal only with choice-of-law clauses commonly appearing in employment contracts. *See, e.g.*, Hunter v. H.D. Lee Co, 563 F. Supp. 1006, 1009 (N.D.N.Y. 1983); H.B. Fuller Co. v. Hagen, 363 F. Supp. 1325, 1331 (W.D.N.Y. 1973). If such limited construction applies, then the contract at issue in *Triad* should have been governed by section 5-1401 of the General Obligations Law.

[149] *See Triad*, 611 F. Supp. at 163-64.

[150] U.S. CONST. amend. XIV, § 1.

[151] Home Ins. Co. v. Dick, 281 U.S. 397, 410-11, (1930); Atlas Credit Corp. v. Ezrine, 25 N.Y.2d 219, 230, 250 N.E.2d 474, 481, 303 N.Y.S.2d 382, 391-92 (1969); *see* Kirgis, *The Roles of Due Process and Full Faith and Credit in Choice of Law*, 62 CORNELL L. REV. 94, 96 (1976); Note, *supra* note 3, at 1663.

[152] U.S. CONST. art. IV, § 1.

[153] Bradford Elec. Light Co. v. Clapper, 286 U.S. 145, 159 (1932); *see* Jackson, *Full Faith and Credit—The Lawyer's Clause of the Constitution*, 45 COLUM. L. REV. 1, 24-34 (1945); Note, *supra* note 3, at 1663.

[154] *See* J. Zeevi & Sons v. Grindlays Bank, 37 N.Y.2d 220, 227-28, 333 N.E.2d 168, 173, 371 N.Y.S.2d 892, 899, *cert. denied*, 423 U.S. 866 (1975); Note, *supra* note 3, at 1663 n.20. Enforcement of another nation's law is premised on the doctrine of comity. *Grindlays Bank*, 37 N.Y.2d at 228, 333 N.E.2d at 173, 371 N.Y.S.2d at 899. Comity has been defined as the reciprocal courtesy which one nation owes to another, presupposing good relations and assuming the prevalence of equity and justice. *See* Russian Socialist Federated Soviet Republic v. Cibrario, 235 N.Y. 255, 258, 139 N.E. 259, 260 (1923). In the legal sense, however, comity is neither a matter of absolute obligation nor of mere courtesy and good will, but rather, a matter of policy. *See* Hilton v. Guyot, 159 U.S. 113, 163-64 (1895); Bachman v. Mejias, 1 N.Y.2d 575, 581, 136 N.E.2d 866, 869, 154 N.Y.S.2d 903, 907 (1956).

[155] *Grindlays Bank*, 37 N.Y.2d at 228, 333 N.E.2d at 173, 371 N.Y.S.2d at 899.

tual disputes.[156] As a result, the *Triad* court should have applied New York law.[157]

In sum, the right to choose a law to govern a contract is limited by three restraints: (a) adhesion contracts; (b) the rule of validation; and (c) public policy considerations.

IV. Scope of Governing Law Clauses

The parlance of conflicts law often refers to the terms "whole law" and "substantive law." The term "whole law" refers to the totality of a jurisdiction's law, including its conflict of law rules.[158] "Substantive law" refers merely to a jurisdiction's local law, including, *inter alia*, statutes and case law.[159] Mindful of this distinction, the issue becomes whether parties who adopt a choice-of-law clause intend to be bound by the state's "whole" or "substantive" law.[160] The rule in New York is that the law referred to in a choice-of-law clause only includes the substantive law of the chosen jurisdiction.[161] If New York is the forum, the courts will invariably apply New York's conflict of law rules.[162] This practice usually sustains the parties' intent because application of the chosen jurisdiction's conflict rules may result in a finding that a different

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[156] New York has adopted other statutory measures which encourage parties to incorporate choice-of-law clauses into their contracts. Under N.Y. U.C.C. § 1-105(1) (McKinney 1964), parties are empowered to adopt a choice-of-law clause so long as the chosen law bears a reasonable relationship to the transaction. *See* Gruson, *supra* note 2, at 341-52. Moreover, section 7-1.10 of the New York Estates, Powers and Trust Law provides that nondomiciliary settlers are empowered to stipulate that New York law shall govern the disposition of the personal property of a trust. N.Y. Est. Powers & Trusts Law § 7-1.10 (McKinney 1967).

[157] Where there is a conflict between New York's public policy and the application of comity, the New York court's own sense of justice and equity as embodied in its own public policy must prevail. *Grindlays Bank*, 37 N.Y.2d at 228, 333 N.E.2d at 173, 371 N.Y.S.2d at 899.

[158] Gruson, *supra* note 4, at 222 & n.83; *see, e.g.*, Babcock v. Jackson, 17 App. Div. 2d 694, 699, 701-02, 230 N.Y.S.2d 114, 121, 125, (4th Dep't 1962) (discussing "whole law" of foreign state), *rev'd on other grounds*, 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963); *In re* Estate of Ortiz, 60 Misc. 2d 756, 762, 303 N.Y.S.2d 806, 813 (Sur. Ct. Kings County 1969) (defining "whole law").

[159] *See* Gruson, *supra* note 4, at 222 & n.83.

[160] Gruson, *supra* note 2, at 362-64.

[161] Siegelman v. Cunard White Star, 221 F.2d 189, 194 (2d Cir. 1955) (Harlan, J.); *see* Restatement (Second) of Conflict of Laws § 187(3) comment h, at 569 (1971); Gruson, *supra* note 2, at 363.

[162] *See, e.g.*, Woodling v. Garrett Corp., 813 F.2d 543, 551 (2d Cir. 1987) (New York choice of law adopts substantive not procedural law of foreign state); Hausman v. Buckley, 299 F.2d 696, 700 (2d Cir. 1962) (under New York law, procedural questions are governed by forum state).

jurisdiction's substantive law governs.[163] As a result, if a New York court 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 law rules is effective, then New York will not query as to the enforceability of the choice-of-law clause in the named foreign jurisdiction and will apply only the substantive law of such foreign jurisdiction.[164]

However, even this time-honored rule is subject to certain limited exceptions.[165] One exception concerns the conflicts rule that New York courts employ concerning the nature and extent of the corporate powers of entities that are incorporated under the laws of jurisdictions other than New York. If a foreign corporation is party to a contract which adopts New York law, a New York court may apply the "internal affairs rule" to questions such as whether, under the laws of the jurisdiction in which it is incorporated, the corporation (a) had the power and authority to enter into and perform the contract, and (b) had properly authorized the execution, delivery, and performance of the contract.[166] As a result, because the "internal affairs rule" is a conflicts rule, New York courts interpreting choice-of-law clauses that stipulate New York law may be compelled to apply the substantive law of another jurisdiction concerning issues of corporate power and capacity.[167]

The leading case in New York is *Greenspun v. Lindley*[168] in which the court of appeals was faced with the question whether the holders of shares in a real estate investment trust had to make a demand on the trustees prior to commencing suit against the trustees. The trust was organized under Massachusetts law and the

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[163] Gruson, *supra* note 4, at 223-24; *see, e.g.*, Carlos v. Philips Business Sys., 556 F. Supp. 769, 774-77 (E.D.N.Y.) (applying procedural New York injunction test under substantive law of foreign states), *aff'd*, 742 F.2d 1432 (2d Cir. 1983).

[164] *See* Gruson, *supra* note 2, at 367; *supra* notes 161-62.

[165] Gruson, *supra* note 4, at 223.

[166] Gruson, *supra* note 2, at 365-67. Questions of the corporation's internal affairs concern, *inter alia*, whether the requisite steps were followed in order to authorize a contract, and whether the requisite officers executed the contract on the entity's behalf. *Id.* at 366; *see, e.g.*, Diamond v. Oreamuno, 24 N.Y.2d 494, 503, 248 N.E.2d 910, 914-15, 301 N.Y.S.2d 78, 85 (1969); Russian Reins. Co. v. Stoddard, 240 N.Y. 149, 154-55, 147 N.E. 703, 704 (1925).

[167] *See, e.g.*, Hart v. General Motors Corp., 129 App. Div. 2d 179, 184-85, 517 N.Y.S.2d 490, 493-94 (1st Dep't 1987) (applying Delaware corporate law); Lewis v. Dicker, 118 Misc. 2d 28, 31-32, 459 N.Y.S.2d 215, 217-18 (Sup. Ct. Kings County 1982) (Pennsylvania law applied).

[168] 36 N.Y.2d 473, 330 N.E.2d 79, 369 N.Y.S.2d 123 (1975).

declaration of trust provided that Massachusetts law governed.[169] Under Massachusetts law, the shareholders were required to make a demand on the trustees prior to commencement of suit.[170] However, the shareholders argued that because the transaction was substantially related to New York, New York law should govern the dispute.[171] The court of appeals upheld the choice-of-law provision and applied Massachusetts law.[172] In so doing, however, the court rejected a perfunctory application of the "internal affairs" choice of law rule; if a foreign corporation or trust has substantial contacts with New York, courts may apply New York law in order to determine questions involving corporate power and capacity.[173]

A recent case in which the internal affairs conflict of law rule was implicated is *Keystone Leasing Corp. v. Peoples Protective Life Insurance Co.*[174] In *Keystone*, the plaintiff brought an action against an insurer to enforce a guaranty contract that the insurer allegedly executed in support of the financial obligations of the insurer's related development company.[175] Although the parties' contract provided that New York law governed,[176] the insurer contended both that Tennessee law applied because the transaction had substantial contacts with Tennessee and that the contract was not authorized and executed in accordance with Tennessee's insurance and corporation law.[177] Applying a grouping of contacts analysis, the court refused to uphold the parties' choice of New York law on grounds that Tennessee had the most significant contacts with the case.[178]

Although the *Keystone* court reached the proper result, it did not correctly employ the reasoning enunciated by the court of appeals in *Greenspun*.[179] Rather than applying the grouping of contacts test, the court should have properly applied the internal affairs rule.[180] Importantly, the defendant insurer was incorporated

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[169] *Id.* at 477, 330 N.E.2d at 80, 369 N.Y.S.2d at 125.

[170] *Id.* at 478, 330 N.E.2d at 81, 369 N.Y.S.2d at 126.

[171] *See id.* at 477, 330 N.E.2d at 80, 369 N.Y.S.2d at 125-26.

[172] *Id.* at 477, 330 N.E.2d at 80, 369 N.Y.S.2d at 125; *accord* Skolnik v. Rose, 55 N.Y.2d 964, 965-66, 434 N.E.2d 251, 252, 449 N.Y.S.2d 182, 183 (1982).

[173] *Greenspun*, 36 N.Y.2d at 477-78, 330 N.E.2d at 81, 369 N.Y.S.2d at 126.

[174] 514 F. Supp. 841 (E.D.N.Y. 1981).

[175] *See id.* at 847.

[176] *See id.*

[177] *See id.* at 847-48.

[178] *See id.*

[179] *See* Gruson, *supra* note 4, at 213 n.27.

[180] *Id.*; *see also supra* notes 168-69 and accompanying text (discussing *Greenspun*).

under Tennessee law.[181] The key issue was whether the guaranty was properly authorized and executed by the insurer.[182] According to *Greenspun*, a New York court faced with this question must look to the law of the state of the entity's incorporation unless the transaction has substantial contacts with New York, in which case New York law will govern.[183] Thus, absent significant New York contacts, the *Keystone* court would have been constrained by *Greenspun* to apply Tennessee law.

In sum, New York courts always apply the forum's own choice of law rules.[184] If a choice-of-law clause stipulates another jurisdiction's law, New York courts will apply New York choice of law rules in order to determine whether the chosen jurisdiction's "substantive" law should govern. New York courts will not, however, apply another jurisdiction's choice of law rules. Finally, if a New York court is faced with a choice-of-law clause which stipulates that New York law will apply, and the issue is whether a corporation or trust organized under another jurisdiction's law properly authorized, executed, and delivered the contract, the New York court should apply the law of the entity's jurisdiction of incorporation, unless the transaction has significant contacts with New York.[185]

V. Conclusion

The trend of the world's insurance markets is toward increased globalization. This increased globalization has not only produced new business opportunities, but has also expanded the interconnectedness between jurisdictions which were formerly independent and separate. However, the heightened capacity, economics, and profits which are appurtenant to this global expansion are often tempered by multijurisdictional disputes which may result in litigation or arbitration. With the increased stakes, parties naturally seek to minimize the degree of uncertainty and unpredictability in connection with their dispute resolution. Nevertheless, the prevailing conflict of law rules, many of which were formulated during a time when commercial relations were more

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[181] *Keystone*, 514 F. Supp. at 843.
[182] *Id.* at 845-47.
[183] *Greenspun*, 36 N.Y.2d at 477, 330 N.E.2d at 80, 369 N.Y.S.2d at 125-26.
[184] *See supra* notes 162-66 and accompanying text.
[185] *See* Gruson, *supra* note 2, at 378-79.

parochial and less complex, are often ill-equipped to provide the certainty and predictability that parties require.

As one of the world's leading centers of finance, commerce, and insurance, New York is often placed in the spotlight of this problem. Thus, New York has a substantial interest in promoting stability, continuity, and certainty in connection with the resolution of multijurisdictional disputes which are handled by the state's legal system.

Because of the dearth of simple and predictable rules as to applicable law, parties to an agreement should have the right to agree on the applicable law.[186] In cases where the parties have agreed to another jurisdiction's law, New York courts should follow the reasonable relationship test articulated by the court of appeals in *A.S. Rampell, Inc. v. Hyster Co.*[187] In cases in which the parties have agreed that New York law should govern, New York courts should sustain their intent by reason of the strong public policy expressed in the General Obligations Law. In so doing, New York courts will be able to reduce the age-old confusion which so often prevails in the area of conflict of laws.

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[186] *See id.*

[187] 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957).