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**CHOICE-OF-LAW, VENUE, AND CONSENT-TO-
JURISDICTION PROVISIONS IN CALIFORNIA
COMMERCIAL LENDING AGREEMENTS:
CAN GOOD DRAFTSMANSHIP OVERCOME BAD
CHOICE-OF-LAW DOCTRINE?**

I. INTRODUCTION

Every year in the United States, thousands of businesses enter into commercial lending agreements.¹ Many of those businesses maximize financing opportunities² by borrowing from lenders outside the state in which they operate.³ Often, this may involve lenders from jurisdictions whose laws governing commercial lending agreements are substantially different from the laws of the state in which the borrower does business.⁴ In such instances, there may be a question as to which state's laws should govern the lending agreement if a dispute arises between the parties.

To enable both borrowers and lenders to plan more effectively by bringing an element of certainty into such multistate transactions,⁵ parties may include contractual choice-of-law provisions in lending agreements.⁶ The ability to choose in advance which law will govern an agreement is very attractive because it affords the parties greater control over the outcome of litigation.⁷ In this way, choice-of-law provisions play an important role in the enforcement of all types of commercial lending agreements, and in the financial success of the enterprises involved in such agreements.

1. Federally insured commercial banks maintained commercial loan portfolios totalling approximately \$589.7 billion in 1987. U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 492 (109th ed. 1989).

2. A business's ability to find more favorable terms, such as lower interest rates and service charges, should increase as that business's ability to find more lenders in competition for its business increases.

3. It appears that most businesses prefer to borrow from financial institutions near their bases of operations; however, in major commercial transactions, the opportunity to save large financing costs is often worth the trade-off of less personalized financial services. Conversely, lenders who are seeking to maximize the rates of return on their assets are often willing to accept potentially greater risks and increased transaction costs which may be associated with out-of-state borrowers.

4. See P. MUELLER, PERSPECTIVE ON CREDIT RISK 13 (1988).

5. See Horowitz, *The Law of Choice in California—A Restatement*, 21 UCLA L. REV. 719, 765 (1974).

6. See Friedler, *Party Autonomy Revisited: A Statutory Solution to a Choice-of-Law Problem*, 37 U. KAN. L. REV. 471 (1989).

7. *Id.*

By their nature, contractual choice-of-law provisions are intended to prevent litigation of conflicts-of-law questions.⁸ However, despite the purpose of such provisions, litigation in California and elsewhere has frequently arisen with regard to the enforcement of choice-of-law clauses.⁹ As a result, courts have been faced with the task of determining when the provisions should be honored and when they should be disregarded. In attempting to resolve this issue, many courts have looked to modern choice-of-law theories for guidance.¹⁰ Unfortunately, most of the modern theories have been formulated to apply in the *absence* of choice-of-law provisions and are based on factors independent of the interests of the parties involved in litigation.¹¹ Since choice-of-law provisions are used preemptively by parties to expressly determine which state's laws should apply to their contracts, the use of most modern choice-of-law theories in the *presence* of choice-of-law provisions is inappropriate.¹²

Dissatisfaction with the use of the modern choice-of-law theories has led commentators to propose various alternative approaches to determine when contractual choice-of-law provisions should be honored.¹³

8. See Horowitz, *supra* note 5, at 765.

9. *Mencor Enters., Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 235 Cal. Rptr. 464 (1987); *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal. App. 3d 280, 135 Cal. Rptr. 230 (1976); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971). New York state and federal courts have adjudicated a substantial number of disputes arising from the enforcement of choice-of-law provisions. See *Triad Fin. Establishment v. Tumpane Co.*, 611 F. Supp. 157 (N.D.N.Y. 1985); *S. Leo Harmonay, Inc. v. Binks Mfg. Co.*, 597 F. Supp. 1014 (S.D.N.Y. 1984), *aff'd*, 762 F.2d 990 (2d Cir. 1985); *Keystone Leasing Corp. v. Peoples Protective Life Ins. Co.*, 514 F. Supp. 841 (E.D.N.Y. 1981); *LaBeach v. Beatrice Foods Co.*, 461 F. Supp. 152 (S.D.N.Y. 1978); *Southern Int'l Sales Co. v. Potter & Brumfield Div. of AMF, Inc.*, 410 F. Supp. 1339 (S.D.N.Y. 1976); *Haag v. Barnes*, 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961). For a more detailed discussion of the California cases, see *infra* notes 143-62 and accompanying text.

10. See, e.g., *North Am. Bank, Ltd. v. Schulman*, 123 Misc. 2d 516, 521, 474 N.Y.S.2d 383, 387 (1984) (court struck down parties' choice of Israeli law, stating, "all objective criteria point to the conclusion that New York . . . bears the greatest 'governmental interest,' or most 'substantial relationship' to this loan agreement"). See *infra* note 34 for a limited discussion of the modern theories.

11. Friedler, *supra* note 6, at 472. Of the three most popular modern theories, none gives the parties' interests serious consideration: "Governmental interest" analysis focuses on the interests of the states involved; the "most significant relationship" approach focuses on the contacts of the parties or the transactions with the forum; and the "better rule of law" approach attempts to do what is best in terms of justice in any particular case. *Id.*

12. Choice-of-law provisions are expressly intended to take the issue of the governing law out of the hands of the courts. Therefore, any modern theory attempting to designate which law should apply to a particular contract containing a choice-of-law provision should be effectively foreclosed.

13. See, e.g., Prebble, *Choice of Law to Determine the Validity and Effect of Contracts: A Comparison of English and American Approaches to the Conflict of Laws, Part I*, 58 CORNELL L. REV. 433, 497-501 (1973).

One theory widely espoused is the autonomy rule.¹⁴ The autonomy rule, with limited exceptions,¹⁵ requires courts to honor contractual choice-of-law provisions as agreed upon by the parties to a transaction.¹⁶ The autonomy rule is the best rule for interpreting choice-of-law provisions because it truly upholds the expressed expectations of contracting parties. In this manner, the autonomy rule creates a climate of certainty for parties engaged in contractual relationships by eliminating unexpected surprise in the interpretation of those contracts. Thus, absent fraud, duress, or any other type of overreaching behavior, the autonomy rule is the only rule which should govern choice-of-law provisions in commercial lending agreements.

Unfortunately, choice-of-law doctrine in California sometimes refutes the autonomy rule and nullifies parties' contractual choice of law.¹⁷ This creates much uncertainty¹⁸ without justification. Parties may avoid this problem by incorporating consent-to-jurisdiction and mandatory choice-of-venue provisions¹⁹ into their agreements, thereby allowing the parties to litigate in states which will honor their choice of law in the event that a dispute arises between them.

This Comment examines the California courts' treatment of choice-

14. Friedler, *supra* note 6, at 471. For an overview of the historical development of the autonomy rule, see Lorenzen, *Validity and Effects of Contracts in the Conflicts of Laws*, 30 YALE L.J. 565 (1921).

15. Fraud and duress are two obvious reasons that courts would not honor choice-of-law provisions. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 comment b (1971). Section 187 of the Restatement (Second) of the Conflict of Laws sets forth two other exceptions: (1) a transaction must have a substantial relationship with the state chosen by the parties in order for a contractual choice-of-law provision to be enforceable; and, (2) enforcement of such provisions does not render the contract in which the provision is contained invalid due to a fundamental public policy of the forum state. *Id.* § 187; see also *infra* notes 94-142 and accompanying text.

16. See generally Note, *Effectiveness of Choice-of-Law Clauses in Contract Conflicts of Law: Party Autonomy or Objective Determination?*, 82 COLUM. L. REV. 1659 (1982).

17. See *Frame*, 20 Cal. App. 3d at 673-74, 97 Cal. Rptr. at 815 (choice-of-law provision designating New York law as controlling forfeiture agreement in employment contract struck down as against California public policy). For a more detailed discussion of *Frame*, see *infra* notes 120-26 and accompanying text.

18. See *infra* notes 143-63.

19. Choice-of-venue and consent-to-jurisdiction provisions are used in contracts in much the same manner as choice-of-law provisions. Each provides parties greater control over disputes arising from contractual agreements. See *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13-14 (1971) (elimination of uncertainties by agreeing in advance on forum held an indispensable element in contracting); *National Equip. Rental, Ltd. v. Szukhent*, 375 U.S. 311, 315-16 (1964) (parties to contract may agree in advance to submit to jurisdiction of particular court). Choice-of-venue and consent-to-jurisdiction clauses provide greater control by granting parties certainty to the situs of litigation. For a detailed discussion of such provisions, see *infra* notes 166-210 and accompanying text.

of-law provisions in commercial lending agreements and critically evaluates the inconsistencies evident in the interpretations of those provisions. Part Two of the Comment discusses the uncertainty created by the California courts' apparent reluctance to unequivocally honor parties' choice-of-law provisions in commercial lending agreements and assesses the potential costs of that uncertainty. Part Three provides a brief overview of the theory of governmental interest analysis,²⁰ and its influence on the California courts regarding general conflicts questions.

Part Four of the Comment begins by examining the influence of governmental interest analysis on the interpretation of choice-of-law provisions. It then discusses the merits of an autonomous approach to contractual choice-of-law provisions and the emergence of the Restatement (Second) as the leading influence in that area of the law today. The Comment critically examines the exceptions to the Restatement's professed endorsement of party autonomy and how those exceptions have provided the courts wide latitude to invalidate parties' choice of law. Next, the Comment surveys the California courts' use of the Restatement, and discusses why, from the standpoint of party autonomy, this use is counterproductive in the context of commercial lending litigation. Part Four then proposes a method for drafting commercial lending agreements that should compel the California courts to honor parties choice of law in such agreements. Finally, Part Four addresses how the doctrine of unconscionability affects the proposed solution.

Part Five of the Comment examines how to implement the solution in a manner which should guarantee that parties' choice of law in commercial lending agreements will be honored. Lastly, the Comment provides the reader with sample provisions which illustrate the solution proposed.

II. STATEMENT OF THE PROBLEM: A LACK OF CERTAINTY IN THE ENFORCEMENT OF COMMERCIAL LENDING AGREEMENTS IN CALIFORNIA

For years, the California courts have appeared reluctant to emphasize party autonomy in the enforcement of choice-of-law provisions in commercial lending agreements.²¹ The inconsistent approaches the

20. See *infra* notes 36-60 and accompanying text.

21. See *Mencor Enters., Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 235 Cal. Rptr. 464 (1987) (court invalidates parties' choice of Colorado law in lending agreement as against public policy under California usury laws, despite legality under Colorado usury law); *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal. App. 3d 280, 135 Cal. Rptr. 230 (1976) (court upholds parties' choice of California law in lending agreement, but qualifies circumstances under which

courts have taken in interpreting such provisions and the manner in which the courts have implemented those approaches illustrate this reluctance.²² Consequently, the courts' decisions have created a climate of uncertainty as to whether choice-of-law provisions will be enforced, a result which is both unnecessary and potentially dangerous.²³

A lender's ability to gauge risk is an essential element in determining its future financial success.²⁴ The more certain a lender is that it will be able to enforce a financing agreement as bargained for, the more accurately the lender can gauge the risk of lending to particular parties.²⁵ The ability to gauge risk allows lenders to set interest rates in a competitive, yet profitable manner.²⁶ The greater the risk a lender believes a customer presents, the higher the rate the lender will charge that customer.²⁷ Conversely, the lower the risk that the lender perceives, the lower the rate the lender will charge.²⁸ Consequently, lenders who feel that they will be able to enforce agreements may be more willing to take on risks that would otherwise be prohibitive, since risk is reduced through the certainty of enforcement.²⁹

When lenders loan money and are unable to collect as expected, several consequences may arise. First, lenders may have to reassess their risks, adding in the element of uncertainty that exists because their agreements may not be enforced under the chosen law. The result could be a refusal by certain lenders to deal with parties who are not as financially secure as those lenders' prime customers.³⁰ When this occurs, marginal businesses which rely on working-capital financing to fund their day-to-

parties' choices will be honored as per Restatement (Second) of the Conflict of Laws); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971) (parties' choice of New York law to govern forfeiture agreement struck down by court as against public policy). See *infra* notes 143-62 and accompanying text for a more detailed discussion of the California courts recent treatment of choice-of-law provisions in lending agreements.

22. See *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964) (utilizing "governmental interest" approach to choice-of-law provision); *but see Gamer*, 65 Cal. App. 3d at 287-89, 135 Cal. Rptr. at 234-35 (adopting approach of Restatement (Second) of Conflict of Laws).

23. See *infra* notes 24-33 and accompanying text.

24. E. COMPTON, *INSIDE COMMERCIAL BANKING* 101 (2d ed. 1983); see also D. AUSTIN, D. HAKALA & T. SCAMPINI, *MODERN BANKING* 194 (1985).

25. E. COMPTON, *supra* note 24, at 101-03.

26. *Id.* at 104.

27. COMMITTEE ON DEVELOPMENTS IN BUSINESS FINANCING OF THE SECTION OF CORPORATION, BANKING AND BUSINESS LAW, AMERICAN BAR ASSOCIATION, *TERM LOAN HANDBOOK* 4 (J. McCann ed. 1983).

28. *Id.*

29. E. COMPTON, *supra* note 24, at 101-02.

30. *Id.* at 97.

day operations may find themselves unable to find needed funds at affordable prices, and they could fail.³¹ Ultimately, not only would the owners, employees, and customers of those businesses suffer, but so would their other creditors. The inability to collect those funds could create even higher financing costs for surviving businesses, and possibly greater hardship. In the worst case, it could result in insolvency for lenders.³² As we have seen recently with regard to the savings and loan industry, lenders' financial failure affects not only the businesses which rely on the lenders, but also the tax-paying public and the innocent investor.³³ Thus, the uncertainty created by an inability to enforce lending agreements under the law chosen by the parties could adversely affect all of us.

III. BACKGROUND

State sovereignty, rather than party autonomy, has for many years provided the basis for modern choice-of-law theory.³⁴ As such, it has

31. *Id.* at 99.

32. Between 1985 and 1988, 638 commercial banks with assets totalling \$52.4 billion failed in the United States. FEDERAL DEPOSIT INSURANCE CORP., 1988 ANNUAL REPORT 16 (1989). The largest number of failures occurred in 1988 when 200 banks with assets totalling \$35.7 billion failed. *Id.* Additionally, of the 13,114 FDIC-insured commercial banks at year-end, 1988, 1,823 reported losses for the year. *Id.* at 55 (Auditor's Report). The record number of failures in 1988 is attributed mainly to an inability of commercial banks to accurately gauge risks in making loans to agricultural and energy concerns, and to "less developed countries." *Id.* (Auditor's Report). While a certain degree of risk is inherent in all lending arrangements, the large number of recent failures in the commercial banking industry is tangible proof of the extensive need for as much certainty as can practically be obtained in any lending transaction.

33. See Redburn, *S & L Bailout 'Triumph' Is Fast Becoming a Mess*, L.A. Times, Feb. 16, 1990, at D1, col. 2; Keating *Predicts S & L Bailout Will Cost \$500 Billion*, L.A. Times, Jan. 15, 1990, at D2, col. 2; Rosenblatt, *Up to \$100 Billion Extra Sought for S & L Rescues*, L.A. Times, Nov. 1, 1989, at A1, col. 2.

34. See Friedler, *supra* note 6, at 486-88. There are three main theories followed by a majority of the court. *Id.* They are "governmental interest" analysis, the "most significant relationship" approach, and the "better rule of law" approach. *Id.* See *infra* notes 36-58 and accompanying text for a discussion of governmental interest analysis.

The "most significant relationship" approach to contractual conflicts questions in the absence of choice-of-law provisions has been defined in the Restatement (Second) of the Conflict of Laws. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (1971). The Restatement approach involves a two-step methodology under which courts make a quantitative and then qualitative assessment of competing states' laws to determine which state has the most significant relationship to the case and whose laws should therefore apply. *Id.* The quantitative step involves examination of the general "rule" for a particular issue, to determine which states have *any* interest in applying their laws. *Id.* This step of the approach really involves nothing more than counting contacts. Section 188 of the Restatement asks the courts to consider place of contracting, place of negotiation, place of performance, location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation, and place of business of each party to the contract to determine which states have an interest in applying their laws. *Id.* § 188(2). The Restatement then directs the courts to make a qualitative assessment of each interested states' contacts to determine which law should be used. *Id.* This is done by the

also provided the rationale by which most state courts have justified their opinions regarding choice-of-law provisions in contractual agreements.³⁵ This section of the Comment provides a basic explanation of the "governmental interest" approach to *general* conflict-of-law problems: conflicts that arise in the absence of a choice of law by the parties to a contract, or in cases involving torts. This section emphasizes the governmental interest approach's strong focus on state sovereignty, and how the approach has influenced the California courts in determining the manner in which to remedy general conflicts problems.

A. *The Governmental Interest Approach to Choice of Law*

Governmental interest analysis, the most influential of modern choice-of-law theories,³⁶ was first proposed by Professor Brainerd Currie in the late 1950s,³⁷ and has since been refined to a great extent by modern case law.³⁸ In theory, governmental interest analysis is based on the

incorporation of a reference to section 6 of the Restatement in the general rule of section 188. *Id.*

Section 6 presents a list of policy considerations which express the philosophic orientation of the Restatement. *Id.* § 6. Section 6 instructs courts to consider the needs of the interstate and international systems, the relevant policies of other interested states including their interests in having their law applied to a particular issue, the protection of party expectations, the basic policies underlying the particular field of law, the objectives of certainty, predictability, and uniformity of result, and the ease of determining and applying the law previously identified as applicable. *Id.*

The "better rule of law" approach to conflicts is based on Professor Leflar's choice-influencing considerations and attempts to "do justice in the individual case." See Friedler, *supra* note 6, at 487. The five choice-influencing considerations are: (1) predictability of results; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum's governmental interest; and, (5) application of the better rule of law. See Leflar, *Conflicts Law: More on Choice-Influencing Considerations*, 54 CALIF. L. REV. 1584, 1586-88 (1966) (emphasis added). One of the first cases to apply this approach was *Milkovich v. Saari*, 295 Minn. 155, 203 N.W.2d 408 (1973).

35. See Horowitz, *supra* note 5, at 765.

36. Friedler, *supra* note 6, at 486.

37. *Id.*

38. See generally Juenger, *Conflict of Laws: A Critique of Interest Analysis*, 32 AM. J. COMP. L. 1 (1984). Governmental interest arose mainly as a response to the traditional "vested rights" approach to conflicts problems. *Id.* Under vested rights, the forum was obliged to apply the law of the state where the right originally vested. *Id.* In torts, the right vested at the place of the wrong; in contracts, the right vested at the place where the contract was "made." *Id.* As Professor Beale stated of the vested rights approach, "A right having been created by the appropriate law, the recognition of its existence should follow everywhere. Thus an act valid where done cannot be called in question anywhere." J.H. BEALE, 3 CASES ON THE CONFLICT OF LAWS 517 (1901).

The main objection to the vested-rights approach was that the territorial orientation of the theory assigned greater weight to foreign than to local law, in effect giving the foreign law extraterritorial force over local law which was the source of the court's authority. E. SCOLES & P. HAY, CONFLICT OF LAWS 14 (1982). Under vested rights, the forum court was often

premise that states have a fundamental interest in promoting the policies underlying their laws by applying them to local, and in appropriate situations, interstate transactions.³⁹ Determining the extent of a state's interest in a particular case depends upon the policy underlying the law and the reasonableness of applying that policy in the given case.⁴⁰

When a conflict between the laws of different states arises under the governmental interest approach, the forum court examines the substance of its relevant laws and those of the other involved states to ascertain the underlying policies behind those laws.⁴¹ Once such policies are defined, the forum court determines which states have an interest in the application of their laws to a specific issue.⁴² Under Currie's approach, four possible situations exist in which governmental interest analysis can be applied.

The first situation arising under Currie's approach is the "true conflict," where two or more states have competing policies underlying their laws which create an interest in having those laws applied.⁴³ When a true conflict arises, governmental interest analysis directs the forum to simply apply its own law.⁴⁴ In that manner, the forum can avoid making a subjective decision as to which states' policies are most deserving of advancement, thereby serving the interests of federalism while solving the choice-of-law conflict.⁴⁵

The second situation arising under Currie's approach is the so-called

placed in the position of denying its own governmental interest in applying its own law to a case without advancing the governmental interests of the state whose law was applied. *Id.*

California's approach to general conflicts questions, called "comparative impairment," provides a good example of the manner in which the traditional governmental interest approach has been refined by modern case law. *See Bernhard v. Harrah's Club*, 16 Cal. 3d 313, 546 P.2d 719, 128 Cal. Rptr. 215 (1976); *see also* Horowitz, *supra* note 5 at 748-58; *see also infra* notes 59-65 and accompanying text for a discussion of the theory of comparative impairment.

39. E. SCOLES & P. HAY, *supra* note 38, at 17 (1982). In Currie's view:

Every state . . . has a governmental interest in effectuating the policies underlying its own laws. Thus, when asked to apply the law of another forum, a court should first inquire into the . . . circumstances in which it is reasonable for the respective states to assert an interest in the application of these policies.

Id. (citing B. CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* 69 (1963)).

40. *Id.*

41. *Id.*

42. *Id.*

43. B. CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* 183-87 (1963).

44. *Id.*

45. Currie asserted that forum law always applies in a true conflict situation because "assessment of the respective values of the competing legitimate interests of two sovereign states, in order to determine which is to prevail, is a political function of a very high order," and noted further that "[t]his is a function which should not be committed to courts in a democ-

“false conflict.”⁴⁶ False conflicts arise when two or more states appear to have conflicting laws, but upon closer examination of the policies underlying those laws, the forum is able to determine that only one of the states has a true governmental interest.⁴⁷ According to Currie, when a false conflict arises, the forum should apply the law of the only interested state.⁴⁸ The identification of false conflicts proved to be one of the most attractive features of Currie’s interest analysis, because through subtle manipulation of the interpretation of a state’s interest or policy, courts were able to avoid finding conflicts and could thereby settle cases in a seemingly amicable manner.⁴⁹

The third situation arising under Currie’s approach involves cases in which no state has an underlying policy which creates a legitimate interest in the application of its laws.⁵⁰ Currie called this situation the “un-

racy.” Currie, *Notes on Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171, 176.

Miliken v. Pratt presents a classic example of Currie’s “true” conflict. 125 Mass. 374 (1878). At the time *Miliken* was decided, Massachusetts’ law prohibited married women domiciled in Massachusetts from entering into contracts guaranteeing the debts of their husbands. *Id.* at 376-77. The underlying policy of the law was to protect Massachusetts’ married women, whom the state did not feel had the proper capacity to contract. *Id.* at 382. Mrs. Pratt, a Massachusetts’ domiciliary, entered into a contract in Maine, guaranteeing the debt of her husband. *Id.* at 376. Under the laws of Maine, married women could contract to guarantee the debt of their husbands. *Id.* The policy behind the Maine law was to protect freedom of contract and to encourage commerce. *Id.* at 382. Mr. Pratt failed to pay the Maine creditor, Miliken, who sued Mrs. Pratt for the enforcement of her guarantee in Massachusetts state court. *Id.* at 375. A true conflict existed between Massachusetts’ policy of protecting married women and the Maine’s policy regarding freedom of contract. Accordingly, Currie would have simply applied the law of the forum, Massachusetts, and voided the guarantee given by Mrs. Pratt on behalf of her husband.

The court in *Miliken* used the vested rights approach to settle the conflict; the governmental interest approach had yet to be proposed by Currie. However, the case represents an excellent example of a true conflict.

46. B. CURRIE, *supra* note 43, at 183-87.

47. W. REESE & M. ROSENBERG, *CONFLICTS OF LAWS, CASES AND MATERIALS* 478 (8th ed. 1984).

48. *Id.* A good example of such a case was *Babcock v. Jackson*, 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963). The case involved the forum’s refusal to apply a foreign guest statute to an auto accident between domiciliaries of the forum in the foreign state. *Id.* at 477, 191 N.E.2d at 280-81, 240 N.Y.S.2d at 745-46. The foreign state was said to have no interest in the application of its law, which prohibited recovery for the foreign domiciliaries; the forum state was said to have an interest in providing recovery, based on the forum’s policy of providing compensation for tort victims. *Id.* at 484, 191 N.E.2d at 285, 240 N.Y.S.2d at 752.

49. W. REESE & M. ROSENBERG, *supra* note 47, at 478. When confronted by a true conflict, Currie advised the forum to reconsider its interests and the interests of the other competing states to determine if a more “restrained and moderate” interpretation of the conflicting interests would allow the forum to avoid the conflict by applying a common policy of both states. *Id.*

50. B. CURRIE, *supra* note 43, at 183-87.

provided-for" case.⁵¹ For lack of a better solution, Currie advised that the forum should simply apply its own law in unprovided-for cases.⁵²

The last situation addressed by governmental interest analysis arises when the forum state has no interest in applying its own law, but a conflict exists between the laws of two or more other states.⁵³ In this situation, Currie again recommended that the forum should apply its own law.⁵⁴ Thus, under governmental interest analysis, *the law of the forum is never displaced by the law of another state* where the court determines that its policies would be advanced by applying its own laws.⁵⁵

Although most courts today do not use the theory as it was originally set forth by Currie,⁵⁶ governmental interest analysis has nonetheless remained the banner by which many states wave their respective choice-of-law flags.⁵⁷ As such, its tremendous emphasis on state sovereignty has been felt in all areas of choice-of-law theory, including those dealing with contractual choice-of-law provisions.⁵⁸

B. California and Governmental Interest Analysis

The California approach to general conflicts of law questions, known as "comparative impairment," is an extension of Currie's governmental interest analysis.⁵⁹ Like governmental interest analysis, comparative impairment looks to the policies underlying the laws of the competing states to establish whether or not those states have interests in the application of their laws to a particular issue.⁶⁰ However, the major difference between comparative impairment and governmental interest analysis is the manner in which comparative impairment solves the problem of true conflicts.⁶¹

When two or more states have legitimate interests in the application of their laws, comparative impairment, unlike governmental interest,

51. *Id.*

52. *Id.*

53. Currie, *Comments on Babcock v. Jackson, a Recent Development on Conflicts of Laws*, 63 COLUM. L. REV. 1233, 1242-43 (1963).

54. *Id.*

55. E. SCOLES & P. HAY, *supra* note 38, at 19.

56. Juenger, *supra* note 38, at 1.

57. See Leflar, *The Nature of Conflicts Law*, 81 COLUM. L. REV. 1080, 1086 (1981).

58. See *infra* notes 68-78 and accompanying text.

59. Horowitz, *supra* note 5, at 748-58.

60. See *Bernhard v. Harrah's Club*, 16 Cal. 3d 313, 320, 546 P.2d 719, 723, 128 Cal. Rptr. 215, 219 (1976).

61. For a discussion of Currie's approach to true conflicts, see *supra* notes 43-45 and accompanying text.

does not automatically apply the law of the forum.⁶² Rather, comparative impairment directs the forum court to evaluate the interests of the competing states involved in the conflict and determine which state's underlying policies would be most impaired if its law were *not* applied.⁶³ Comparative impairment then applies the law of that state.⁶⁴ The rationale behind comparative impairment may be seen as an attempt by the forum to best serve the needs of federalism by finding the alternative which does the least damage to the states whose laws are competing for application.⁶⁵ Thus, as with governmental interest analysis, state sovereignty is a primary concern in the manner in which comparative impairment settles conflicts between the laws of differing states.

IV. ANALYSIS: PARTIES' CHOICE-OF-LAW PROVISIONS

A. Governmental Interest Analysis Applied to Parties' Choice of Law

As with their treatment of general conflicts of law problems, the California courts have traditionally been influenced by governmental interest analysis in determining the validity of choice-of-law provisions within the framework of contractual agreements.⁶⁶ One of the first examples of the treatment of a choice-of-law provision in a commercial lending agreement in California commercial litigation is *Ury v. Jewelers Acceptance Corp.*⁶⁷ *Ury*, decided in 1964, involved the enforcement of a lending agreement between a California jewelry retailer and a New York

62. *Bernhard*, 16 Cal. 3d at 320, 546 P.2d at 723, 128 Cal. Rptr. at 219.

63. *Id.*

64. *Id.*

65. *Id.*, 546 P.2d at 723-24, 128 Cal. Rptr. at 219-20. As the California Supreme Court stated in *Bernhard*:

"An attempted balancing of conflicting state policies . . . is difficult to justify in the context of a federal system in which . . . states are empowered to mold their policies as they wish [The process] can accurately be described as . . . an accommodation of conflicting state policies, as a problem of allocating domains of law-making power in multi-state contexts"

Id. (quoting Horowitz, *The Law of Choice in California—A Restatement*, 21 UCLA L. REV. 719, 753 (1974)).

66. See *Gamer v. duPont Glove Forgan, Inc.*, 65 Cal. App. 3d 280, 289, 135 Cal. Rptr. 230, 234 (1976) ("[S]tatements of plaintiff do not create an issue of fact as to the substantial relationship between the contract and the State of New York."); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 673, 97 Cal. Rptr. 811, 814 (1971) (application of New York law would not be foreclosed if New York had "substantial contacts with the transactions and the parties . . ."); *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 15, 38 Cal. Rptr. 376, 379 (1964) (quoting trial court, "'California does not have such significant relationships with the transaction that its governmental interest required application of its own . . . laws rather than the significantly different . . . laws of New York.'" (citation omitted)).

67. 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964).

commercial credit corporation.⁶⁸ The agreement contained a choice-of-law provision designating New York law as controlling if a dispute arose between the parties.⁶⁹ Under New York law, the agreement was not usurious.⁷⁰ However, the retailer claimed that since the interest rates charged by the New York lender were usurious under California law, the agreement should not be enforced by the California courts.⁷¹ The court, holding that New York law controlled,⁷² relied primarily on the connection between the contract and New York, and not on the choice-of-law provision.⁷³ The court found that California's governmental interest was not sufficient to require application of its own usury laws rather than the significantly different usury laws of New York.⁷⁴ It was only after the court had determined that New York law should apply⁷⁵ that it addressed the contractual choice-of-law provision.⁷⁶ Even then, the court premised its decision to honor the provision on the fact that New York was the place the contract was both made and performed.⁷⁷ In this man-

68. *Id.* at 13-15, 38 Cal. Rptr. at 378-79.

69. *Id.* at 14, 38 Cal. Rptr. at 378-79.

70. *Id.* at 17, 38 Cal. Rptr. at 380-81.

71. *Id.* at 20, 38 Cal. Rptr. at 382.

72. *Id.*

73. *Id.* at 16, 38 Cal. Rptr. at 379-80. The court essentially relied on the fact that the contract was "made" in New York; the court considered the principal place of performance for the contract as New York, since the place of repayment of the notes was New York and the money was made available to the borrower in New York. *Id.* at 16-17, 38 Cal. Rptr. at 380. On that basis, the court held that New York usury law should apply and that the lending agreement should be enforced. *Id.* at 18, 38 Cal. Rptr. at 381.

74. *Id.* at 15, 38 Cal. Rptr. at 379.

75. *Id.* at 16-17, 38 Cal. Rptr. at 380.

76. *Id.* at 18-19, 38 Cal. Rptr. at 381. The court stated:

We need not decide, and we do not, that this provision in the contract [that the contract be "construed" pursuant to New York law] would cause New York law to apply if the transaction had no substantial connection with New York. . . .

. . . In the case before us, the place of performance is New York and it is reasonable to interpret the contractual provision . . . as calling for application of the law of New York in order to give *additional* weight to the validity of the whole agreement.

Id. (emphasis added).

77. *Id.* at 18, 38 Cal. Rptr. at 381. In enunciating its policy, the court stated,

But because the place of making the contract and the place of performance are the State of New York, we apply the rule of validation of contracts, and hold that the contractual provision amounts to a selection by the parties that the laws of New York shall govern the contract. Parties naturally expect that the obligations of a contract will be fulfilled.

Id.

The "rule of validation" which the court in *Ury* invoked, describes a method of analysis utilized in cases involving commercial transactions across state lines, in which "[t]wo states [have] interests in having their policies prevail on the issue of the validity of the transaction—one state's law validating and the other invalidating the transaction and in which court[s] [have] held that the state's policy which validated the transaction would prevail." Horowitz, *supra* note 5, at 760.

ner, *Ury* endorsed governmental interest as the primary factor in the California courts' determination of the validity of contractual choice-of-law provisions.

By its nature, governmental interest analysis places primary emphasis on the interest of a state in applying its laws and promulgating its policies. Thus, when dealing with contractual choice-of-law provisions, discounting the intentions of the parties is an inevitable consequence of the governmental interest approach.⁷⁸ As such, the interpretation of contractual choice-of-law provisions under California case law at the time of *Ury* reflected a policy which focused on state sovereignty rather than party autonomy, a focus detrimental to upholding the expectations of the parties.

B. Restatement Section 187: Responding to the Need for Party Autonomy

The fundamental purpose of contract law is to protect the expectations of the contracting parties by making it possible for them to accurately ascertain their rights and obligations.⁷⁹ In multistate transactions, the best way to protect those expectations is to allow parties to choose the state whose laws will govern their contractual agreements.⁸⁰ In this manner, contract law can provide certainty, predictability, and uniformity of result, enabling individuals and businesses to plan their affairs most effectively.⁸¹ The ability of parties to choose the laws which will govern their transactions is known as party autonomy.⁸² Today, the notion of party autonomy in contractual choice-of-law is generally accepted by

78. According to Professor Friedler, "[a]ll current choice-of-law theories, including 'interest analysis,' totally discount the parties' specific intent regarding which law should be applied to their contract." Friedler, *supra* note 6, at 486 n.80.

79. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 comment c (1971).

80. *Id.*

81. *Id.*

82. Friedler, *supra* note 6, at 471. The autonomy doctrine can be traced to the writings of Dumoulin (1500-1566), one of the great French legal scholars of the 16th century. Dumoulin believed that the will of the parties is sovereign, and relied on their express or implied intentions to select the applicable law in any particular transaction. K. LIPSTEIN, PRINCIPLES OF THE CONFLICT OF LAWS, NATIONAL AND INTERNATIONAL 12 (1981). Dumoulin's view replaced the then-prevalent views of the Italian scholar Bartolus (1314-1357), that the law of the place where the contract was made (*lex loci solutionis*) governed consequences arising subsequent to its formation. See Lorenzen, *Validity and Effects of Contracts in the Conflict of Laws*, 30 YALE L.J. 565, 573 (1921). According to Bartolus and his followers, the *lex loci* "governed the intrinsic validity and direct effects of contracts as a matter of law, regardless of the intentions of the parties." *Id.* Dumoulin's view was temporarily replaced by the view of d'Argentre, advocating a theory of the territoriality of laws, but the autonomy theory was again popularized during Pothier's time (1699-1772). *Id.*

both the courts⁸³ and legal scholars.⁸⁴ However, despite this apparent acceptance, the only modern theory⁸⁵ that deals specifically with party

83. *Siegelman v. Cunard White Star, Ltd.* is perhaps the first case to take a definitive stand in support of party autonomy. 221 F.2d 189, 195 (2d Cir. 1955). Several commentators have interpreted the cases as supporting the autonomy rule. See Prebble, *supra* note 13, at 443, 497-98 (1973); Reese, *Choice of Law in Torts and Contracts and Directions for the Future*, 16 COLUM. J. TRANSNAT'L L. 1, 22 (1977); Yntema, *Contract and Conflict of Laws: "Autonomy" in Choice of Law in The United States*, 1 N.Y.L.F. 46, 47 (1955).

84. See Ehrenzweig, *Contracts in the Conflict of Laws, Part One: Validity*, 59 COLUM. L. REV. 973, 990 (1959); Friedler, *supra* note 6, at 473; Horowitz, *supra* note 5, at 765; Prebble, *supra* note 13, at 503, 519; Reese, *Contracts and the Restatement of Conflict of Laws, Second*, 9 INT'L & COMP. L.Q. 531, 536 (1960).

The primary objection to the autonomy rule, offered originally during the 1930s, was that parties do not have the power to agree to a choice of law because by doing so they are essentially taking the legislative function away from the states. See Note, *supra* note 16, at 1664 n.23. It was argued that since the validity of a contract is a conclusion of law, the parties may have no effective voice in the choice of law governing validity unless there has been an actual delegation to them of legislative power. *Id.* This argument was set forth by Judge Learned Hand in *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115 (2d Cir. 1931):

People cannot by agreement substitute the law of another place . . . [A]n agreement is not a contract, except as the law says it shall be, and to try and make it one is to pull on one's bootstraps. Some law must impose the obligation, and the parties have nothing whatever to do with that; no more than with whether their acts are torts or crimes.

Id. at 117.

The general notion that choice-of-law provisions were a legislative act was also supported by Professor Beale, the Reporter for the American Institute's Committee on Conflict of Laws, Beale, *What Law Governs the Validity of a Contract*, 23 HARV. L. REV. 260, 260 (1910). Thus, this notion was reflected in the original Restatement of the Conflict of Laws, which does not mention party autonomy. RESTATEMENT, CONFLICT OF LAWS (1934). However, the modern view rejects the idea that choice-of-law provisions usurp the legislative function since under choice-of-law rules, the forum determines whether the parties to a contract can choose the law that will govern their transaction. Reese, *supra*, at 534. Reese answered Judge Hand in no uncertain terms, stating, "If parties are permitted to choose the law to govern the validity of the contract, it is not because they are legislators but simply because the forum has adopted a choice of law rule which provides that the law chosen by the parties shall be applied." *Id.* See also Rheinstien, Book Review, 15 U. CHI. L. REV. 478, 486 (1948).

Another, more practical view towards choice-of-law provisions was offered by then-Judge Harlan in *Siegelman*:

Instead of viewing the parties as usurping the legislative function, it seems more realistic to regard them as relieving the courts of the problem of resolving a question of conflict of laws. Their course might be expected to reduce litigation, and is to be commended as much as good draftsmanship which relieves courts of problems of resolving ambiguities. To say that there may be no reduction in litigation because courts may not honor the provision is to reason backwards. A tendency toward certainty in commercial transactions should be encouraged by the courts.

221 F.2d at 195.

At least one commentator has argued that the question is not "whether or not the parties inherently have the power to help shape legislative jurisdiction by private contract, or whether a forum's conflicts rule could delegate that power to them, but rather whether it is proper as a matter of federalism to allow the parties' intentions to shape legislative jurisdiction." Note, *supra* note 16, at 1664.

85. See Friedler, *supra* note 6, at 488.

autonomy in the contractual choice-of-law context is the approach of section 187 of the Restatement (Second) of the Conflict of Laws.⁸⁶

The Restatement approach has been described as the "embodiment of the autonomy principle"⁸⁷ and has become the primary tool for a majority of courts in interpreting contractual choice-of-law provisions today.⁸⁸ Since its inception in 1971, the Restatement has also been adopted by the California courts as the correct approach to be used in cases interpreting choice of law by parties in lending and other contractual agreements.⁸⁹ Unfortunately, however, the Restatement approach does not always uphold the expectations of contracting parties, and therefore its application is not appropriate in the context of commercial lending litigation.

Subsection 187(1) of the Restatement provides that "[t]he law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue."⁹⁰ Comment c of section 187 explains that the intentions of the parties to a contract will be honored as long as they can reasonably be construed from extrinsic evidence, such as the use of provisions of a foreign law, within such a contract.⁹¹ The comment further explains that based on extrinsic evidence "as to all such matters, the forum will apply the provisions of the chosen law."⁹² In this manner, subsection (1) implies that intent is paramount in interpreting choice-of-law provisions; however, this is true only *if* the parties could have resolved the conflict with an explicit provision in the contract directed to the issue. The result is that section 187 appears to emphasize party autonomy, even in cases where there is an absence of an express contractual provision for choice of law.

Subsection 187(2) is the most important subsection of section 187. It provides that:

The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an

86. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

87. Friedler, *supra* note 6, at 489.

88. *Id.* at 488-89.

89. *See, e.g.,* Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 20 Cal. App. 3d 668, 673, 97 Cal. Rptr. 811, 814 (1971) (contracting parties may specify controlling law if not contrary to public policy).

90. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 187 (1971).

91. *Id.* comment c.

92. *Id.*

explicit provision in their agreement directed to that issue, unless either

- (a) the chosen state has *no substantial relationship* to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
- (b) application of the law of the chosen state would be *contrary to a fundamental policy* of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.⁹³

On its face, subsection 187(2) appears to support party autonomy through deference to contracting parties' expectations. It indicates that even when parties could not have resolved a particular issue by a specific provision in an agreement, the law of the state chosen by the parties to govern the contract will still control *unless* it has no substantial relationship to the parties, *or* the provision violates a fundamental policy of a state with a greater interest than that chosen. However, it is the limitations of the section, framed in terms of exceptions, which illustrate that the Restatement approach is internally inconsistent and how section 187, as interpreted by some courts, could be characterized as a limitation on party autonomy—not unlike the choice-of-law theories section 187 implicitly professes to replace.

C. *Application of the Restatement Exceptions*

1. A "substantial relationship"

Section 187(2)(a) sets forth the first exception to the enforcement of choice-of-law provisions in contractual agreements.⁹⁴ This exception indicates that a court's ability to enforce a choice-of-law provision depends on the existence of a substantial relationship⁹⁵ between the parties to a

93. *Id.* § 187(2) (emphasis added).

94. *Id.* § 187(2)(a).

95. Morris Levin was one of the first scholars to formally propose that a contract must have a substantial connection to the state whose law is chosen to govern the contract. Levin, *Party Autonomy: Choice-of-Law Clauses in Commercial Contracts*, 46 GEO. L.J. 260, 261 (1957). Levin's rule proposed that:

Where the parties to a commercial contract have made an express stipulation that the law of a particular state or nation should govern the contract, and the law so stipulated has a substantial connection with the transaction and its enforcement would not be contrary to the public policy of the forum, then the forum should use the internal (domestic) law of the particular state or nation stipulated as governing all questions arising under the contract.

Id. (emphasis omitted). Levin's rule, which also incorporates the public policy exception,

contract, or the contract itself, and the state whose law is designated as controlling.⁹⁶ If no such relationship exists, then the provision should not be enforced.⁹⁷

Comment f of section 187 indicates that the rationale for requiring a substantial relationship between the state chosen and the parties or the issue is that such a relationship provides evidence of a reasonable basis for the parties' choice.⁹⁸ However, the requirement of a substantial relationship impairs certainty in contractual relationships and therefore should be eliminated.

appears to be a precursor to section 187 of the Second Restatement of the Conflict of Laws. Levin saw the requirement of a substantial connection as a "reaffirmance of the restrictive policy against self-legislation by the parties," and as "a buttress against those who fear the use of a strange or exotic law unconnected with the transaction." *Id.* at 263. *See also* Lorenzen, *supra* note 82, at 673. Other commentators have opposed the requirement of a substantial relationship as a qualification to the enforceability of choice-of-law provisions. *See* Ehrenzweig, *supra* note 84, at 990. ("There is little reason . . . for limiting the parties' express choice to a law having a substantial, or for that matter any, contact with the case.")

96. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(a) (1971). Another reason given for this limitation is preventing the extension of party autonomy to a purely local transaction. Friedler, *supra* note 6, at 490. The limitation has also been justified as an effort to discourage parties from entering into contracts with the purpose of evading the laws of the forum state. *Id.* *See* Hall v. Superior Court, 150 Cal. App. 3d 411, 197 Cal. Rptr. 757 (1983), for an example of a case where the parties to a California transaction attempted to avoid California's corporate security law by including a choice-of-law provision designating Nevada law as controlling their contract.

97. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 187(2)(a) (1971). Comment f of the Restatement indicates that the requirement that parties to a multistate contract have a substantial relationship with the chosen state may be waived if there is a reasonable basis for their choice. *Id.* § 187 comment f. The comment notes that:

[W]hen contracting in countries whose legal systems are strange to them as well as relatively immature, the parties should be able to choose a law on the ground that they know it well and that it is sufficiently developed. For only in this way can they be sure of knowing accurately the extent of their rights and duties under the contract.

Id.

Still, many courts, particularly in New York, seem to demand some substantial relationship between the transaction and the law chosen. *See, e.g.,* Haag v. Barnes, 9 N.Y.2d 554, 559, 175 N.E.2d 441, 443, 216 N.Y.S.2d 65, 68 (1961) (law chosen must be of jurisdiction with "most significant contacts with the matter in dispute").

The requirement of a "reasonable" relationship between the transaction and the state in contractual choice-of-law disputes has also been endorsed by the Uniform Commercial Code. U.C.C. § 1-105 (1989). Section 1-105 states in relevant part that:

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

Id. § 1-105(1).

98. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 comment f (1971). The comment explains that the forum will not "apply a foreign law which has been chosen by the parties in the spirit of adventure or to provide mental exercise for the judge." *Id.*

To begin with, *any* reason that two freely bargaining parties have for choosing a particular state's laws to govern their contracts should provide a reasonable basis for honoring that choice.⁹⁹ The relationship between the state chosen and either the parties or the contract is irrelevant as far as it relates to upholding the expectations of parties to that contract. By requiring such a relationship, the Restatement merely places the emphasis of section 187 back on state sovereignty, while greatly limiting the ability of parties to freely contract for the law to govern their agreements. As the Restatement itself points out, the parties' choice of law should be upheld even in cases where that choice was made to avoid the laws of one state which may treat their transaction unfavorably.¹⁰⁰ The need for certainty in contract law requires this result. Thus, the first "exception" of the Restatement section 187 has provided the courts with a mechanism for invalidating choice-of-law provisions, despite the wishes of the parties who enter into the agreements.

There is another compelling reason why the California courts should honor choice-of-law provisions in commercial litigation, regardless of whether a relationship between the parties or issue and the state chosen exists. In 1986, the California Legislature passed Assembly Bill 3223, modifying California's choice-of-law doctrine.¹⁰¹ In essence, the statute requires the courts to honor choice-of-law provisions in commercial contracts which designate California as the chosen state of law, re-

99. The *only* time that such a choice should not be honored is when it would automatically invalidate a contract, thereby usurping the purpose of entering into agreements in the first place. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 comment e (1971) ("If parties have chosen a law that would invalidate the contract, it can be assumed that they did so by mistake.").

100. *Id.*

101. Act of Sept. 20, 1986, ch. 968, 1986 Cal. Stat. 3346, 3346-47 (codified as amended as CAL. CIV. CODE § 1646.5 (West Supp. 1990)). This section provides in pertinent part:

[T]he parties to any contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than two hundred fifty thousand dollars (\$250,000), . . . may agree that the law of this state shall govern their rights and duties in whole or in part, *whether or not the contract, agreement, or undertaking or transaction bears a reasonable relation to this state*. This section does not apply to any contract, agreement, or undertaking (a) for labor or personal services, (b) relating to any transaction primarily for personal, family, or household purposes

Nothing in this section shall be construed to limit or deny the enforcement of any provision respecting choice of law in any contract, agreement, or undertaking to which this section does not apply.

CAL. CIV. CODE § 1646.5 (West Supp. 1990) (emphasis added). The same statute that provided for this amendment also amended Chapter 1 of Title 5 of Part 2 of the California Code of Civil Procedure regarding choice of forum and forum non conveniens. See Act of Sept. 20, 1986, ch. 968, Cal. Stat. 3346, 3347-48 (codified as amended at CAL. CIV. PROC. CODE § 410.30-40 (West Supp. 1990)).

regardless of whether the agreement or the parties to the agreement have any relationship to the state whatsoever.¹⁰² The purpose of the statute is to promote California as a leading commercial and financial center by allowing businesses to settle disputes under California law regardless of their connection to the state.¹⁰³

The importance of this legislative action cannot be overstated. It directly supports the autonomy principle in contractual choice-of-law, and at the same time, unquestionably refutes the California judicial system's endorsement of section 187 of the Restatement (Second).¹⁰⁴ Consequently, California courts that continue to require a substantial connection with the chosen state before enforcing choice-of-law provisions directly contradict the express intent of the state legislature. The invalidity of such a position is self-evident.

Finally, based on the United States Supreme Court's decision in *Allstate Insurance Co. v. Hague*,¹⁰⁵ there is no constitutional basis for requiring a substantial relationship between the parties or the issue and the chosen state.¹⁰⁶ In *Allstate*, the Court enunciated its constitutional requirements with regard to choice of law. In doing so, the Court continued its previous expansion of the states' power to decide choice-of-law issues.¹⁰⁷ A four-member plurality of the Court held that "for a State's

102. CAL. CIV. CODE § 1646.5 (West Supp. 1990).

103. At the hearing on Assembly Bill 3223, the California Assembly Committee on the Judiciary stated:

According to the source of this bill, Richard Mosk, a private attorney and arbitrator, the bill is modeled after a similar statute enacted in New York in 1984 for the purpose of fostering New York as an international arbitration center. The sponsor believes this bill would accomplish the same result for California. The bill would enable foreign businesses entering a commercial contract to designate California and the laws of California, a neutral forum, to govern any contract disputes that arise.

Hearing on AB 3223, Assembly Committee on Judiciary, March 31, 1986.

104. See, e.g., *Mencor Enters., Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 438, 235 Cal. Rptr. 464, 468 (1987) ("parties, generally speaking, have power to determine the terms of their contractual engagements") (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971)).

105. 449 U.S. 302 (1981) (Brennan, J., plurality opinion).

106. See *infra* note 110.

107. Note, *supra* note 16, at 1663. ("*Allstate* . . . confirmed and extended the subsequent trend in Supreme Court decisions widening the area of freedom that states enjoy in deciding choice-of-law issues."). *Home Insurance Co. v. Dick* was one of the first cases to deal with the constitutional limitations of choice of law. 281 U.S. 397 (1930). In *Dick*, the United States Supreme Court announced that the fourteenth amendment's Due Process Clause may be used to prevent a forum state from unreasonably applying its own law in conflicts disputes. *Id.* at 411. The case involved a conflict between the use of Mexican and Texan law. *Id.* at 404-05. The forum was Texas, but the only true contact between the case and the state was the fact that the suit was being litigated in Texas (jurisdiction was provided *in rem* through garnishment). *Id.* at 408. The Supreme Court reversed the Texas Supreme Court, holding that the Due Process Clause precluded application of Texas law. *Id.* at 411-12. The Court's rationale

substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."¹⁰⁸ However, the plurality struggled to find the requisite aggregation of contacts that would create a sufficient state interest so that the forum could apply its own law.¹⁰⁹ In that manner, the Court's holding created the now-prevalent view among commentators that there are no true constitutional limitations on choice of law.¹¹⁰ Consequently, the practical result of the decision appears to be

was that the parties had expressly agreed to be bound by Mexico's law and that "Texas law may not validly affect contracts which are neither made nor are to be performed in Texas," thus implying that application of Texas law would have been fundamentally unfair. *Id.* at 410.

In *Alaska Packers Association v. Industrial Accident Commission of California*, the Court addressed whether the Full Faith and Credit Clause of article IV, section 1 of the United States Constitution could restrict the application of a forum's own law by requiring the forum to apply the law of another state. 294 U.S. 532, 539 (1935). Petitioner in the case sought to limit damages to an injured worker through the application of Alaska's workmen's compensation laws. *Id.* The petitioner argued that since the injury took place in Alaska, California was required to give "full faith and credit" to that state's law, despite the fact that the worker had originally contracted to work in Alaska under an agreement made in California. *Id.* Justice Stone, writing for the Court, stated:

[T]he conflict is to be resolved, not by giving automatic effect to the full faith and credit clause, compelling the courts of each state to subordinate its own statutes to those of the other, but by appraising the governmental interests of each jurisdiction, and turning the scale of decision according to their weight.

Id. at 547.

In *Pacific Employers Insurance Co. v. Industrial Accident Commission*, another workmen's compensation case, the Court discarded the *Alaska Packers* balancing test and held that the Full Faith and Credit Clause only required the forum to have *some* interest in the application of its laws. 306 U.S. 493, 504 (1939). The Court thus further removed full faith and credit as a vehicle for compelling a state to apply another state's laws.

108. *Allstate*, 449 U.S. at 312-13 (Brennan, J., plurality opinion).

109. *Id.* at 313. Although he worked in Minnesota, the decedent in the case had resided, obtained insurance, and had been killed in Wisconsin. *Id.* at 305-06. His widow moved to Minnesota after his death and filed in Minnesota state court. *Id.* at 305. Minnesota law allowed the plaintiff to recover under multiple uninsured motorist policies. *Id.* at 305-06. Under Wisconsin law, such stacking of the policies for recovery was not allowed. *Id.* at 306.

110. See Juenger, *Supreme Court Intervention in Jurisdiction and Choice of Law: A Dismal Prospect*, 14 U.C. DAVIS L. REV. 907, 915-16 (1981); Von Mehren & Trautman, *Constitutional Control of Choice of Law: Some Reflections on Hague*, 10 HOFSTRA L. REV. 35, 38 (1981); Weintraub, *Who's Afraid of Constitutional Limitations on Choice of Law?*, 10 HOFSTRA L. REV. 17, 34 (1981).

Significant in the Supreme Court's decision in *Allstate* was the manner in which the Court merged the due process and full faith and credit analyses used in considering constitutional limitations on choice-of-law issues. In its opinion, the Court made clear that it no longer distinguishes between the two types of constitutional violations in regard to choice-of-law questions. The Court stated:

This Court has taken a similar approach in deciding choice-of-law cases under both the Due Process Clause and the Full Faith and Credit Clause. In each instance, the Court has examined the relevant contacts and resulting interests of the State whose

that as long as there is *any* contact with a chosen state sufficient to create a state interest, the Court will allow application of that state's law, even if another state has a materially greater interest. Thus, in applying the *Allstate* test, it appears that *parties' choice of law* would be a sufficient contact to create a state interest which would justify application of that law under constitutional standards.¹¹¹ The California Legislature endorsed this view when it removed the requirement of a substantial relationship

law was applied. Although at one time the Court required a more exacting standard under the Full Faith and Credit Clause than under the Due Process Clause for evaluating the constitutionality of choice-of-law decisions, the Court has since abandoned the weighing-of-interests requirement.

Allstate, 449 U.S. at 308 n.10 (citations omitted) (Brennan, J., plurality opinion).

Even if, as Judge Hand stated, choice-of-law rules could be equated to setting the parameters of the states' legislative power to affect a contractual relationship, an analogy of those rules to the rules that determine judicial jurisdiction further illustrates that the autonomy rule does not overstep the constitutional limitations on choice of law. *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115, 117 (2d Cir. 1931). Through *International Shoe Co. v. Washington* and its progeny, the Supreme Court has made clear that due process, and not federalism, is the basis for determining jurisdictional legitimacy over foreign citizens. 326 U.S. 310 (1945). The Court stated in *Insurance Corp. v. Compagnie Des Bauxites De Guinee*:

It is true that we have stated that the requirement of personal jurisdiction, as applied to state courts, reflects an element of federalism and the character of state sovereignty vis-a-vis other States The restriction on state sovereign power described in *World-Wide Volkswagen Corp.*, however, must be seen as ultimately a function of the individual liberty interest preserved by the Due Process Clause. That Clause is the only source of the personal jurisdiction requirement and the Clause itself makes no mention of federalism concerns. Furthermore, if the federalism concept operated as an independent restriction on the sovereign power of the court, it would not be possible to waive the personal jurisdiction requirement: Individual actions cannot change the powers of sovereignty, although the individual can subject himself to powers from which he may otherwise be protected.

456 U.S. 694, 702 n.10 (1982). Analogously, "where the parties have freely and knowingly chosen the law of a particular state to govern their contract, it is not unfair to hold them to their bargain." Note, *supra* note 16, at 1667.

The Court's emphasis on fundamental fairness in *Allstate* cannot be overstated, as it formed the basis for the rationale behind the decision. In arriving at its result, the Court stated that there was "no element of unfair surprise or frustration of legitimate expectations . . ." 449 U.S. at 318 n.24 (Brennan, J., plurality opinion). Thus, while concerns for state sovereignty are certainly not to be overlooked, the Court has clearly sent a message that due process is the test in choice of law. See W. REESE & M. ROSENBERG, *supra* note 49, at 370 ("*Allstate* suggests that the only serious test is due process. Once due process is satisfied the full-faith requirement fades away.").

111. Justice Stevens, concurring in *Allstate*, stated that a choice-of-law decision by a state "would violate the Due Process Clause if it were totally arbitrary or if it were fundamentally unfair to either litigant." 449 U.S. at 326 (Stevens, J., concurring). Stevens found that "[a] choice of law decision that frustrates the justifiable expectations of the parties can be fundamentally unfair" and further that the "desire to prevent unfair surprise to a litigant has been the central concern in this Court's decisions under the Due Process Clause." *Id.* at 327 (Stevens, J., concurring). Thus, in a contractual choice-of-law situation, a court may be violating the Due Process Clause by not honoring the law chosen by the parties since, as Stevens pointed out, it may be fundamentally unfair not to honor their justified expectations.

with the state through its passage of Assembly Bill 3223.¹¹² In that respect, the courts in California could seemingly resolve issues of involving parties' choice of law quite easily by simply adopting the approach of Assembly Bill 3223—and honoring the parties' intent—regardless of the relationship between the contract and the chosen state.

2. Public policy

Subsection 187(2)(b) of the Restatement provides a second, somewhat less easily defined mechanism through which the courts may escape the effects of a choice-of-law provision.¹¹³ This subsection, known as the "public policy" exception,¹¹⁴ indicates that public policy may be used to invalidate a contractual choice-of-law provision when the law of the chosen state would be "contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue"¹¹⁵ Unfortunately, what constitutes a "fundamental policy" of a state is unclear. Comment g of section 187 explains, "[n]o detailed statement can be made of the situations where a 'fundamental' policy of the state of the otherwise applicable law will be found to exist."¹¹⁶ The Comment continues by stating that "[t]o be 'fundamental,' a policy must in any event be a substantial one."¹¹⁷ Despite the ambiguity as to what constitutes a "fundamental" public policy, the Restatement expresses no reservations as to the right of a state to invalidate an otherwise appropriate choice-of-law provision. As Comment g explains, "[f]ulfillment of the parties' expectations is not the only value in contract law; regard must also be had for state interests and for state regulation."¹¹⁸ Thus, the Restatement, in a manner which appears to defy its stated purpose,¹¹⁹ endorses state sovereignty as a primary factor in determining the validity of choice-of-law provisions.

112. Act of Sept. 20, 1986, ch. 968, 1986 Cal. Stat. 3346, 3346-47 (codified as amended at CAL. CIV. CODE § 1646.5 (West Supp. 1990)). See *supra* notes 101-04 and accompanying text.

113. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971).

114. See *Barnes Group, Inc. v. C & C Prods., Inc.*, 716 F.2d 1023, 1039 (4th Cir. 1983).

115. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971).

116. *Id.* comment g.

117. *Id.*

118. *Id.*

119. *Id.* comment e. Comment e explains the rationale of the Restatement approach: to protect the justified expectations of parties entering into contractual agreements, by "letting the parties choose the law to govern the validity of [their] contract[s] and the rights created thereby." *Id.* The comment states further that "[g]iving parties this power of choice is also consistent with the fact that, in contrast to other areas of the law, persons are free within broad limits to determine the nature of their contractual obligations." *Id.* It would be difficult to find a more definitive endorsement of the doctrine of party autonomy.

An example of a California court's reliance on the public policy exception is *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*¹²⁰ In *Frame*, a California employee of Merrill Lynch sought a determination that he did not forfeit his profit-sharing rights under his employment contract when he resigned and took employment with a competitor of Merrill Lynch.¹²¹ The contract designated New York law as controlling,¹²² and contained a forfeiture provision which was valid under New York law but invalid under California law.¹²³ The court held that California law governed on the issue of the forfeiture agreement, despite the presence of the choice-of-law provision.¹²⁴ While recognizing the parties' general right to choose the law that would govern their agreement,¹²⁵ the court nonetheless held that public policy foreclosed the state from recognizing the existence of the provision.¹²⁶

Despite the apparent endorsement of the public policy exception in *Frame*, the difficulty in applying the exception is well noted by scholars and jurists alike.¹²⁷ Most of the criticism surrounds the ambiguity of what constitutes a state's fundamental public policy and the ease with which courts are able to invoke the exception.¹²⁸ Perhaps the best illustration of the problem is *Barnes Group, Inc. v. C & C Products, Inc.*¹²⁹

Barnes Group involved a breach of a non-competition clause in an

120. 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971).

121. *Id.* at 670, 97 Cal. Rptr. at 812.

122. *Id.* at 673, 97 Cal. Rptr. at 814.

123. *Id.*

124. *Id.* at 674, 97 Cal. Rptr. at 814.

125. *Id.* at 673, 97 Cal. Rptr. at 814. The court began by announcing its recognition of the validity of contractual choice-of-law provisions by stating that "contracting parties may by agreement specify what law is to control their contract . . ." *Id.* The court, however, then qualified this assertion based on the public policy exception, requiring the "enforcement of the contract by a local court in accordance with the foreign law agreed to be controlling does not result in an evasion of the settled public policy or a statute of the forum protecting its citizens." *Id.* (quoting trial court).

126. *Id.* The court said that "an agreement designating applicable law will not be given effect if it would violate a strong California public policy." *Id.* Further, California's doctrine on the forfeiture issue was found to represent a "strong public policy," which, the court held, the choice-of-law provision would not be allowed to defeat. *Id.*

127. See, e.g., *Barnes Group*, 716 F.2d at 1039 (Murnaghan, J., concurring in part and dissenting in part). Judge Murnaghan stated in *Barnes Group* that "the fundamental policy exception to the general rule of § 187 [may] become 'an escape valve out of which all the predictability and certainty of the autonomy rule [honoring contractual choices of law] flows,' [and may, therefore] threaten to swallow the rule." *Id.* (Murnaghan, J., concurring in part and dissenting in part) (quoting Note, *Effectiveness of Choice-of-Law Clauses in Contract Conflicts of Law: Party Autonomy or Objective Determination?*, 82 COLUM. L. REV. 1659, 1673 (1982)).

128. Friedler, *supra* note 6, at 495.

129. 716 F.2d 1023 (4th Cir. 1983).

agreement in which the parties had stipulated that Ohio law would govern their transaction.¹³⁰ The plaintiff in the case sought recovery for the defendant's alleged tortious interference with contracts that the plaintiff maintained with certain of its sales agents, some of whom worked in Alabama.¹³¹ Under Alabama law, covenants not to compete were void; however, in Ohio, the covenants were valid.¹³² The defendant sought to defeat the choice-of-law provision which designated the application of Ohio law on grounds that under Alabama law covenants not to compete were against public policy.¹³³ In applying section 187 of the Restatement (Second),¹³⁴ the Fourth Circuit described the public policy exception as the "most vexing element of the Restatement (Second) formulation, in determining whether to adhere to [a] contractual choice-of-law provision."¹³⁵ The court stated further that "[i]t is apparent that there can be no clear-cut delineation of those policies that are sufficiently 'fundamental,' within the meaning of [section] 187(2)(b), to warrant overriding a contractual stipulation of controlling law."¹³⁶ Nonetheless, the court overruled the parties' choice of law by applying Alabama law and voiding the covenant not to compete.¹³⁷ The majority concluded that "[t]o honor the contractual choice of law would make enforceable a contract flatly unenforceable in Alabama, surely impinging upon the 'fundamental policy' of Alabama."¹³⁸

The court, which itself invoked the public policy exception while espousing the difficulty of its application,¹³⁹ appeared to demonstrate disdain for party autonomy by overriding the parties' choice of law. Moreover, the court, in its rush to invalidate the choice-of-law provision,

130. *Id.* at 1028.

131. *Id.* at 1027.

132. *Id.* at 1032.

133. *Id.* at 1028.

134. *Id.* at 1029.

135. *Id.* at 1030.

136. *Id.* at 1031.

137. *Id.* at 1032. The court distinguished between situations in which the contractually chosen law merely diverges slightly from that of the state whose law would otherwise apply, and situations in which the chosen law would validate an otherwise unenforceable contract. *Id.* The court stated:

[N]ot every situation where contractually chosen law diverges merely in degree from that of the state whose law would otherwise apply impinges upon the fundamental policy of that state At the other extreme, it seems apparent that where the law chosen by the parties would make enforceable a contract flatly unenforceable in the state whose law would otherwise apply, to honor the choice-of-law provision would trench upon the state's "fundamental policy."

Id. at 1031.

138. *Id.* at 1032.

139. *Id.* at 1030-31.

misapplied the requirements of section 187(2)(b) by never analyzing whether Alabama had a materially greater interest than Ohio on the issue of determining the validity of covenants not to compete.¹⁴⁰ The end result not only failed to protect the expectations of the parties, but it also undermined the other goals of contract law: providing certainty, predictability and uniformity of results.¹⁴¹

In this manner, *Barnes Group* demonstrated the inherent difficulties in applying the fundamental policy exception: (1) that no clear-cut analysis exists to determine when a state policy is fundamental and when it is not; and, (2) application of the exception often overrides the wishes of the parties who enter into contractual agreements. Despite these difficulties, however, public policy still remains the primary justification for the invalidation of contractual choice-of-law provisions in the law today.¹⁴²

D. The Creation of Uncertainty: California Relies on the Restatement Approach

Today, the Restatement approach is the method of choice in California for the interpretation of contractual choice-of-law provisions.¹⁴³ However, because of the difficulty in applying the approach, fundamental problems involving contract law have arisen with respect to its use, particularly in the enforcement of commercial lending agreements.

One of the first and most well-known California cases to abandon governmental interest in favor of Restatement section 187 in the interpretation of a choice-of-law provision in lending agreements is *Gamer v. duPont Glore Forgan, Inc.*¹⁴⁴ *Gamer*, decided in 1976, involved the enforcement of a choice-of-law provision which selected New York law to govern a contract for a margin account between an individual and his stockbroker.¹⁴⁵ The plaintiff in *Gamer* complained that the provision amounted to a waiver of his rights under the California usury laws, and that it therefore should not have been honored by the lower California

140. The Restatement approach calls for an objective determination of the states which have contacts with the issue, a subjective analysis of which state has the most significant relationship, and finally a determination of whether that state's fundamental policy has been violated. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971).

141. *Id.* § 187 comment e.

142. See Horowitz, *supra* note 5, at 766-67; Mullenix, *Another Choice of Forum, Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 FORDHAM L. REV. 291, 352-53 (1988); Prebble, *supra* note 13, at 509-12; Note, *supra* note 16, at 1674-77.

143. See, e.g., *Mencor Enters. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 438-40, 235 Cal. Rptr. 464, 468-70 (1987).

144. 65 Cal. App. 3d 280, 135 Cal. Rptr. 230 (1976).

145. *Id.* at 283, 135 Cal. Rptr. at 231.

courts.¹⁴⁶ Despite this argument, the *Gamer* court upheld the parties' choice of law. However, in doing so, the court qualified the circumstances under which choice-of-law provisions would be honored.¹⁴⁷ The court's analysis relied on the test laid out in Restatement section 187. The court focused on both the relationship of the contract with New York, and whether or not the public policy exception of 187(2)(b) was applicable.¹⁴⁸ The court dealt with the latter issue first by quoting *Frame* in enunciating its attitude towards public policy:

As a general rule, it is said that contracting parties may by agreement specify what law is to control their contract if "enforcement of the contract by a local court in accordance with the foreign law agreed to be controlling does not result in an evasion of the settled public policy or a statute of the state of the forum protecting its citizens."¹⁴⁹

The court determined, however, that even though the rate of interest being charged by the broker exceeded the legal rate then permitted in California, it *was* permitted under the laws of New York and, on that basis, the agreement did not offend public policy.¹⁵⁰ Additionally, since the defendant's principal place of business was New York, the court found that the relationship of the contract with New York was sufficient to warrant honoring the choice-of-law provision.¹⁵¹ However, despite upholding the provision, it is the manner in which the *Gamer* court analyzed the validity of the parties' choice of law which illustrates why the Restatement approach is fundamentally inconsistent.

Rather than presuming the validity of the provision, the court in *Gamer* assumed the opposite and applied the Restatement in a manner which suggests that the exceptions of section 187(2) can more accurately

146. *Id.* at 285, 135 Cal. Rptr. at 232.

147. *Id.* at 286-87, 135 Cal. Rptr. at 233.

148. *Id.* at 287-88, 135 Cal. Rptr. at 234 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971)).

149. *Id.* at 287, 135 Cal. Rptr. at 233 (quoting *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 673, 97 Cal. Rptr. 811, 814 (1971)).

150. *Id.* at 290, 135 Cal. Rptr. at 235. In determining whether California public policy had been offended, the court invoked section 203 of the Restatement (Second) of Conflict of Laws, which states:

The validity of a contract will be sustained against the charge of usury if it provides for a rate of interest that is permissible in a state to which the contract has a substantial relationship and is not greatly in excess of the rate permitted by the general usury law of the state of the otherwise applicable law under § 188.

Id. at 288, 135 Cal. Rptr. at 234 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 203 (1971)).

151. *Gamer*, 65 Cal. App. 3d at 289, 135 Cal. Rptr. at 234-35.

be viewed as limitations.¹⁵² Rather than emphasizing the need for upholding the parties' expectations and focusing on the certainty that the choice-of-law provision was intended to provide, the court instead searched for reasons not to honor the parties' intent.¹⁵³ The practical result of the *Gamer* decision is that the "exceptions" were used to swallow up the general rule of the Restatement which favors enforcement of the parties' choice of law.¹⁵⁴ In doing so, the use of the Restatement in *Gamer* created an issue of even greater concern than the mere application of the test itself.¹⁵⁵

By qualifying the circumstances under which choice-of-law provisions will be honored, *Gamer* has taken much of the certainty which is necessary in lending relationships out of the hands of contracting parties. Instead, contractual autonomy has been replaced with judicially created qualifications which disfavor parties' intent and which have made it extremely difficult for businesses to plan effectively since they can never be sure which laws may govern their contracts. As noted previously, abandoning party autonomy could be especially detrimental to certainty in

152. *Id.* at 285, 135 Cal. Rptr. at 232. The court stated the issue was whether the parties' choice-of-law was *invalid* because the contract had no substantial relationship with New York, or because the parties' choice would "do violence" to California public policy. *Id.*

153. *Id.* at 287-89, 135 Cal. Rptr. at 234-35.

154. Friedler, *supra* note 6, at 490.

155. Prior to *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964), there are few examples of parties attempting to use the courts to invalidate contractual choice-of-law provisions, and none in which a California appellate court refused to honor the intent of the parties who stipulated their choice of law in a lending agreement. *Boole v. Union Marine Ins. Co.* is perhaps the earliest example of the courts' treatment of such provisions, and established the view that the courts in California are bound by the parties' choice of law. 52 Cal. App. 207, 198 P. 416 (1921). *Boole* involved a marine insurance policy. *Id.* at 208, 198 P. at 416. The issue in the case centered around whether a constructive total loss of a ship had occurred. *Id.* at 210-11, 198 P. at 417. California and English law differed on the question; however, the majority in *Boole* enforced a provision in the policy that all claims for loss under the policy were to be adjusted according to English law. *Id.* The court held that

the parties . . . may agree to be bound by the law of a foreign jurisdiction . . . , and may stipulate that the policy shall be construed and governed by the laws, usages, and customs of a foreign state, and such laws, usages, and customs of a foreign state as are applicable shall be deemed to be a part of the written contract.

Id. at 209-10, 198 P. at 417. The issue in *Boole* did not involve validation of a party's promise as it had in *Ury*, 227 Cal. App. 2d at 15, 38 Cal. Rptr. at 379, and *Gamer*, 65 Cal. App. 3d at 283, 35 Cal. Rptr. at 231, but rather dealt with the interpretation of a term in an insurance policy. *Boole*, 52 Cal. App. at 208, 198 P. at 416. Nonetheless, it was that interpretation which was dispositive as to the outcome of the case, and therefore the *Boole* holding can be seen as supporting the general principle of autonomy in choice of law in California. See also *People v. Globe & Rutgers Fire Ins. Co.*, 96 Cal. App. 2d 571, 573, 216 P.2d 64, 65-66 (1950) (contractual provision that insurance policy was "[w]arranted to be subject to English law and usage as to liability for and settlement of any and all claims" given effect in determining computation of particular average loss).

the enforcement of commercial lending arrangements.¹⁵⁶ Another more recent California case illustrates this point well.

In *Mencor Enterprises, Inc. v. Hets Equities Corp.*,¹⁵⁷ a California borrower sued a Colorado lender for treble the amount of interest paid by the borrower on a promissory note.¹⁵⁸ The trial court sustained the lender's demurrer to the complaint for usury without leave to amend, holding as a matter of law that the Colorado interest rate selected by the parties did not constitute usury entitling the California borrower to sue for damages under California usury law.¹⁵⁹ The Court of Appeal reversed.¹⁶⁰ The appellate court held that the trial court committed reversible error in failing to examine "the reasonable relationship of the contract to Colorado, the substantial contacts of the parties with Colorado and consideration of California's fundamental policy with respect to usury."¹⁶¹

Mencor Enterprises represents the culmination of the California courts' recent interpretations of Restatement section 187.¹⁶² Unfortunately, the case also stands for the notion that party autonomy is *not* the primary consideration in interpreting choice-of-law provisions in contractual agreements in California. Part of the reason for this may rest with the apparently inconsistent approach of the Restatement itself.¹⁶³ However, regardless of where the fault lies, parties entering into commercial lending agreements which are later litigated in California cannot be certain that the law of the state they have chosen to govern their agreements will be applied. For these reasons, this Comment proposes a manner in which choice-of-law provisions in commercial lending agreements may be drafted so as to force the California courts to honor the intent of the parties involved.

E. Resolution of the Problem

Given the California courts' endorsement of section 187 of the Restatement¹⁶⁴ and the inherent uncertainty that the Restatement approach

156. See *supra* notes 24-33 and accompanying text.

157. 190 Cal. App. 3d 432, 235 Cal. Rptr. 464 (1987).

158. *Id.* at 434, 235 Cal. Rptr. at 465.

159. *Id.*

160. *Id.* at 441, 235 Cal. Rptr. at 470.

161. *Id.*

162. The *Mencor Enterprises* court relied on both *Gamer* and *Ury* in its decision. 190 Cal. App. 3d at 440, 235 Cal. Rptr. at 469-70 (citing *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal. App. 3d 280, 135 Cal. Rptr. 230 (1976); *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964)).

163. See *supra* notes 55-104 and accompanying text.

164. See *Mencor Enters., Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 438, 235 Cal.

fosters,¹⁶⁵ parties to commercial lending litigation in California have only one option to assure that their choice of law will be honored: move the litigation out of California to a court of the state designated by the parties in their agreement. Only in this manner can the parties assure that the California courts will not abrogate their intent by refusing to enforce choice-of-law provisions in those agreements. Removal of the litigation from California to a court of the parties' choosing can easily be accomplished by adding two provisions to lending agreements in addition to the parties' choice of law. The first is a mandatory choice-of-forum provision; the second, consent to jurisdiction by the parties to the chosen state.

This part of the Comment examines the endorsement of contractual choice-of-forum and consent-to-jurisdiction clauses by the United States Supreme Court and by the California courts. The Comment then examines recent case law which distinguishes between parties' mandatory and permissive contractual forum selection. The section concludes that parties to commercial lending litigation in California can choose to litigate in a state outside of California that will honor their choice of law, but to make a specific choice of forum effective, the parties must specify the chosen venue with mandatory language which coincides with both parties' consent-to-jurisdiction.

1. Choice-of-forum provisions

In *The Bremen v. Zapata Off-Shore Co.*,¹⁶⁶ the United States Supreme Court endorsed the validity of choice-of-forum provisions by stating unequivocally that "such clauses are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances."¹⁶⁷ The Court held that the burden of proving that the forum selected by the contracting parties was unreasonable rested on the resisting party to demonstrate evidence of fraud, duress, or other overreaching behavior in the formation of the contract.¹⁶⁸ In its decision, the Court explained its rationale, stating that "[t]here are compelling reasons why a freely negotiated private . . . agreement, unaffected by fraud, undue influence, or overweening bargaining power . . . should be given full effect. . . . The elimination of . . . uncertainties by agreeing in advance on a forum acceptable to both parties is

Rptr. 464, 468 (1987); *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal. App. 3d 280, 288, 135 Cal. Rptr. 230, 234 (1976).

165. See *supra* notes 143-63 and accompanying text.

166. 407 U.S. 1 (1972).

167. *Id.* at 10.

168. *Id.* at 15.

an indispensable element in . . . trade, commerce, and contracting."¹⁶⁹

By rejecting the hostility with which choice-of-forum clauses had traditionally been viewed by the courts,¹⁷⁰ and emphasizing the importance of certainty in consensual agreements,¹⁷¹ the Court in *Bremen* made clear that choice-of-forum clauses will always be upheld in the absence of extreme hardship that would deprive the resisting party of a meaningful day in court.¹⁷² Thus, the use of choice-of-forum provisions to select where disputes arising from contractual agreements will be adjudicated is now accepted by the courts¹⁷³ and lays the foundation for honoring choice-of-forum provisions in lending agreements in California commercial litigation.

The California Supreme Court has also held that forum-selection clauses will be given effect absent a showing that enforcement would be unfair or unreasonable. In *Smith, Valentino & Smith v. Superior Court*,¹⁷⁴ a contract between a Pennsylvania corporation doing business in California and a California corporation included a forum-selection clause requiring each party to litigate any disputes in the other's forum.¹⁷⁵ The court, relying on *Bremen*, first disposed of the petitioner's assertion that forum-selection clauses were "per se" invalid as constituting attempts to oust courts' of their jurisdiction by declaring that such assertions are "hardly more than a vestigial legal fiction' which ' . . . reflects something of a provincial attitude regarding the fairness of other tribunals.'"¹⁷⁶ The court expressed unequivocal support for the use of

169. *Id.* at 12-14.

170. *Id.* at 9. See also Recent Decisions, *Jurisdiction*, 6 VAND. J. TRANSNAT'L L. 309, 311-12 (1972). Most of the resistance to honoring the provisions was built around the same arguments that initially created difficulties in enforcing choice-of-law provisions. Some courts saw forum selection as an ouster of jurisdiction and therefore a usurpation of the legislative function. *Id.*

171. *Id.* at 13-14.

172. *Bremen*, 407 U.S. at 18. The Court acknowledged that the forum selection clause in question was negotiated at arm's length by sophisticated, knowledgeable businessmen, and concluded that the clause was a vital part of the agreement on which the parties had relied in contracting. *Id.* at 12.

173. See *Docksider Ltd. v. Sea Technology Ltd.*, 875 F.2d 762 (9th Cir. 1989) for a recent decision affirming this view. See also *Pelleport Investors, Inc., v. Budco Quality Theatres, Inc.*, 741 F.2d 273, 280 (9th Cir. 1984) (forum selection clause to be enforced absent evidence of fraud, undue influence, overwhelming bargaining power or serious inconvenience in litigating in selected forum).

174. 17 Cal. 3d 491, 551 P.2d 1206, 131 Cal. Rptr. 374 (1976).

175. *Id.* at 494, 551 P.2d at 1208, 131 Cal. Rptr. at 376.

176. *Id.* at 495, 551 P.2d at 1208, 131 Cal. Rptr. at 376 (quoting *The Bremen v. Zapata Off-Shore Oil Co.*, 407 U.S. 1, 12 (1972)). In support of this view, *Smith* cited *Central Contracting Co. v. Maryland Casualty Co.*, 367 F.2d 341 (3d Cir. 1966). *Smith*, 17 Cal. 3d at 495, 551 P.2d at 1209, 131 Cal. Rptr. at 377. In *Central Contracting*, the Third Circuit held "It is becoming

such clauses by stating that forum-selection clauses will always be given effect "unless the party assailing the clause establishes that . . . the forum selected would be unavailable or unable to accomplish substantial justice."¹⁷⁷ Finally, in upholding the clause in question, the court declared that "[n]o satisfying reason . . . has been suggested why enforcement should be denied a forum selection clause appearing in a contract entered into freely and voluntarily by parties who have negotiated at arm's length."¹⁷⁸ In this manner, California endorsed the use of forum-selection provisions in commercial agreements.

Under *Bremen* and *Smith*, the California courts are bound to respect the wishes of parties who choose to have their cases heard in forums outside of the state. Absent overreaching behavior, the California courts are powerless to undermine the parties' choice. Thus, by including a choice-of-forum provision in their agreements, parties to commercial lending agreements may effectively move their litigation out of California into a forum which will respect their true intentions when entering into such agreements. However, in order to do so, parties must make sure that their court of choice has proper jurisdiction to hear their case. This can be achieved through the use of consent-to-jurisdiction clauses.

2. Consent-to-jurisdiction provisions

Consent-to-jurisdiction provisions are a second, equally important tool for assuring that parties to commercial lending agreements can litigate in a state which will honor their choice of law. By stipulating in advance to submit to the jurisdiction of a particular state for any disputes arising out of their agreements, parties can make sure that their choice of venue, and thus, their choice of law, is implemented in enforcing the terms under which they have contracted. Below is a brief summary of relevant case law illustrating support for this proposition both at the federal level and in California.

The United States Supreme Court endorsed the validity of parties' consent to jurisdiction in *National Equipment Rental, Ltd. v. Szukhent*.¹⁷⁹ In *Szukhent*, the Court held that "it is settled . . . that parties to a contract may agree in advance to submit to the jurisdiction of a given

more widely recognized that for reasons of business or convenience the parties may have bargained that all litigation arising out of their complex activity under a contract shall be drawn into one jurisdiction." *Central Contracting*, 367 F.2d at 344-45.

177. *Smith*, 17 Cal. 3d at 494, 551 P.2d at 1208, 131 Cal. Rptr. at 376.

178. *Id.* at 495, 551 P.2d at 1209, 131 Cal. Rptr. at 377.

179. 375 U.S. 311 (1964).

court.”¹⁸⁰ In this manner, and in accord with its previous decision in *Bremen* endorsing forum selection by the parties,¹⁸¹ the Court expanded its view that parties may consent to the jurisdiction of a chosen court, and thus determine where disputes arising out of their contracts will be litigated.

The view that parties may agree in advance to submit to the jurisdiction of a chosen court has also been endorsed by the California courts. *Berard Construction Co. v. Municipal Court*¹⁸² is a good example of a California court upholding a consent-to-jurisdiction clause in a commercial contract. The suit involved a lease agreement¹⁸³ under which the plaintiff sued for breach of contract.¹⁸⁴ The defendant in the case moved to dismiss for lack of jurisdiction.¹⁸⁵ The relevant provision in the contract read as follows:

This lease is executed in Los Angeles, California, and shall be construed under the laws of the State of California, and the parties hereto agree that any action relating to this lease shall be instituted and prosecuted in the courts in Los Angeles County and each party waives the right to change of venue.¹⁸⁶

The municipal court called the paragraph “a venue provision, not a jurisdiction provision.”¹⁸⁷ However, the appellate court reversed, holding that the provision was an “unequivocal consent to the jurisdiction of the California courts,” and that “[t]he waiver of the ‘right to change of venue’ does not detract from the effect of this consent; it merely precludes either party from seeking to change the place of trial to another court.”¹⁸⁸ Thus, the defendant’s consent was given effect.¹⁸⁹

As the cases illustrate, parties’ ability to expressly submit to the jurisdiction of a court of their choosing is unquestioned. Thus, as with choice-of-venue provisions, California courts must honor parties’ consent-to-jurisdiction clauses in commercial lending agreements.

180. *Id.* at 315-16.

181. *Bremen*, 407 U.S. at 9-10.

182. 49 Cal. App. 3d 710, 122 Cal. Rptr. 825 (1975).

183. *Id.* at 720, 122 Cal. Rptr. at 832.

184. *Id.* at 712, 122 Cal. Rptr. at 826.

185. *Id.*

186. *Id.* at 720-21, 122 Cal. Rptr. at 832 (emphasis omitted).

187. *Id.* at 721, 122 Cal. Rptr. at 832.

188. *Id.*

189. *Id.* at 722, 122 Cal. Rptr. at 833. The court stressed that the petitioner’s claim that he was unaware of, and had not read, the consent-to-jurisdiction provision in the contract was not a legitimate defense to its enforcement. *Id.* Rather, the court stated, “One who signs a contract must exercise, in doing so, the care of a reasonably prudent person in the circumstances. If he has failed to read it, its provisions bind him nevertheless.” *Id.*

3. The use of mandatory language

The prevailing view today is that choice-of-forum and consent-to-jurisdiction provisions will always be honored where the provisions are used concurrently in contractual agreements and the parties' choice of forum is specified with *mandatory* language.¹⁹⁰ Authority supporting this proposition can be found in a recent Ninth Circuit opinion rendered in *Docksider Ltd. v. Sea Technology, Ltd.*¹⁹¹

In *Docksider*, the parties entered an agreement whereby the plaintiff was granted a license to distribute equipment manufactured by Sea Tech.¹⁹² The agreement provided as follows:

This agreement shall be deemed to be a contract made under the laws of the State of Virginia, United States of America, and for all purposes shall be interpreted in its entirety in accordance with laws of said State. Licensee hereby agrees and consents to the jurisdiction of the courts of the State of Virginia. Venue of any action brought hereunder shall be deemed to be in Gloucester County, Virginia.¹⁹³

A dispute arose under the contract and *Docksider* filed suit in the United States District Court for the Central District of California.¹⁹⁴ Sea Tech filed a motion to dismiss, claiming that the court lacked subject matter jurisdiction on the basis of the forum-selection clause.¹⁹⁵ The district court granted the motion, and on appeal, the Ninth Circuit affirmed.¹⁹⁶

The sole issue before the appellate court in *Docksider* was whether the venue clause contained in the contract was mandatory or permissive and, therefore, whether or not the court was bound to honor it, or if the parties' choice of venue was only one of many jurisdictions where suit could be maintained.¹⁹⁷ *Docksider* contended that the clause was permissive, being merely a consent to the jurisdiction of Virginia.¹⁹⁸ Sea Tech claimed that the clause was mandatory, vesting jurisdiction *and* venue exclusively in the state court for the County of Gloucester, Vir-

190. See *Docksider*, 875 F.2d at 763; *Sterling Forest Assoc. v. Barnett-Range Corp.*, 840 F.2d 249, 251 (4th Cir. 1988); *Nascone v. Spudnuts*, 735 F.2d 763, 764 (3d Cir. 1984); *In re Fireman's Fund Ins. Co.*, 588 F.2d 93, 94 (5th Cir. 1979).

191. 875 F.2d 762 (9th Cir. 1989).

192. *Id.* at 763.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.*

ginia.¹⁹⁹ The majority in *Docksider* found that the clause was mandatory and therefore *required* enforcement.²⁰⁰ The court reasoned that “Docksider not only consented to the jurisdiction of the state courts of Virginia, but further agreed by mandatory language that the venue for all actions arising out of the license agreement would be Gloucester County, Virginia.”²⁰¹ Further, the court distinguished permissive consent to jurisdiction from mandatory consent by pointing to another Ninth Circuit case, *Hunt Wesson Foods, Inc. v. Supreme Oil Co.*,²⁰² to demonstrate an example of a clause held to be permissive.²⁰³ The clause quoted from *Hunt Wesson* read as follows:

“Buyer and Seller expressly agree that the laws of the State of California shall govern the validity, construction, interpretation and effect of this contract. The courts of California, County of Orange, shall have jurisdiction over the parties in any action at law relating to the subject matter of the interpretation of the contract.”²⁰⁴

The critical difference between the language used in *Docksider* and that in *Hunt Wesson* was that the clause in *Docksider* contained the additional sentence that “[v]enue of any action brought hereunder shall be deemed to be in Gloucester County, Virginia.”²⁰⁵ The *Docksider* court held that this language required enforcement because *Docksider* had not only consented to the jurisdiction of the state courts of Virginia, but had further agreed by *mandatory* language that the venue for all actions arising out of the licensing agreement would be Gloucester County, Virginia.²⁰⁶ The court stated that “in cases in which forum selection clauses have been held to require litigation in a particular court, the language of the clauses clearly required *exclusive* jurisdiction.”²⁰⁷ Further, the court found that whether or not other states might otherwise have jurisdiction over actions arising from the agreement, all actions *had to be* filed and prosecuted in Virginia.²⁰⁸ In that respect, if the language in *Docksider* had

199. *Id.*

200. *Id.* at 764.

201. *Id.*

202. 817 F.2d 75 (9th Cir. 1987).

203. *Docksider*, 875 F.2d at 763-64 (citing *Hunt Wesson Foods, Inc. v. Supreme Oil Co.*, 817 F.2d 75 (9th Cir. 1987)).

204. *Id.* (quoting *Hunt Wesson Foods, Inc. v. Supreme Oil Co.*, 817 F.2d 75, 77 (9th Cir. 1987)).

205. *Id.* at 764.

206. *Id.*

207. *Id.* (quoting *Hunt Wesson Foods, Inc. v. Supreme Oil Co.*, 817 F.2d 75, 77 (9th Cir. 1987)) (emphasis in original).

208. *Id.*

been more specific, the question as to proper venue might never have arisen.²⁰⁹

The prevailing rule that has emerged from *Docksider* and other cases is that when consent-to-jurisdiction clauses are accompanied by choice-of-forum clauses which require exclusive interpretation, then the courts have no choice but to enforce the choice-of-forum clauses and grant exclusive jurisdiction.²¹⁰ As such, it appears that the use of such clauses by the parties to lending agreements in conjunction with choice-of-law provisions is the only viable method to assure that the parties' choice of law will be honored. However, even in the face of these protective clauses, there is still one possible barrier to upholding the parties' wishes that California courts may attempt to use to invalidate the parties' choice of law. It involves the doctrine of unconscionability.

F. Addressing the Potential Problem of Unconscionability

As indicated above, parties' ability to determine where disputes arising from their contracts will be litigated is endorsed by the modern case law, both at the federal level and in California state-court decisions.²¹¹ Conversely, the ability to choose a situs for litigation which correlates to the parties' choice of law *should* ensure that the choice of law will be honored. Nonetheless, given the California courts' prior treatment of parties' contractual choice of law in general,²¹² the courts' reaction to the

209. The ensuing litigation might have been prevented if the provision in question had been made clearer by adding the statement: "This provision is *mandatory* and *not permissive*, unless waived by lender."

210. *Docksider*, 875 F.2d at 764; *see also Sterling Forest*, 840 F.2d at 250 (following provision held mandatory: "This agreement shall be construed and enforced in accordance with the laws of the State of California and the parties agree that in any dispute jurisdiction and venue shall be in California."); *Nascone*, 735 F.2d at 764 (following provision characterized as "reasonable" and "explicit": "This franchise shall be construed according to the laws of the State of Utah, and venue for any proceeding relating to the provisions shall be Salt Lake County, State of Utah."); *Fireman's Fund*, 588 F.2d at 94 (provision which stated: "If the Sub-contractor shall institute any suit or action for the enforcement of any of the obligations under this agreement, the venue of such suit or action shall be laid in the County of Essex and State of New Jersey," valid to lay venue in New Jersey). Thus, where venue is specified with mandatory language, the clause will be enforced. When only jurisdiction is specified, the clause will generally not be enforced without some further language indicating the parties' intent to make jurisdiction exclusive. *See Docksider*, 875 F.2d at 764.

211. *See supra* notes 166-78 and accompanying text.

212. *See Mencor Enters. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 435, 235 Cal. Rptr. 464, 466 (1987) (court invalidates parties' choice of law of Colorado in lending agreement as against public policy under California usury laws, despite legality under Colorado usury law); *Gamer v. duPont Glove Forgan, Inc.*, 65 Cal. App. 3d 280, 287-88, 135 Cal. Rptr. 230, 234 (1976) (court upholds parties' choice of California law in lending agreement, but qualifies circumstances under which parties' choices will be honored as per Restatement (Second) of Con-

methodology proposed above will probably be hostile.

California courts could attempt to invalidate mandatory choice-of-forum or consent-to-jurisdiction provisions by invoking the doctrine of unconscionability. In that way, parties' ability to move commercial lending litigation out of California to a state which will honor their choice of law could be frustrated. However, through proper draftsmanship and careful consideration of the process used in creating financing agreements, the parties should be able to avoid judicial invalidation of the proposed provisions.

This part of the Comment discusses the concept of unconscionability and how it has been used in California to invalidate contractual clauses. The Comment further discusses the manner in which unconscionability has been applied in invalidating procedural provisions in lending agreements, and concludes that unconscionability could be used by the courts in California to invalidate choice-of-forum or consent-to-jurisdiction provisions in lending agreements, thus invalidating the parties' choice of law in the process.

1. The meaning of unconscionability

Section 2-302 of the Uniform Commercial Code provides that:

If [a] court as a matter of law finds [a] contract or any clause of [a] contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.²¹³

While the Code does not attempt a precise definition of unconscionability,²¹⁴ the concept has been described in case law as "an absence of meaningful choice on the part of one of the parties [to a transaction] together with contract terms which are unreasonably favorable to the other party."²¹⁵ Phrased another way, unconscionability is said to have both a

flict of Laws); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d. 668, 673, 97 Cal. Rptr. 811, 814 (1971) (parties' choice of New York law to govern forfeiture agreement struck down by court as against public policy).

213. U.C.C. § 2-302 (1987). While Article Two of the Uniform Commercial Code applies to sales contracts, it provides a general illustration of the manner in which the concept may be used in invalidating any or all clauses in a contractual agreement.

214. *Id.* The Code does mention, however, that the "basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract." *Id.* official comment 1. See also J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* 406-07 (3d ed. 1987).

215. *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965).

“procedural” element and a “substantive” element.²¹⁶

The procedural element of unconscionability focuses on two factors: “oppression” and “surprise.”²¹⁷ Oppression has been defined as gross inequality of bargaining power resulting in no real negotiation and thus placing one party in a position where it is forced to accept the terms of the contract as offered.²¹⁸ Surprise, on the other hand, entails the extent to which the supposedly agreed-upon terms of the bargain are hidden in a printed form drafted by the party seeking to enforce the disputed terms.²¹⁹ Characteristically, procedural unconscionability involves a form contract, drafted by a party with a superior bargaining position,²²⁰ and which entails terms which are not read or understood by the non-drafting party.²²¹

Substantive unconscionability has been discussed in cases in terms of “overly harsh” or “one-sided” results.²²² However, one commentator has pointed out that “unconscionability turns not only on a ‘one-sided’ result, but also on an absence of ‘justification’ for it.”²²³ This means that substantive unconscionability must be evaluated as of *the time a contract is made*.²²⁴ Thus, if a contract may be characterized as an allocation of risks between the parties, then a contractual term is “substantively suspect” if it reallocates the risks of a bargain in an objectively unreasonable or unexpected manner.²²⁵

Unconscionability has most commonly been used by the courts in consumer sales transactions, where the opportunity for oppressive terms seems the greatest.²²⁶ Additionally, most of the cases in which uncon-

216. *Industrialease Automated & Scientific Equip. Corp. v. R.M.B. Enters.*, 58 A.D.2d 482, 487 n.4, 396 N.Y.S.2d 427, 431 n.4 (1977); Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485, 487 (1967).

217. *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 486, 186 Cal. Rptr. 114, 121 (1982). See also *Geldermann & Co. v. Lane Processing*, 527 F.2d 571, 575 (8th Cir. 1975) (“Two important considerations are whether there is a gross inequality of bargaining power . . . and whether the aggrieved party was made aware of . . . the provision in question.”).

218. *A & M Produce*, 135 Cal. App. 3d at 486, 186 Cal. Rptr. at 121 (citing *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 245, 249 (D.C. Cir. 1965)).

219. See Eddy, *On the “Essential” Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CAL. L. REV. 28, 43 (1977); Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757, 764 (1969); Spanogle, *Analyzing Unconscionability Problems*, 117 U. PA. L. REV. 931, 943 (1969).

220. See J. CALAMARI & J. PERILLO, *supra* note 214, at 418.

221. *A & M Produce*, 135 Cal. App. 3d at 486, 186 Cal. Rptr. at 121-22 (1982).

222. See, e.g., *Weaver v. American Oil Co.*, 257 Ind. 458, 462, 276 N.E.2d 144, 146 (1971); *Shroeder v. Fageol Motors, Inc.*, 86 Wash. 2d 256, 260, 544 P.2d 20, 23 (1975).

223. Eddy, *supra* note 219, at 45.

224. See *supra* note 213 and accompanying text.

225. *A & M Produce*, 135 Cal. App. 3d at 487, 186 Cal. Rptr. at 122.

226. E. FARNSWORTH & A. MCCORMACK, *CONTRACTS* 313 (1982).

scionability has arisen involve a combination of both procedural and substantive unconscionability²²⁷ and it is generally agreed that "if more of one is present, then less of the other is required."²²⁸ On the whole, however, judges have been cautious in applying the doctrine of unconscionability "recognizing that the parties often must make their contract quickly, that bargaining power will rarely be equal, and that courts are ill-equipped to deal with problems of unequal distribution of wealth in society."²²⁹

2. California case law

Although little authority exists in California case law which deals with unconscionability in commercial contracts, one leading case is *A & M Produce v. FMC Corp.*²³⁰ In *A & M Produce*, a produce company sued an agricultural equipment company from which it had bought a weight-sizing machine,²³¹ alleging breach of express and implied warranties and misrepresentation.²³² The defendant corporation had printed the agreement between the parties on both sides of a single sheet of paper and had included on the reverse side three key provisions.²³³ The first was entitled "Seller's Remedies," outlining the buyer's obligation to pay the seller's reasonable attorneys' fees in connection with any default by the buyer; the second was entitled "Warranty," containing a disclaimer of warranties in bold print; and the third was labeled "Disclaimer of Consequential Damages," stating in smaller print that the seller was not liable for consequential damages arising out of the agreement.²³⁴ The weight-sizing machine, purchased by A & M to process tomatoes, did not perform as promised, causing A & M to lose hundreds of thousands of dollars.²³⁵ In the ensuing litigation, FMC argued that the contract clauses were enforceable as agreed upon and that FMC was therefore not liable for the plaintiff's losses.²³⁶ The court, however, disagreed with FMC's

227. *Id.* at 315.

228. *Id.* Not all unreasonable risk allocations are to be considered unconscionable. *A & M Produce*, 135 Cal. App. 3d at 487, 186 Cal. Rptr. at 122. Rather, "enforceability of [a] clause is tied to the procedural aspects of unconscionability such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk reallocation which will be tolerated." *Id.* (citations omitted).

229. E. FARNSWORTH & A. MCCORMACK, *supra* note 226, at 316.

230. 135 Cal. App. 3d 473, 186 Cal. Rptr. 114 (1982).

231. *Id.* at 478, 186 Cal. Rptr. at 116.

232. *Id.* at 480, 186 Cal. Rptr. at 118.

233. *Id.* at 479, 186 Cal. Rptr. at 117.

234. *Id.*

235. *Id.* at 481, 186 Cal. Rptr. at 118.

236. *Id.* at 481-82, 186 Cal. Rptr. at 118-19.

contention, and held for A & M, stating that the contract clauses were unconscionable and therefore void.²³⁷

With regard to procedural unconscionability, the court found that although most courts generally view businessmen as possessing a greater degree of commercial understanding and greater economic muscle than the average consumer, some inexperienced businessmen may still be unfairly "surprised" by the terms of a contract.²³⁸ In that regard, the court pointed out, the plaintiff had testified that he had never read the back of the contract and was therefore unaware of the disclaimers on which the defendant relied.²³⁹ Additionally, the court found that FMC made no attempt to inform A & M of the clauses in question and although the printing on the warranty disclaimer was conspicuous, the court found that the terms of the related consequential damages exclusion were not.²⁴⁰ Based on those factors, the court found that the first prong of procedural unconscionability had been met, and the plaintiff was indeed unfairly surprised.²⁴¹

After dealing with the issue of unfair surprise, the court then addressed the second prong of procedural unconscionability which deals with oppression.²⁴² The court found that although A & M was a fair-sized farming operation, it had been dealing with a major corporation on whose expertise it had relied in agreeing to the contract's terms.²⁴³ More importantly, the court observed, the terms on the FMC contract were standard boilerplate and non-negotiable.²⁴⁴ The court held, therefore, that the contract did not truly constitute a "bargain" between the parties because it was based on unequal bargaining power, and on that basis, oppression was present in the contract.²⁴⁵

Finally, the *A & M Produce* court looked to the contract to determine whether it was also substantively unconscionable.²⁴⁶ The court found that by including the warranty disclaimer in the contract, FMC was, in essence, guarantying nothing about the product's performance.²⁴⁷ The court further found that "[s]ince a product's performance forms the fundamental basis for a sales contract, it is patently unreasonable to as-

237. *Id.* at 485, 186 Cal. Rptr. at 121.

238. *Id.* at 489, 186 Cal. Rptr. at 124.

239. *Id.* at 490, 186 Cal. Rptr. at 124.

240. *Id.*, 186 Cal. Rptr. at 124-25.

241. *Id.*

242. *Id.* at 491, 186 Cal. Rptr. at 125.

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*

sume that a buyer would purchase a standardized mass-produced product from an industry seller without any enforceable performance standards."²⁴⁸ That factor, along with A & M's reliance on FMC's expertise in recommending the equipment, prompted the court to hold the warranty disclaimer commercially unreasonable and therefore void.²⁴⁹

3. Unconscionability in lending agreements—a focus on unfair surprise

In utilizing the doctrine of unconscionability in a commercial sales contract, the *A & M Produce* court emphasized the need to establish all of the elements of unconscionability in order to invalidate what it considered commercially unreasonable provisions within that agreement.²⁵⁰ However, case law indicates that when dealing with procedural provisions within *lending* agreements, other courts have been willing to invalidate those types of provisions on the basis of unfair surprise alone.²⁵¹ In that regard, parties' ability to move the situs of lending litigation away from California in order to ensure that their choice of law will be honored could be frustrated by the courts in California based solely on procedural unconscionability. A recent case involving the invalidation of a jury waiver provision in a lending agreement by the federal bankruptcy court in Illinois illustrates this point well.

Unsecured Creditors' Committee ex rel. Heartland Chemicals Corp. v. Banque Paribas (In re Heartland Chemicals Corp.),²⁵² involved a provision for the waiver of a jury trial in a lending agreement between an Illinois corporation and a French bank.²⁵³ The provision was printed in capital letters and located on the page preceding the signature page.²⁵⁴ The court held, however, that the provision was unenforceable because the debtor's waiver of a jury trial was not made knowingly and voluntarily.²⁵⁵ First, the court said that although the waiver was printed in capital letters, it was buried in several other provisions both preceding

248. *Id.*

249. *Id.* at 492, 186 Cal. Rptr. at 125. The court found that FMC either impliedly or expressly warranted the product it sold to A & M. *Id.* On that basis, the court also held that the provision excluding consequential damages was unreasonable and therefore unenforceable since FMC had breached that warranty. *Id.* Consequential damages for the plaintiff were, therefore, "explicitly obvious" under the circumstances. *Id.*

250. *Id.* at 486, 186 Cal. Rptr. at 121.

251. See, e.g., *Unsecured Creditors' Comm. ex rel. Heartland Chems. Corp. v. Banque Paribas (In re Heartland Chems. Corp.)*, 103 Bankr. 1018 (Bankr. C.D. Ill. 1989).

252. 103 Bankr. 1018 (Bankr. C.D. Ill. 1989).

253. *Id.* at 1019.

254. *Id.*

255. *Id.* at 1020.

and following it which were also in capitals.²⁵⁶ Second, the court pointed to the fact that the part of the contract that the jury waiver was included in was labeled "Submission to Jurisdiction: Waiver of Bond," which gave the borrower no notice of its consent to jury waiver.²⁵⁷ Finally, the court observed that although the provision was located on the page preceding the signature page, that location placed it on the nineteenth page of a twenty-page document.²⁵⁸ On those grounds, the court invalidated the provision.²⁵⁹

Heartland Chemicals appears to illustrate that when dealing with procedural provisions within lending agreements, the only valid basis for the invalidation of a procedural provision is unfair surprise. The underlying rationale is based on the nature of procedural provisions. Procedural provisions focus on the manner in which an agreement is *enforced*, rather than what is actually contained in the agreement. In that respect, it seems that absent unreasonable substantive terms within an agreement, the courts would like to encourage the enforcement of contracts in the most effective manner possible. An attempt to invalidate a procedural provision in any agreement which has been knowingly entered into by both sides would seem to circumvent the very purpose of entering into the agreement in the first place. Thus, procedural provisions should always be enforced in the absence of unfair surprise. However, there are other, more general reasons for focusing on unfair surprise rather than oppression or substantive unconscionability when dealing with provisions which are specific to lending agreements.

First, oppression deals with unequal bargaining power, an issue of great concern in standard sales agreements, but of little importance with respect to financing arrangements. In a standard sales agreement, the seller is in control of his own destiny, whereas in a lending agreement, the lender is not. For instance, if one business sells a defective product and attempts to extricate itself through disclaimers contained in a sales agreement which are unknown to the buyer at the time of contracting, the law naturally disfavors such an arrangement because the buyer is not getting the benefit of the bargain.²⁶⁰ In cases where unequal bargaining exists, the seller's actions can be viewed as even more egregious because the seller can often control the quality of the product he sells and should

256. *Id.*

257. *Id.* at 1019-20.

258. *Id.* at 1020.

259. *Id.*

260. See E. FARNSWORTH & A. McCORMACK, *supra* note 226, at 812-13. The benefit of the bargain relates to the "expectation interest" which arises when a party expects to receive the value of performance contracted for. *Id.*

therefore be held accountable in the event that the product does not perform as represented. However, oppression does not apply in this manner to lenders and borrowers.

Lenders take much greater risks than do sellers of traditional products because it is the borrower's performance, rather than the lender's, which controls the success or failure of any given transaction. In that respect, the lender can only attempt to mitigate risk by making assumptions as to an individual business's abilities to perform under an agreement, and then to set interest rates accordingly.²⁶¹ Additionally, the lender has a stake in the success of the borrower. Therefore, it is in the lender's best interest to try and put together a workable agreement. This type of incentive does not exist in a traditional buyer and seller relationship other than in the hopes of the seller for repeat sales. Finally, all things being equal, the purpose of including choice-of-forum, choice-of-law and consent-to-jurisdiction clauses in lending agreements has little to do with the terms of the agreement other than to ensure that it is enforced. On that basis, there is no valid basis for a borrower to claim that the inclusion of such provisions is oppressive or substantively unfair.

For the reasons stated above, the focus of this Comment is preventing judicial invalidation of procedural provisions (such as parties' choice of law, venue, or consent to jurisdiction) in lending agreements solely on the basis of unfair surprise.

V. RECOMMENDATION

A. Drafting the Agreement

The resisting parties in both *A & M Produce Co. v. FMC Corp.*²⁶² and *Unsecured Creditors' Committee ex rel. Heartland Chemicals Corp. v. Banque Paribas (In re Heartland Chemicals Corp.)*²⁶³ argued successfully that their lack of awareness of procedural clauses within contracts justified voiding those provisions.²⁶⁴ However, the unfair surprise which supported invalidation of the contractual provisions in those cases is easily remedied. Moreover, those remedies can be applied without hesita-

261. See E. COMPTON, *INSIDE COMMERCIAL BANKING* 101-04 (2d ed. 1983); D. AUSTIN, D. HAKALA & T. SCAMPINI, *MODERN BANKING* 194 (1985); COMMITTEE ON DEVELOPMENTS IN BUSINESS FINANCING OF THE SECTION OF CORPORATION, BANKING AND BUSINESS LAW, AMERICAN BAR ASSOCIATION, *TERM LOAN HANDBOOK* 4 (J. McCann ed. 1983).

262. 135 Cal. App. 3d 473, 186 Cal. Rptr. 114 (1982).

263. 103 Bankr. 1018 (Bankr. C.D. Ill. 1989).

264. *Heartland Chemicals*, 103 Bankr. at 1019; *A & M Produce*, 135 Cal. App. 3d at 490, 186 Cal. Rptr. at 124.

tion to commercial lending agreements which include parties' choice-of-law, choice-of-forum, and consent-to-jurisdiction provisions.

This part of the Comment proposes a manner in which provisions within lending agreements may be written which should compel the California courts to honor the parties' choice of a situs for litigation which, in turn, will honor the parties' choice of law. First, this part of the Comment proposes procedural safeguards which should be employed by parties to ensure that both sides are aware of all key terms within their agreements. Next, the Comment suggests the manner in which those provisions should be drafted within an actual lending agreement. Finally, the Comment provides sample provisions which illustrate the methodology suggested.

1. Procedural safeguards

When entering into a commercial lending agreement, both parties must make sure that the other side is aware of all key terms contained within the agreement. The best and most effective manner in which this can be accomplished is by agreeing in advance that both parties will utilize the services of attorneys in drafting agreements and that both attorneys will *make sure* that the other side is aware of any key terms either party is likely to invoke in the event of litigation. In commercial lending agreements, this may entail an explanation of the choice-of-law, consent-to-jurisdiction and mandatory choice-of-forum clauses by the lender's attorney to the borrower's attorney.²⁶⁵ Additionally, documentation supporting meetings in which the key terms are discussed, if possible, should be maintained. Such documentation may simply entail a memo to a superior informing them of the progress of the proposed transaction. However, the effect will have been to have laid the initial groundwork to defend against a claim of unfair surprise by a resisting party should litigation later arise regarding the manner in which the contract was formed.

2. The writing

Supervising the manner in which the contract is formed is the first step in preventing invalidation of key clauses in a lending agreement. However, as the cases discussed illustrate, the *structure* of the agreement itself is crucial to its eventual enforcement.²⁶⁶ There are several safe-

265. Although this type of arrangement may simply prove too cumbersome, the parties should discuss and subsequently acknowledge at least the *presence* of the clauses within the agreement.

266. See, e.g., *Heartland*, 103 Bankr. at 1019-20; *A & M Produce*, 135 Cal. App. 3d at 490-91, 186 Cal. Rptr. at 125.

guards which may be employed in drafting lending agreements which should ensure that the parties' choice-of-law, choice-of-forum, and consent-to-jurisdiction clauses will be honored.

First, choice-of-forum, choice-of-law and consent-to-jurisdiction clauses should be placed in any lending agreement in the most conspicuous manner possible. The clauses should each be labeled separately within their respective sections in the agreement, and those labels should be underlined to give both parties clear notice as to their presence.²⁶⁷ Additionally, the clauses should be placed as close as possible to the beginning of the agreement.

Second, the clauses should each be printed completely in bold type with capital letters. To avoid confusion, the clauses should be the *only* provisions within the agreement printed in this manner. This should not cause a problem since other provisions within lending agreements normally contain elements which are negotiated—such as the amount, rate and term of the financing—and therefore do not lend themselves to unfair surprise.

Lastly, the provisions should be initialed by the borrower when the agreement is signed to signify that the borrower has read and understands them. In this way, along with the utilization of attorneys to explain the terms of the agreement and to obtain parties' assent, a lender should be able to prove unequivocally that there was no unfair surprise.

Below are sample provisions which could be included in lending agreements which may help to assure that the parties' intent to move litigation out of California will be honored by the California courts. While not dispositive as to the courts' ultimate treatment of the parties' choices, these samples are intended to provide guidance to those enterprises hoping to better guarantee the enforcement of their commercial lending agreements as intended. The waiver of right to *forum non conveniens* is included in the sample as a further precautionary measure in assuring that not only California, but also the *chosen* court will honor the parties' wishes.²⁶⁸ Parties may be best served to include such a provision

267. One court has suggested that separate headings highlighting particular provisions in a contract will alleviate any unconscionability problems. *See Dorman v. International Harvester Co.*, 46 Cal. App. 3d 11, 120 Cal. Rptr. 516 (1975).

268. The possibility that the action could be dismissed relying on a motion for *forum non conveniens* seems highly unlikely given the substantial burden on the moving party to prove inconvenience and the availability of a more convenient forum. *See Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 255 (1981) ("there is ordinarily a strong presumption in favor of the plaintiff's choice of forum, which may be overcome only when . . . factors clearly point towards trial in [another] forum"); *see also Gulf Oil v. Gilbert*, 330 U.S. 501, 508 (1947) ("unless the balance [of the litigants' interests are] strongly in favor of the defendant, the plaintiff's

in an actual lending agreement in a separate section as per the recommendations above.

B. Sample provisions

GOVERNING LAW. THIS AGREEMENT, THE NOTES, AND THE ANCILLARY DOCUMENTS SHALL BE DEEMED TO HAVE BEEN MADE IN THE STATE OF _____ AND THE VALIDITY OF THIS AGREEMENT, THE NOTES, AND THE ANCILLARY DOCUMENTS, AND THE CONSTRUCTION, INTERPRETATION, AND ENFORCEMENT THEREOF, AND THE RIGHTS OF THE PARTIES THERETO SHALL BE DETERMINED UNDER, GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS OF THE STATE OF _____, WITHOUT REGARD TO THE CONFLICTS OF LAW RULES OF THE STATE IN WHICH SUIT IS INITIATED PERTAINING TO THIS AGREEMENT.

JURISDICTION AND VENUE. TO THE EXTENT PERMITTED BY LAW, THE PARTIES HERETO AGREE THAT ALL ACTIONS OR PROCEEDINGS ARISING IN CONNECTION WITH THIS AGREEMENT, THE NOTES, OR THE ANCILLARY DOCUMENTS, SHALL BE TRIED AND LITIGATED ONLY IN THE STATE AND FEDERAL COURTS LOCATED IN THE COUNTY OF _____, STATE OF _____, OR, AT THE SOLE OPTION OF LENDER, IN ANY OTHER COURT IN WHICH LENDER SHALL INITIATE LEGAL OR EQUITABLE PROCEEDINGS AND WHICH HAS SUBJECT MATTER

choice of forum should rarely be disturbed"). To begin with, the parties will have *chosen* the state where litigation is undertaken, and thus, absent overreaching behavior, the moving party would be hard-pressed to demonstrate why that choice should not be honored. Additionally, there is little reason to assume that the moving party could show why any other state is more convenient than the chosen state, since *one* of the parties would *have* to be burdened by litigating there at least as much as it would be by litigating in the chosen state. The fairest resolution, then, would be to honor the parties' original choice.

If suit is initiated or removed to federal court, the possibility then exists that a resisting party might attempt to have the case *transferred* to a "more convenient forum" under 28 U.S.C. § 1404(a) (1982). In *Norwood v. Kirkpatrick*, 349 U.S. 29 (1955), the United States Supreme Court held that since section 1404(a) involves the transfer of a proceeding, rather than dismissal, Congress, by enacting the statute, "intended to permit courts to grant transfers on a lesser showing of inconvenience." *Id.* at 32. However, for the reasons stated above, it is extremely unlikely that under section 1404(a), a case involving a contract which includes a mandatory choice-of-forum clause and a consent-to-jurisdiction provision could be transferred.

As a preventative step to provide maximum assurance that the *chosen* court will honor the parties' wishes, a waiver of any right to bring a motion of *forum non conveniens* could be included in the provisions regarding jurisdiction and venue.

JURISDICTION OVER THE MATTER IN CONTROVERSY. THE PARTIES FURTHER AGREE THAT THE AFOREMENTIONED CHOICE OF VENUE IS TO BE CONSIDERED MANDATORY AND NOT PERMISSIVE IN NATURE, THEREBY PRECLUDING THE POSSIBILITY OF LITIGATION IN ANY JURISDICTION OTHER THAN THAT SPECIFIED IN THIS SECTION _____ OR BY THE LENDER, BORROWER AND BANK, TO THE EXTENT THEY MAY LEGALLY DO SO, HEREBY WAIVE ANY RIGHT EACH MAY HAVE TO ASSERT THE DOCTRINE OF FORUM NON CONVENIENS OR TO OBJECT TO VENUE TO THE EXTENT ANY PROCEEDING BROUGHT IN ACCORDANCE WITH THIS SECTION _____ AND STIPULATE THAT THE STATE AND FEDERAL COURTS LOCATED IN THE COUNTY OF _____, STATE OF _____ SHALL HAVE IN PERSONAM JURISDICTION AND VENUE OVER SUCH PARTY FOR THE PURPOSE OF LITIGATING ANY SUCH DISPUTE, CONTROVERSY, OR PROCEEDING ARISING OUT OF OR RELATED TO THIS AGREEMENT, THE NOTES, OR THE ANCILLARY DOCUMENTS. TO THE EXTENT PERMITTED BY LAW, SERVICE OF PROCESS SUFFICIENT FOR PERSONAL JURISDICTION IN ANY ACTION AGAINST BORROWER MAY BE MADE BY REGISTERED OR CERTIFIED MAIL, RETURN RECEIPT REQUESTED, TO ITS ADDRESS INDICATED IN EXHIBIT _____ ATTACHED HERETO. BORROWER AGREES THAT ANY FINAL JUDGMENT RENDERED AGAINST IT IN ANY ACTION OR PROCEEDING SHALL BE CONCLUSIVE AS TO THE SUBJECT OF SUCH FINAL JUDGMENT AND MAY BE ENFORCED IN OTHER JURISDICTIONS IN ANY MANNER PROVIDED BY LAW.²⁶⁹

VI. CONCLUSION

Choice-of-law provisions serve a useful purpose by providing certainty, predictability and uniformity of result in the event of litigation regarding the enforcement of commercial contracts.²⁷⁰ Knowing in advance which law will govern their contracts enables businesses to better plan their affairs and thus, to operate more efficiently.²⁷¹

269. D. SCHECHTER, *CASES AND MATERIALS ON ASSET-BASED COMMERCIAL FINANCE* 25 (1989) (reprinted and modified with permission).

270. Horowitz, *supra* note 5, at 765; Friedler, *supra* note 6, at 471.

271. Horowitz, *supra* note 5, at 765; Friedler, *supra* note 6, at 471.

The need for certainty in the enforcement of commercial lending agreements is even greater than that required in most other types of commercial contracts. By their nature, lending agreements involve long-term commitments in which the success of lenders is dependent on the financial stability of their borrowers and on the ability to enforce agreements should that stability falter.

Traditional approaches to choice of law focus on state sovereignty rather than the wishes of the interested parties entering into contracts. Traditional approaches do not always uphold the justified expectations of parties entering into contracts and therefore can sometimes undermine the primary goals of contract law.²⁷² Those approaches are thus inadequate in determining the validity of parties' contractual choice of law.

One approach to the interpretation of contractual choice-of-law provisions which focuses specifically on honoring the parties' choice of law is the autonomy rule.²⁷³ The autonomy rule, with limited exceptions, forces courts to honor the parties' choice of law in contractual agreements.²⁷⁴ Therefore, the autonomy rule is the best rule to follow when interpreting parties' choice of law because it is the only rule which truly upholds the parties' settled expectations.

The courts in California have abandoned traditional approaches to conflict problems involving parties' choice of law in favor of the approach of the Restatement (Second) of the Conflict of Laws.²⁷⁵ On its face, the Restatement approach appears to focus on party autonomy.²⁷⁶ However, the Restatement approach contains exceptions which have been used by the courts in California to circumvent the wishes of the parties in regard to choice of law.²⁷⁷ Thus, the use of the Restatement approach by the California courts has created much uncertainty surrounding the enforceability of parties' choice of law in lending and other contractual agreements.

272. See *supra* notes 66-78 and accompanying text.

273. Friedler, *supra* note 6, at 474.

274. *Id.* at 478; RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

275. *Mencor Enters., Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 436, 235 Cal. Rptr. 464, 466 (1987); *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal. App. 3d 280, 287-88, 135 Cal. Rptr. 230, 233-34 (1976); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 673, 97 Cal. Rptr. 811, 814 (1971). See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

276. See *supra* notes 90-92 and accompanying text.

277. See *Mencor Enters.*, 190 Cal. App. 3d at 432, 235 Cal. Rptr. at 464 (court invalidated parties' choice of Colorado law in lending agreement as against public policy under California usury laws, despite legality under Colorado usury law); *Frame*, 20 Cal. App. 3d at 668, 97 Cal. Rptr. at 811 (parties' choice of New York law to govern forfeiture agreement struck down by court as against public policy).

The costs of uncertainty in the enforcement of lending agreements created by the California courts can be high. Uncertainty could force lenders to tighten credit or raise interest rates, potentially depriving financing to businesses which rely on lenders for needed working capital in their day-to-day operations. An inability to obtain financing could force some of those enterprises out of business. Additionally, an inability to accurately gauge risk due to uncertainty could impact the lenders themselves. In the worst case, this could create societal costs which would far outweigh the measures needed to prevent uncertainty.²⁷⁸

The solution to avoiding those costs by ensuring that parties' choice of law will be honored and lending agreements will be enforced as agreed upon is to move litigation arising from lending agreements out of the California courts and into the courts of the state whose laws have been chosen by the parties to govern their agreements. This can be accomplished through the use of mandatory choice-of-venue and consent-to-jurisdiction clauses included in the agreements.

The use of provisions to move litigation out of the California courts is the first step in ensuring that the parties' intent will be recognized. However, only through proper draftsmanship and careful consideration of the process used in creating financing agreements will parties' choices be honored. In that manner, the expectations of the parties can be upheld, and the certainty that is essential in all commercial transactions will be provided.

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278. See *supra* notes 30-33 and accompanying text.

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