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Paul B. Stephen

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CHOICE OF LAW AND ITS CONSEQUENCES: CONSTITUTIONS FOR INTERNATIONAL TRANSACTIONS

*Paul B. Stephan**

I bring to international transactions a certain confusion of interests. U.S. public law, especially constitutional law, invites a consideration of the structure and design of legal institutions and the impact of institutional design on the kinds of legal rules that the institutions produce. I find these issues compelling, but I also find myself unable to work up much enthusiasm for the substantive content of U.S. constitutional law. By contrast, private law, and particularly the law that governs international commerce, fascinates me. Yet most private law scholarship concentrates on the content of the rules and attempts to determine which outcomes might advance particular private and societal interests. Given my concerns with law-making processes, I prefer to look at the institutional structures that produce those rules, and am more agnostic about the desirability of any particular substantive outcome. What attracts me to choice of law, then, is how it fits in with other institutional structures that generate rules and standards governing private international transactions that deal with intellectual property.

I. THE CONSTITUTIONS OF INTERNATIONAL TRANSACTIONAL LAW

To understand what choice of law does and can do, consider four highly stylized representations of different constitutions for international transactional law.¹ Each presents a distinct allocation of authority as to the production of the substantive

* Percy Brown, Jr. Professor, University of Virginia School of Law.

1. I use the term "constitution" in the political economy sense, embracing rules about rulemaking and not rules governing primary conduct. Put differently, political economy envisions lawmaking as a kind of a game, a constitution as the rules of the game, and other law as the outcome of that game. See JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 77-80 (1962); DENNIS C. MUELLER, *CONSTITUTIONAL DEMOCRACY* 63-64 (1996).

rules. In other words, each specifies a different legal process for generating substantive law.

- 1) An international organization constitution designates an authoritative international framework for generating those rules, including an international organ that promulgates law and another that applies that law to particular events in the course of dispute resolution.
- 2) A harmonization constitution recognizes some kind of technically adept body that generates laws for political bodies—sovereign states—to adopt through their normal law-making processes.
- 3) A choice-of-law constitution establishes a set of rules that harmonizes the approach taken by individual states in deciding which sovereign's laws shall apply to particular transactions. These rules might be authoritarian, in the sense that private parties would have limited ability to tailor transactions to come under one or another body of law, or transactional, in the sense that parties could choose their law as part of the transaction.
- 4) A snatch-and-grab constitution allows states to assert what authority they can over transactions, based on their control over people and things.

Let me describe each in some detail.

An international organization suggests constitutional law in the conventional sense. A public organ derives the authority to enact and apply rules based on some constitutive document. For international transactions involving intellectual property, we have the TRIPS agreement,² an international instrument that both recognizes law-making authority on the part of the World Trade Organization (WTO) to define intellectual property rights and empowers the WTO dispute resolution body to police national adherence to the agreed rules. We also have the European Community, which under the Treaty of Rome and its

2. Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, *LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND* vol. 31 (1994); 33 *I.L.M.* 1197 (1994).

various successor treaties³ has the right to impose intellectual property rules on the member states of the European Union. In each instance, a centralized lawmaker makes the rules, to which national and subnational bodies have some obligation to adhere.

Harmonization shares with the first model an aspiration to have a uniform set of rules applying globally, but approaches this goal in a less organized and coercive fashion. The World Intellectual Property Organization and the National Commissioners for Uniform State Laws each in their own way embody a harmonization constitution. Technically adept specialists draft a body of rules meant to have wide if not universal applicability. A broader group then adopts the draft, which then becomes a template for national or subnational legislation. If the project takes off, transactors will face a single body of rules, whether governing domain names on the Internet or the scope of intellectual property licenses.

Professor Patchel focuses on a third strategy, namely bolstering a shared consensus among states as to the appropriate rules for allocating lawmaking jurisdiction and choosing which law to apply. I take her to mean this when she discusses the systemic values implicated by choice of law. But we easily can imagine different systems that would be consistent with this overall concept. A more authoritarian approach, for example, would assign jurisdiction and applicable law based on hard-to-change characteristics. An example from Europe is the rule that, for purposes of choosing which law governs a company's internal governance, declares that a company will be deemed located in the jurisdiction where the preponderance of its activities takes place. Under this regime, companies can select law only by shifting activities, which may mean moving a physical plant, employees and offices. A more transactional approach allows parties either to designate law by contract—the classic choice-of-law clause—or to make formal choices that determine

3. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 573 (1992), *incorporating changes made by Treaty on European Union*, Feb. 7, 1992, O.J. (C 224) (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 [hereinafter TEU], *and amended by Treaty of Amsterdam*, 1997 O.J. (C 340) 1. The TEU, *supra*, amended the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 1973 Br. Brit. T.S. No. 1 (Cmd. 5179-II), *as amended by Single European Act*, 1987 O.J. (L 169) 1, [1987] 2 C.M.L.R. 741.

which law applies. In the United States, for example, we have reached a consensus that the place of incorporation determines which law governs firm governance. Given how easy it is to change the place of incorporation, firms readily can select the rules under which they will operate.

We should not neglect a fourth alternative, which in the contemporary world governs most applications of criminal law and much other international regulation. Under a snatch-and-grab constitution, a state will regulate any transaction where it has some power over the persons or assets involved. U.S. antitrust practice offers many examples: when anticompetitive business practices affect U.S. consumers and our government has the ability to harass persons or assets associated with the companies engaged in this behavior, we do not stay our hand just because liability under our laws affects the interests of other nations. Title III of the Helms-Burton legislation,⁴ which creates the possibility of a cause of action on behalf of victims of Castro's expropriations against foreign businesses that "traffick" with their confiscated property, illustrates the same principle. Moreover, I take it that when Germany forbids the circulation of "hate speech" over or through the Internet, it backs up this command through its power to prosecute persons found in Germany who originate or receive such speech (including accessing forbidden web sites) or who facilitate such access (Internet service providers with personnel or assets in Germany). Generalizing a bit, when a state regulates transactions outside the territory it governs, it typically relies on a snatch-and-grab principle, even though many try to justify their actions in terms of objective and systemic principles such as "reasonableness."

Each of these constitutions identifies a locus of law-making authority: the international institution that makes and applies law; the private groups that recommend uniform laws, with the consent of individual states; particular states based upon agreed upon rules; and particular states depending on the circumstances that bring persons and things under their power. Each affects the international licensing of intellectual property, because each to a certain degree operates in the

4. Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996, 22 U.S.C. §§ 6021-6091 (Supp. 1998).

world where these transactions take place. My interest, however, is not in identifying these arrangements so much as in developing a criteria for assessing their comparative advantages.

II. THE POLITICAL ECONOMY OF INTERNATIONAL TRANSACTIONAL CONSTITUTIONS

I will not rehearse here all the pros and cons of organizing international lawmaking through an international institution or harmonization. Professor Janger does a commendable job of summarizing the key points. Rather, I concede their strengths as a method to generate comprehensive solutions to collective action problems and instead will focus on the downside of these approaches.

Two kinds of problems inhere in both international institutions and harmonization. The first is that private interests may influence the lawmaking process to achieve redistributive goals (private rent-seeking). Writers of software (licensors), for example, might dominate the rulemaking process and impose on the rest of the world a set of rules that diminishes overall welfare but that make the licensors better off. To the extent the rules are both mandatory and comprehensive, they are more likely to have redistributive consequences. The second is that the lawmakers may place their own institutional interest above that of society (institutional rent-seeking). International bureaucrats may engage in self-aggrandizement, as when they insist on the right to approve particular national policies or endorse a proposal for legal unification that sacrifices clear policy choices to overcome obstacles to adoption.

In earlier work I explored the ways in which international institutions and the harmonization process might be peculiarly susceptible to these shortcomings.⁵ I will not repeat those arguments here, but rather rest on the assertion that, across some range of subjects, these two strategies for organizing international lawmaking present substantial costs that would

5. These articles include: *Barbarians Inside the Gates: Public Choice Theory and International Economic Law*, 10 AM. U. J. INT'L L. & POL'Y 745 (1995), *Accountability and International Lawmaking: Rules, Rents and Legitimacy*, 17 NW. J. INT'L L. & BUS. 681 (1996-97), *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743, 788-96 (1999).

justify a search for alternative approaches. I do not claim that international institutions and harmonization are inherently undesirable, but rather that situations exist where they are. Specifying the extent of such situations and their frequency is not my purpose here.

Snatch-and-grab jurisdiction has obvious drawbacks. It encourages opportunism by states that will seek to extract rents from people and assets that come under their sway. Businesses will face greater legal uncertainty in the absence of clear rules as to what law will apply to their transactions. Universal adherence to this approach would reduce the world of international transactions to something like Hobbes' state of nature, "solitary, poore, nasty, brutish, and short."⁶ We must resign ourselves to the inevitability that states *in extremis* will resort to snatch and grab, as a logical extension of their right to self defense, but we do not have to like it or to tolerate any greater use than necessary.

The question thus becomes one of envisioning how a choice-of-law constitution would work in a world where the other alternatives may present serious problems. A range of options present themselves. For example, we could take an authoritarian approach, as I noted above. This would involve a widely adopted set of rules that look to the substance of a transaction to assign law-making jurisdiction. To some extent international taxation operates in this fashion, with (at least in theory) the substance of a transaction, and not its form, dictating which state has the right to impose its taxes. Alternatively, the great majority of nations involved in international business might agree that across a certain range of questions parties would have the option to choose among regulatory jurisdictions. They could implement this transactional system by adopting a presumption in favor of honoring choice-of-law and choice-of-forum clauses in contracts. To supplement explicit contracting, they could agree to accept essentially formal attributes as determinative of jurisdiction, such as the place of a party's incorporation.⁷

6. THOMAS HOBBS, *LEVIATHAN* 65 (Prometheus Books 1988) (1651).

7. I describe this transactional approach in greater detail in Paul B. Stephan, *Regulatory Cooperation and Competition—The Search for Virtue*, in *TRANSATLANTIC REGULATORY COOPERATION* (George Bermann et al. eds., forthcoming 2000).

I suspect that the authoritarian approach to choice of law has less to recommend it than might first appear. First is the problem of incompleteness and instability. For purposes of analysis, one should assume that the mandatory system will impose outcomes on persons engaged in business transactions that those persons would prefer to avoid; otherwise, such a system would only replicate a transactional approach to choice of law. Actors seeking to avoid undesirable outcomes face several alternatives: they may accept their fate; they may emigrate to acquire the law that they find more desirable; or they may put pressure on their local decisionmakers to pick a different choice-of-law rule. If the first two alternatives are sufficiently unattractive, one would expect that actors would increase the pressure to undermine the regime. And because of the interdependence of a choice-of-law constitution—the system operates as a system only if substantially all states adhere to the same set of rules—departures by only a few important jurisdictions probably would lead to cascades of defections. In short, a mandatory choice-of-law regime would cover fewer transactions, and face greater pressures to change, than would a transactional approach.

Second, mandatory rules generate greater costs. Mandatory application of really bad rules will lead over time to emigration; over the short run they will generate evasion. Both strategies involve the wasteful expenditure of resources. Moreover, persons may exploit a mandatory regime to induce the government to enact rules that will hurt potential competitors, such as by mandating barriers to entry into an industry. Whether such attempts at rent-seeking are successful would be beside the point, because the efforts to obtain such rules are themselves costly and wasteful.⁸

What, then, are the drawbacks of a largely transactional approach to choice of law? Allowing parties either explicitly to designate law through contract, or implicitly through the assumption of a highly mutable formal characteristic, empowers persons engaged in market transactions. Where we have reason to suspect that markets do not work properly, this should

8. Dennis Mueller has observed that increasing mobility of firms limits the ability of governments to engage in redistribution through taxation. Dennis C. Mueller, *Constitutional Constraints on Governments in a Global Economy*, 9 CONST. POL. ECON. 171 (1998). In the text I generalize this point to cover regulation.

trouble us. As conventionally conceived, market failure comes in three types: (1) incompleteness, i.e., a failure to take into account socially important considerations such as distributive justice or inalienable rights; (2) monopoly power due to failure of competition; and (3) evolutionary dead ends due to standardization. I will ignore the first problem, as it is unlikely to arise in software licensing and in any event beyond the scope of our discussion. The second and third issues are significant.

Competition, and thus transactional choices of rules, may break down either because of informational asymmetries or due to monopoly problems. A familiar story justifying consumer protection rules imputes wiliness to merchants and vulnerability to the customer. Absent monopoly power on the part of the merchant, however, this story works only if most customers are misinformed. In a competitive market merchants compete for the marginal consumer, and it does not take too many well-informed consumers at the margin to induce merchants to offer terms that assume full information.⁹

But are information technology markets competitive? I will not stray here into the troubled waters of the Microsoft litigation. Two points suffice. First, even where a firm possesses monopoly power, either alone or as part of a cartel, it does not follow that it always will use this advantage to induce its customers to accept bad law, as opposed to higher prices. Unless exogenous constraints on prices exist (as in the case of regulated industries such as some forms of international transport), we would expect monopolists to gouge through increasing revenues. Thus, even if we believe Microsoft truly is the evil empire, we still need a convincing story as to why it would exploit its customers by choosing unfavorable legal rules. Second, Microsoft aside, the dynamism of the information technology markets suggests the existence of strong competitive forces. This ferment may produce considerable uncertainty and thus information problems, but not necessarily one-sided advantages. And we should never lose sight of how contracts function as a means of managing uncertainty.¹⁰

9. See Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387 (1983).

10. See Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

What then of evolutionary dead ends? Some have argued that the benefits derived from standardization of contractual terms may deter innovation with respect to other terms. The common metaphor is the story of the manual typewriter keyboard, which (so the story goes) reflected an effort to slow down typists so as not to exceed the capacity of the typewriter. Once computer keyboards appeared, the need for the function disappeared, but the inefficient layout remained because of the high costs involved in switching to a new system. So freedom of contract, bolstered by a robust transactional choice-of-law regime, might lead to the evolution of standard terms that, in a dynamic environment, can become costly to use but even more costly to replace.¹¹

This concern is genuine but invites two rejoinders. First, it seems clear that the more dynamic the environment in which contracting takes place, the greater the likelihood that break-outs from evolutionary dead ends will occur. New problems will make reliance on learned forms and conventional terms impossible. I need to be persuaded that the environment in which international licensing of intellectual property takes place is not challenging or rapidly changing. Second, I need to be convinced that selection of mandatory rules through a legislative process, whether an international organization or a harmonization effort, will produce terms that shortcut evolutionary problems without bringing new costs. Based on the record of both of these processes in other matters of significance to international commerce, one cannot be optimistic.

III. CLOSING REMARKS

I intentionally have avoided addressing the topic that so much of the discussion at this conference has confronted, namely the desirability or flaws of the UCITA. Others, better versed than I am in the vagaries of e-commerce and the nuances of intellectual property licensing, can take up that task. What I have attempted to do here is sketch out a framework for attacking that problem, by putting UCITA in a broader context of institutional structures that produce law for interna-

11. For a review of the problem, see Clayton P. Gillette, *Harmony and Stasis in Trade Usages for International Sales*, 39 VA. J. INT'L L. 707 (1999); Steven Walt, *Novelty and the Risks of Uniform Sales Law*, 39 VA. J. INT'L L. 671 (1999).

tional commerce. My intuition is that UCITA straddles more than one constitution, and that reconsidering how it fits in with the other structures might lead us to a better response to the challenges that the new contracting environment presents. But I leave it to others to test that hypothesis.