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Jurisdictional Competition and the Dim Prospects for Uniformity**

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THE PUBLIC CHOICE OF CHOICE OF LAW IN SOFTWARE TRANSACTIONS: JURISDICTIONAL COMPETITION AND THE DIM PROSPECTS FOR UNIFORMITY†

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Going last in a program like this is both a blessing and a curse. On the one hand, you get to sum up, draw conclusions, and generally have the last word. On the other hand, to the extent that you had prepared remarks or observations to make, you might as well start fresh. There are only so many original things to say. By the end of the day most of them have been said. In the hope of avoiding this problem, I propose to take what we have learned today about the law of international software transactions and, in this panel about the law of “choice of law,” apply it to a slightly different question.

Most of our conversation has focused on substantive law, on how the law of international software transactions should relate to the law of sale of goods and the law of intellectual property licenses. In the background has been a turf battle between experts on two substantive areas of law, contract and copyright. Not surprisingly, proponents of contract believe that principles of consent and exchange should trump the copyright policies¹ that establish the boundaries of intellectual property rights. Again, not surprisingly, proponents of copyright argue for the primacy of intellectual property law and point out that some aspects of IP law rise to the level of social policy and may not be waived.² I intend to shift the focus to political institu-

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1. See Raymond T. Nimmer, *International Information Transactions: An Essay on Law in an Information Society*, 26 BROOK. J. INT'L L. 5, 13-14 (2000).

2. See Rochelle Cooper Dreyfuss, *UCITA in the International Marketplace: Are we about to Export Bad Innovation Policy?*, 26 BROOK. J. INT'L L. 49, 52-53 (2000); Samuel K. Murumba, *The Emerging Law of the Digital Domain and the Contract/IP Interface: An Antipodean Perspective*, 26 BROOK. J. INT'L L. 91, 106-07 (2000).

tions, and to replace the question "what is the correct rule?" with the question "who should make the rules?" Which institutions should we choose to generate the substantive law of international transactions in computer information? Since this is a panel on "choice of law" I will ask the question in a more focused way, "which institution should generate the *choice of law rules* for international software transactions?"

I. LOCATING THE CHOICE OF CHOICE-OF-LAW RULE

Kathy Patchel's explication of choice-of-law principles and how they apply in the case of UCITA helps to crystallize both the choice-of-law question *and* the choice-of-institutions question.³ A choice-of-law rule is an institutional choice among the substantive law of sovereign countries. The sovereign whose interest is most strongly implicated by the transaction gets to govern (subject, in most cases, to the parties' choice of governing law). In this way, choice-of-law-principles allow courts and parties to determine which menus of substantive law terms will govern the transaction. But this is only part of the question. Substantive law, and indeed choice-of-law rules, for multi-jurisdictional transactions can be generated in a number of ways:

- Non-uniform state law (within the United States) or national law (for international transactions);
- Uniform state law (*à la* the UCC⁴) or national law (*à la*

3. See Kathleen Patchel, *Choice of Law and Software Licenses: A Framework for Discussion*, 26 BROOK. J. INT'L L. 117 (2000).

4. The Uniform Commercial Code is a joint product of the American Law Institute and the National Conference of Commissioners of Uniform State Law. "The American Law Institute was formed in 1923 for the purpose of preparing Restatements of the common law," DAVID G. EPSTEIN ET AL., BASIC UNIFORM COMMERCIAL CODE TEACHING MATERIAL 1 (3d ed. 1988) (citing H. GOODRICH & P. WOLKIN, THE STORY OF THE AMERICAN LAW INSTITUTE (1961)), but joined the UCC project in 1945. William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1 (1967). The National Conference of Commissioners on Uniform State Laws is a quasi governmental body, organized in 1892 "to promote uniformity in law . . . through voluntary state action." EPSTEIN, *supra*, at 1. "The Commissioners are appointed by state officials, usually the governor. The Commissioners meet once a year; each state votes as a unit on each proposal. The work of the Conference is financed primarily by the proportional assessment paid by each state." *Id.* See also Allison Dunham, *A History of the National Conference of Commissioners of Uniform State Laws*, 30 LAW &

UNIDROIT⁵ or UNCITRAL⁶);

- Supra-state or supra-national law (i.e., in the United States, federal law, and in the European Union, EU Directive⁷); or,

CONTEMP. PROBS. 233 (1965).

5. The International Institute for the Unification of Private Law—UNIDROIT—was established in 1926 as an arm of the League of Nations and then re-established in 1940 as an independent intergovernmental organization. See International Institute for the Unification of Private Law, done at Rome, Mar. 15, 1940, 15 U.S.T. 2494, T.I.A.S. No. 5743. Its purpose is to “examine ways of harmonizing and co-ordinating the private law of States and groups of States, and to prepare gradually for the adoption by the various States of uniform legislation in the field of private law.” *Id.* art. 1. UNIDROIT is comprised of 58 Member States including the United States (a member since 1964). See 22 U.S.C. § 269(g) (1998). UNIDROIT is financed by the annual contributions of its members and the Italian Government. See *International Institute for the Unification of Private Law (Unidroit)* (visited Apr. 6, 2000) <<http://www.unidroit.org/english/presentation/pres.htm>> (on file with author). Based in Rome, UNIDROIT is a three-tiered organization with a Secretariat, a Governing Council and a General Assembly. See *id.* The General Assembly is the ultimate decision-making body of the organization, comprised of one representative from each Member State (except from the Italian government) with voting power over its annual budget, Work Programme and the election of the Governing Council. See *id.* UNIDROIT has either led or aided the creation of several international conventions, including: International Convention on the Travel Contract; United Nations Convention on the Contracts for the International Sale of Goods; and, UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects. See *id.*

6. The United Nations Commission on International Trade Law was established in 1966 by the General Assembly to promote harmonization in the area of international trade law. See G.A. Res. 2205, U.N. GAOR, 21st Sess., Supp. No. 16, at 99, U.N. Doc. A/6316 (1967). The Commission is composed of 36 Member States, representing the world’s various geographical regions, elected by the General Assembly for six-year terms. See *United National Commission on International Trade Law* (visited Apr. 6, 2000) <<http://www.uncitral.org/english/commiss/index.htm>> (on file with author). Major works of UNCITRAL include: United Nations Convention on the International Sales of Goods; United Nations Convention on the Carriage of Goods by Sea; Convention on the Recognition and Enforcement of Foreign Arbitral Awards; Model law on Cross-Border Insolvency; and, Model Law on Electronic Commerce. See *id.*

7. A Directive issued by the European Council or Commission “shall be binding, as to the result to be achieved upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and method.” TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, art. 249 (ex art. 189), O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 573 (1992) [hereinafter EC TREATY], 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. A Directive, which becomes effective when a Member State is notified, requires the Member State “to take the legislative and/or administrative action needed to implement the

- International law, through bilateral or multilateral treaty or potentially through customary international law.

Broadly speaking, these legislative approaches can be characterized as bottom-up (non-uniform state or national law), voluntary top-down (uniform or model law), and mandatory top-down (U.S. federal law or EU Directive). Each has relative benefits and disadvantages.

Bottom-up. In a decentralized, non-uniform regime, each jurisdiction (i.e., nation or state) makes its own law without consideration of the law of other jurisdictions. Such non-uniform lawmaking has the benefit of adaptation to local conditions, and more direct accountability. It has the disadvantage that, as Madison pointed out in Federalist 10,⁸ a faction may capture the local government and oppress a minority. In addition, non-uniform law may be subject to jurisdictional competition.⁹ Jurisdictional competition occurs when states and nations use local law to compete for business and investment. An attractive rule may cause capital to flow into the relevant state. The effect of such competition is ambiguous. Usually, the jurisdiction with the more efficient rule will attract more business. This is often referred to as a "race to the top." However, the possibility of inter and intra-jurisdictional

directive's purposes." GEORGE A. BERMAN ET AL., *CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW* 75 (1993). In theory, Directives do not have to be detailed, but are often specifically drafted as to how they are to be implemented. *See id.* However, although Directives may be "binding" on a Member State, it may not be directly applicable. *See id.*

8. THE FEDERALIST NO. 10 (James Madison).

9. Some commentators argue that interstate competition produces a "race to the bottom," *see, e.g.,* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 665-66 (1974); Lucian Ayre Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1443-44 (1992); Others argue that it produces a "race to the top." *See* Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 564-71 (1984); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporate Law*, 76 NW U.L. REV. 913, 919 (1982). Roberta Romano argues that it is a race for predictability and stability. Roberta Romano, *Law as Product: Some Pieces of the Corporate Puzzle*, 1 J.L. ECON. & ORG. 225, 273-78 (1985). She observed that many jurisdictions have enacted liberal corporate law, but that Delaware remains the incorporation champ. This is because it has an experienced corporate bar, a small bench which is familiar with corporate law issues, and a corporate code which can only be amended by a two-thirds vote of both houses of the state legislature. *See id.*

externalities undercut this prediction. Most importantly, there is the possibility of interstate externality. This occurs when citizens of one jurisdiction can favor local businesses at the expense of citizens of other jurisdictions. Jurisdictional competition is more likely to result in a so-called "race to the bottom."¹⁰

Top-down (voluntary). Centralized but voluntary lawmaking has some powerful advantages as well. A centralized drafting process brings expertise and drafting talent to bear on the legislative project,¹¹ and makes that expertise available to multiple jurisdictions. Also, the desire for uniform enactment may reduce the power of local faction. Since local enactment of the uniform law is voluntary, issues that might endanger universal enactment must be avoided by the legislative drafters. Provisions which favor a faction in one state may disadvantage the citizens of another state. Therefore, to be uniformly enacted, the statute must be a product of consensus.¹² This need for consensus has the natural tendency to narrow the scope of uniform laws to topics where consensus can be reached. This can be both an advantage (where agreement can be reached) and a disadvantage (if regulation is necessary and no consensus is possible). The need for consensus creates two powerful dynamics. First, if consensus can be achieved only by anticipating the result of capture, the uniform lawmaking process may

10. For a more comprehensive discussion, see Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569 (1998). In addition to interstate externality, there is the possibility of intra-firm externality. For example, a state can adopt a rule that favors a corporate constituency that controls the decision where to incorporate or where to do business, while imposing costs on a disenfranchised constituency within the firm (i.e., the jurisdiction can favor managers at the expense of shareholders). Finally, there is the possibility of temporal externality. This occurs when a legislature can adopt a rule that appears efficient at the time, but will impose costs on citizens after the legislator has left office. For example, a legislator or legislative coalition can encourage a chemical plant to locate in the jurisdiction. This will have short term benefits for the jurisdiction and the legislature. However, this may cause long term harm to the environment or citizens which will not manifest until after the relevant legislator has left office.

11. See James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096, 2096 (1991).

12. See Janger, *supra* note 10, at 580, 583; Ted Janger, *The Locus of Lawmaking: Uniform State Law, Federal Law, and Bankruptcy Reform*, 74 AM. BANKR. L.J. (forthcoming Winter 2000).

unavoidably facilitate capture.¹³ Second, uniform law drafters may be forced to anticipate the effect of jurisdictional competition. Here, the effect is ambiguous. Where jurisdictional competition will lead to a race to the top, anticipation of jurisdictional competition will be beneficial (though perhaps not quite as beneficial as actual competition), and where jurisdictional competition will lead to a race to the bottom, the effect will be deleterious.¹⁴

Top-Down Mandatory. Centralized mandatory rulemaking eliminates both the costs and benefits of anticipated jurisdictional competition,¹⁵ and can (in some cases) benefit from the advantages of expertise and drafting skill. However, the federal government in the United States and the European Union are also subject to capture, and they may provide the convenience of "one-stop interest group shopping."¹⁶ Note, in the United States this is compounded by the possibility of government by minimum winning coalition¹⁷ and the ability to horsetrade.¹⁸ In Europe, given the relative youth of the EU mechanisms and the focus that many decisions are subject to unanimity or supermajority requirements in the Council of Ministers, the need for consensus may still provide a salutary discipline on special interest coalition building, but I leave that to the commentators on EU law. What does this Cook's tour of institutional strategies tell us about the preferred locus of

13. See Janger, *supra* note 10, at 578-80.

14. See *id.*

15. As I have noted elsewhere, federal law is self-executing. Therefore jurisdictional competition is not a problem. See Janger, *supra* note 12.

16. See William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275 (1988); Jonathan R. Macy, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223 (1986); Edward J. Janger, *The FDIC's Fraudulent Conveyance Power Under the Crime Control Act of 1990: Bank Insolvency Law and the Politics of the Iron Triangle*, 28 CONN. L. REV. 67 (1995).

17. See WILLIAM H. RIKER, *THE THEORY OF POLITICAL COALITIONS* 255 (1962); JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 211, 242-44 (1962).

18. See Maxwell L. Stearns, *The Public Choice Case Against the Item Veto*, 49 WASH. & LEE L. REV. 385 (1992). Economists are divided over whether "vote trading" is likely to be efficient. See William H. Riker & Steven J. Brams, *The Paradox of Vote Trading*, 67 AM. POL. SCI. REV. 1235, 1236 (1973) (pork creates negative externalities for voters who don't benefit from the pork, but rational legislators will nonetheless seek to procure pork for their own districts); BUCHANAN & TULLOCK, *supra* note 17, at 145 (logrolling is likely welfare enhancing).

lawmaking with regard to international software transactions? Should we use bottom-up, voluntary top-down, or mandatory top-down? In particular, is uniform law-making of the UCITA type a viable option?

II. IDENTIFYING THE TRANSACTIONS

In order to answer this question, it is necessary to briefly identify and describe the transactions at issue. The first transaction type is the *mass market* transaction in information in *tangible form*. For example, Professor Dessemontet goes to a store in Lausanne, Switzerland and buys a compact disk containing RealPlayer for his son, along with a license, the terms of which are printed in very small letters on the outside of the box. Professor Dessemontet pays in cash, and loads the program onto his home computer.

The second type of transaction is a *mass market* transaction in information, where the information is *downloaded electronically* through the use of the World Wide Web or other communications device. For example, Professor Dessemontet uses his home computer, located in Lausanne, Switzerland, to download RealPlayer for his son, pays with his credit card, "agrees" on-line to the terms of a "click wrap" license, and installs the program onto that computer. While Professor Dessemontet's computer is in Lausanne, Real Networks' server is located in Seattle, Washington.

The third type of transaction is a *customized* transaction between *commercial parties*. Here an example might be a license contract entered into by a major bank for a complex, custom designed, payroll management system with a Canadian software designer.

III. INTERSTATE EXTERNALITY, JURISDICTIONAL COMPETITION AND CHOICE OF LAW

As noted above, a common concern for both bottom-up and top-down (voluntary) lawmaking is that any rule which creates an opportunity for a jurisdiction to capitalize on an interstate externality may lead to a race to the bottom, or an anticipated race to the bottom. Thus, a threshold question for choosing the appropriate locus of lawmaking for regulation of these transactions is, "do these transactions create an opportunity for interstate externality?" The answer appears to be yes, at least with

regard to mass market transactions. Since a licensor of mass market software can do business all over the world, a state which adopts licensor friendly rules can set the rules for the world, to the extent choice-of-law rules allow this to happen. If this is the case, what does this tell us about the appropriate institution for generating choice-of-law rules?

With regard to multi-jurisdictional software transactions, in the absence of an enforceable choice-of-law clause, there are two possible choice-of-law rules. The law of the licensor can control or the law of the licensee can control. This matters because in many cases, the first question to be decided will be whether a choice-of-law clause in a click-wrap license should be viewed as part of the contract. As Professor Patchel points out, principles of interest analysis would strongly suggest that, at least with regard to mass market transactions, a software license is similar to a sale of goods, and the most significant interest lies in the jurisdiction of the licensee. As Professor Dessemontet has pointed out, European jurisdictions follow that approach.¹⁹ In the United States, by contrast, the law is in disarray,²⁰ and UCITA adopts the law of the licensor ap-

19. See François Dessemontet, *The European Approach to E-Commerce and Licensing*, 26 BROOK. J. INT'L L. 59, 72-73 (2000).

20. In at least two cases, the courts have applied the law of the licensee's jurisdiction to the transaction. But these cases provide little basis for predicting how courts will rule in other cases. See *McConnell & Sons, Inc. v. Target Data Systems, Inc.*, 84 F. Supp.2d 961 (N.D. Ind. 1999); *NMP Corp. v. Parametric Tech. Corp.*, 958 F. Supp. 1536 (N.D. Okla. 1997).

In the *Target Data* case, the court held that, where the contract was silent as to choice of law, the licensee's law (also the law of the forum) governed the contract dispute. However, the *Target* court's efforts to identify the "situs" of the contract provide little guidance for modern mass market software transactions. First the court found that, based on its research and that of defendant, there were no "substantive differences" between the law of the licensor (Connecticut) and the licensee (Indiana), and that, therefore, the "forum should apply forum law." *Target Data*, 84 F. Supp.2d at 973. The court then explored Indiana's conflict-of-law rules, and tried to identify the state with the most "intimate contact" with the transaction. *Id.* at 973 n.15. The court held that Indiana law controlled because: (1) while the contract was primarily negotiated in Connecticut, the contract was signed by plaintiff in Indiana, and, "under Indiana law, a contract is deemed made in the state where the last act necessary to make it a binding agreement occurs," *id.* at 973 (citation omitted); (2) "[t]he contract was performed in Indiana (by either . . . [plaintiff's] employees in Indiana, or by . . . [defendant's] employees via modem," *id.*; (3) the software which constituted the "subject matter of the contract" was presumably located in both the licensor's and licensee's state, *id.*; and, (4) the plaintiff resided in Indiana, and the defendant in Connecticut, *see id.*

In *NMP Corp. v. Parametric Tech. Corp.* the contract between the parties

proach with regard to software downloaded electronically.²¹ While such a rule appears to be inconsistent with “interest analysis,” there is a plausible argument that the interest in facilitating commerce over the world wide web justifies the rule. Which approach, however, is preferable from the perspective of encouraging uniformity in choice-of-law rules and discouraging a race to the bottom with regard to the substantive law of licensing?²²

At first blush, the law of the licensor rule, coupled with UCITA’s routine enforcement of forum selection clauses²³ would appear to exacerbate the possibility of interstate externality, whether adopted as a non-uniform law, uniform law, or as a top-down rule. Starting with the non-uniform, bottom-up approach the analysis plays out as follows. If one

contained a choice-of-law clause, selecting Massachusetts law, and a clause contractually limiting the time within which to bring suit. The court engaged in tortured reasoning to conclude that the law of Oklahoma (the licensee’s jurisdiction) controlled. To accomplish this, the court treated the contract as a sale of goods and applied Article 2 of Oklahoma’s UCC to conclude that the clause was enforceable. 958 F. Supp. at 1541-42.

21. Section 109(b)(1) of UCITA provides:

- (b) *In the absence of an enforceable choice-of-law term, the following rules apply:*
 - (1) An access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor is located when the agreement is made.

UCITA § 109 (emphasis added).

22. One further question is why there is such concern if the choice-of-law provisions can be waived by contract? In this regard, the concern may be overstated with regard to customized negotiated transactions. However, where mass market transactions are concerned, there is more reason for concern. Mass market license transactions involve off the rack terms, with no opportunity to negotiate, under conditions of imperfect information. One example is presented by the problem of private information. Personal information is the coin of the realm in the new economy, but many software licensee may not realize the value of what he/she is giving up in terms of private information or contract rights. Indeed, the information may be gathered without asking (by depositing a “cookie”). Even if the licensee knows the value of the information given, there are serious difficulties in detecting breach. If a customer provides personal information subject to a privacy policy, and the purchaser of that information breaches the agreement and sells the information, the consumer is unlikely to find out. Finally, there is no opportunity to negotiate the terms of a click wrap license, nor is such negotiation necessarily desirable. It is unrealistic to expect consumers to read complex licenses. Even if they could understand them, it may not be efficient for them to spend the time. This is not to say that the default rules need to be mandatory, but they should, perhaps be “sticky” in the manner of warranty terms under Article 2 of the UCC.

23. UCITA § 110.

jurisdiction adopts a UCITA type rule, then licensors in that jurisdiction get the benefit of local law, so long as suit is brought there. This will put pressure on other jurisdictions to adopt the same rule if they wish to attract licensors' business. Licensors' assets are electronic and mobile which puts further pressure on local legislators to adopt law that is substantively friendly to licensors. At the same time jurisdictions that have many licensees and few licensors, or a strong tradition of consumer protection, will be unlikely to adopt the location of licensor rule. Thus, in a bottom-up-world, the law of the licensor rule creates a strong pressure to race to the bottom with regard to substantive rules, and also leaves a strong possibility of non-uniformity with regard to both substantive and choice-of-law rules.

If a jurisdiction adopts the UCITA approach as a proposed uniform law, in the top-down (voluntary) regime, the analysis is largely the same. However, the inclusion of a law of the licensor choice-of-law rule appears likely to endanger uniform enactment. Jurisdictions which do not have a significant licensor constituency, or which have a strong tradition of consumer protection, are likely to resist the uniform rule in order to insure their own domestic policy concerns.

Finally, the top-down mandatory approach remedies the uniformity problem with regard to choice-of-law rules, but creates a second problem. Central adoption of a law of the licensor rule might create a strong pressure on jurisdictions to use their substantive law of licensing to compete for licensors, which in turn creates an incentive to race to the bottom with regard to the substantive law of licensing.

Thus a law of the licensor rule is unlikely to become a uniform choice-of-law rule under either a decentralized or uniform law approach, and is likely to create an incentive towards a substantive race to the bottom if it is adopted as a mandatory rule of international law. One might ask, therefore, whether a law of the licensee rule will work better from either perspective. At first glance, the law of the licensee rule would not appear to solve the problem. The same pressures that would likely defeat uniform adoption of a UCITA type rule would work in reverse with regard to a law of the licensee rule. Even if the uniform or model law drafters were to choose a law of the licensee rule, some jurisdictions would likely adopt a law of the licensor rule independently. While this has not occurred

in Europe, this may be because, as Professor Dessemontet has pointed out, this mode of commerce is still new to the European Union.

IV. CONCLUSION

However, there is a possible solution to the problem that yields a uniform choice-of-law rule and minimizes inefficient jurisdictional competition. It might be possible to adopt a "law of the licensee" rule as a mandatory top-down rule. This would render the choice-of-law rule uniform, but would leave individual jurisdictions free to experiment with their software licensing regime. While states would be free to adopt licensor friendly legal rules, the effect of those rules would be confined to their borders. This would limit the incentive for software licensors to go hunting for friendly jurisdictions, and would preserve the ability of states to experiment as new patterns of commerce develop. In short, it might be best to adopt a top-down law of the licensee rule, in order to obtain the benefits of a decentralized regime for the development of licensing law.

