

THE ARBITRATORS' DUTY TO RESPECT THE PARTIES' CHOICE OF LAW IN COMMERCIAL ARBITRATION

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INTRODUCTION

Arbitration is all about choice. The parties choose whether to arbitrate their disputes, whom the decision-makers will be, where the arbitration will take place, and what procedures will be applied.¹ One of arbitration's defining characteristics is party autonomy, which is sometimes used specifically to refer to the parties' ability to choose the law that will govern their dispute.² As noted by one scholar, "The right of parties to themselves identify the law to apply and the obligation on arbitrators to respect that choice is the one overwhelming and truly international conflict of laws rule which [sic] has developed in international commercial arbitration."³ By contrast, in domestic commercial arbitration,⁴ outdated parochial rules sometimes still

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¹ Arbitration has been defined as a process whereby parties voluntarily agree to refer their disputes to an impartial third person or persons selected by the parties for a decision that is final and binding on the parties. Parties usually make these choices by way of a written contract or agreement, referred to as the arbitration agreement. See MARTIN DOMKE, DOMKE ON COMMERCIAL ARBITRATION §1:1 (Larry E. Edmonson ed., 3d ed. 2003); THOMAS H. OEHMKE, COMMERCIAL ARBITRATION § 1:5 (3d ed. 2004).

² See JULIAN D.M. LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 69 (1978); Edith Friedler, *Party Autonomy Revisited: A Statutory Solution to a Choice-of-Law Problem*, 37 U. KAN. L. REV. 471 (1989).

³ LEW, *supra* note 2, at 582.

⁴ For purposes of this article, I use the term "domestic commercial arbitration" to refer to arbitrations with little or no connection to any country other than the United States. For example, such an arbitration would be between two commercial

apply to invalidate the parties' choice of applicable law.⁵ In such cases, arbitrators and reviewing courts will not honor the parties' choice of law unless the law chosen bears a reasonable or substantial relationship to the parties or the underlying transaction.⁶ The purpose of this article is to demonstrate that there is no valid reason to disregard the mutually agreed-upon choice of law made by the parties to an arbitration agreement arising out of a commercial transaction, provided that there are no extenuating circumstances.⁷

While there is much scholarly debate regarding the extent to which parties are free to choose the law applicable to their disputes,⁸ few, if any, of these scholars consider how these arguments differ in the context of domestic commercial arbitration as opposed to litigation. As a result, arbitrators who face this issue have little guidance. This article contends that

entities, both of which are United States residents or citizens, and involving a contract that is made and is to be performed in the United States.

⁵ See discussion *infra* Part IV.

⁶ RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 187(2) (1971).

⁷ The proposal for greater party autonomy is limited to arbitration agreements arising out of commercial transactions, and would exclude consumer or employment arbitrations where there may be a significant difference in the bargaining power between the parties such that strict observance would be unfair. For purposes of this article, a "commercial transaction" is defined as a contractual relationship between two or more businesspersons or entities acting in their capacity as such. One method of ensuring a certain level of business sophistication in connection with such agreements would be to create a monetary threshold that must be met before the rule would apply, as has been done by some states. See *infra* Part IV.D.

⁸ See, e.g., Friedler, *supra* note 2, at 479–84 (giving an overview of the modern approaches to choice-of-law issues); Richard K. Greenstein, *Is the Proposed U.C.C. Choice of Law Provision Unconstitutional?*, 73 TEMP. L. REV. 1159, 1159–61 (2000) (questioning whether the proposed amendment to the Uniform Commercial Code, requiring that choice-of-law clauses be enforced whether or not the transaction bears any relation to the state designated, violates constitutional principles); Philip J. McConaughay, *Reviving the "Public Law Taboo" in International Conflict of Laws*, 35 STAN. J. INT'L L. 255, 258 (1999) (exploring whether the distinction between public and private law issues remain useful when analyzing which provisions are appropriate objects of conflicts analyses); Larry E. Ribstein, *Choosing Law by Contract*, 18 J. CORP. L. 245, 247 (1993) (arguing that the policies that support a presumption of enforcing choice-of-law clauses extend to all contexts); Robert A. Sedler, *Constitutional Limitations on Choice of Law: The Perspective of Constitutional Generalism*, 10 HOFSTRA L. REV. 59, 67 (1981) (suggesting that "significant constitutional limitations on choice of law" are "aberrations"); Barry W. Rashkover, Note, *Title 14, New York Choice of Law Rule for Contractual Disputes: Avoiding the Unreasonable Results*, 71 CORNELL L. REV. 227, 227 (1985) (explaining that the debate over choice-of-law clauses focuses on the competing values of the recognition of interested jurisdictions' legislative policies and party autonomy).

domestic commercial arbitration is more similar to international commercial arbitration than to domestic litigation, such that the conflict of laws rules that apply in international commercial arbitration should apply to domestic commercial arbitration as well. The corollary to this theory is that there are significant differences between commercial arbitration and commercial litigation, such that different conflict of laws rules ought to apply. Thus, arbitrators and reviewing courts should respect the choice of law made by the parties to a domestic commercial arbitration agreement regardless of whether there is any connection between the underlying transaction and the law chosen, just as is done in international commercial arbitration.

The remaining parts of this article expound upon this theme. Part I provides a hypothetical example of how this choice of law issue could arise and its potential consequences. Part II briefly describes the evolution of attitudes towards arbitration generally and specifically with respect to party autonomy over the last century. Part III explains why arbitrators and reviewing courts should honor the parties' choice of law in the context of domestic commercial arbitration agreements. Part IV explains how judicial conflict of laws rules may come into play in arbitration and how they may operate to undermine party autonomy in some cases. Part V responds to constitutional and public policy concerns that have been raised with respect to allowing parties to choose a law that has little or no connection to the parties or their agreement. This part analyzes the debate regarding whether parties should be given greater autonomy in the context of domestic commercial arbitration as compared to litigation. Finally, the Article concludes that a greater respect for parties' choices of law will allow for more efficient dispute resolution.

I. AN EXAMPLE OF THE PROBLEM

Imagine that Penn Ocean, a Pennsylvania company, owns several ocean-going vessels, each worth several million dollars. Imagine further that one of the vessels requires significant repair, which will cost approximately one and a half million dollars. Penn Ocean solicits bids for the work from various shipyards around the United States. As part of its bid-proposal package, Penn Ocean includes a draft contract that it used for a previous ship repair transaction with a Massachusetts shipyard.

The draft contract contains a clause requiring that all disputes arising out of or in connection with the contract be resolved by arbitration in Pennsylvania, but selects Massachusetts law to govern. Penn Ocean proposes Massachusetts law because Massachusetts has some of the oldest operating shipyards in the United States, and therefore has some of the most well-developed law relating to ship repair contracts. Additionally, Penn Ocean became familiar with Massachusetts law in its past ship-repair transactions involving the Massachusetts shipyard.

Penn Ocean receives bids from shipyards in several states, but the most competitive bid comes from a large and well-established shipyard in Louisiana. Accordingly, Penn Ocean enters into intense and prolonged negotiations with the shipyard in Louisiana. The parties and their attorneys agree to amend many parts of the original draft contract through negotiations, but leave the arbitration and applicable law clauses as originally proposed by Penn Ocean. Penn Ocean is particularly glad not to have Louisiana's law apply because of its unfamiliarity with a civil law system.

In this scenario, why should two large, sophisticated and experienced companies not be allowed to choose another state's law to govern their transaction if they so desire? Both sides made an informed and conscious choice and had expert legal representation. Thus, there should be no concern that one party is able to take unfair advantage of the other. Penn Ocean had valid reasons for choosing the law of another state, which were accepted by the other contracting party.

The choice of applicable law can make a big difference. For example, different states have different statutes of limitations;⁹ thus, the applicable law can determine whether suit may still be brought depending on how much time has passed. Some states allow arbitrators to award punitive damages, while others do not.¹⁰ Some states limit the amount of punitive damages that

⁹ New York's statute of limitations for contractual claims is six years, while California's is four years. N.Y. C.P.L.R. 213 (McKinney 2003); CAL. CIV. PROC. CODE § 337 (West 2003).

¹⁰ New York is in the minority of states in not allowing the award of punitive damages by arbitrators. *See* Garrity v. Stuart, 40 N.Y.2d 354, 357-58, 353 N.E.2d 793, 795, 386 N.Y.S.2d 831, 833 (1976); *see also* E. WENDY TRACHTE-HUBER & STEPHEN K. HUBER, ALTERNATIVE DISPUTE RESOLUTION: STRATEGIES FOR LAW AND BUSINESS 665 (1996).

may be awarded in civil actions.¹¹ Some states allow disclaimers of implied warranties¹² and others do not.¹³ Therefore, the governing law can be critical to the outcome of a claim.

The case for upholding the parties' choice of law would be even stronger if Penn Ocean had bargained for the choice of Massachusetts law by making some concession during the contract negotiations. If an arbitrator were to refuse to enforce the parties' choice of law as reflected in the contract, the arbitrator would be upsetting the balance of the bargain made by the parties.

II. A BRIEF HISTORY OF THE TREATMENT OF CHOICE-OF-LAW CLAUSES IN ARBITRATION

The foregoing hypothetical illustrates some of the reasons why commercial parties may choose a particular law to govern their transaction. However, arbitrators and reviewing courts do not always respect the parties' choice of law. This next section briefly considers the evolution of judicial attitudes towards arbitration in the United States generally and with respect to choice-of-law clauses in arbitration agreements specifically over the last century. It then briefly compares domestic practice to accepted practices in international commercial arbitration.

A. *The Evolution of Judicial Attitudes in the United States*

Historically, there has been significant judicial resistance to arbitration as a means of alternative dispute resolution, largely because it usurped the jurisdiction of the courts.¹⁴ Until well

¹¹ See, e.g., ALA. CODE § 6-11-21 (2003); VA. CODE ANN. § 8.01-38.1 (Michie 2000).

¹² See, e.g., ALA. CODE § 7-2-316(2); CAL. CIV. CODE §§ 1791.3, 1792.3 (West 2004); FLA. STAT. ANN. § 672.316(2) (West 2004); 810 ILL. COMP. STAT. ANN. 5/2-316(2) (West 2004); MASS. GEN. LAWS ANN. ch. 106, § 2-316(2) (West 2004).

¹³ See, e.g., KAN. STAT. ANN. § 50-639 (2003); MISS. CODE ANN. §§ 75-2-314-15 (1972), 11-7-18 (Supp. 2003).

¹⁴ J. STEWART MCCLENDON & ROSABEL E. EVERARD GOODMAN, INTERNATIONAL COMMERCIAL ARBITRATION IN NEW YORK 114 (1986); see also *Matter of Sprinzen*, 46 N.Y.2d 623, 629, 389 N.E.2d 456, 458, 415 N.Y.S.2d 974, 976 (1979).

An agreement to submit to arbitration disputes arising out of a contract, once condemned by the judiciary of this State as tending to oust the courts of their jurisdiction and, thus, declared void as contrary to settled policy, is now favorably recognized as an efficacious procedure whereby parties can

into the twentieth century, "American courts regularly invalidated arbitration agreements as an encroachment on the judicial province and, hence, contrary to public policy."¹⁵ With the passage of the Federal Arbitration Act ("FAA") in 1925,¹⁶ this attitude began to change.¹⁷ Today, U.S. judges are usually quite content to move cases off their dockets by enforcing arbitration agreements.

Consistent with the judicial hostility towards arbitration generally, U.S. courts were also skeptical of choice-of-law clauses.¹⁸ According to one well-known legal commentator, permitting parties to choose the law applicable to their transactions "practically makes a legislative body of any two persons who choose to get together and contract. . . . [which is] [s]o extraordinary a power in the hands of any two individuals [that it] is absolutely anomalous."¹⁹

Over time, however, courts began to recognize the importance of choice-of-law clauses in contracts and arbitration agreements,²⁰ particularly in the international context. As the U.S. Supreme Court has stated:

select their own nonjudicial forum for the "private and practical" resolution of their disputes "with maximum dispatch and at minimum expense."

Id. (citations omitted).

¹⁵ MCCLENDON & GOODMAN, *supra* note 14, at 114.

¹⁶ 9 U.S.C. § 1 *et seq.* (2000).

¹⁷ In *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510–11 (1974), the U.S. Supreme Court referred to the FAA as "reversing centuries of judicial hostility to arbitration agreements." See also *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 55 (1995) ("Congress passed the FAA 'to overcome courts' refusals to enforce agreements to arbitrate.") (citation omitted).

¹⁸ See, e.g., *Alaska Packers Ass'n. v. Indus. Accident Comm'n*, 294 U.S. 532, 550 (1935); *Jones v. Sea Tow Servs. Freeport NY, Inc.*, 30 F.3d 360, 366 (2d Cir. 1994) (refusing to enforce choice of English law in salvage contract between two U.S. citizens because there was no reasonable relation to England); *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 948 (7th Cir. 1994) (refusing to honor the parties' designation of Delaware law due to insufficient connections between the contract and the State of Delaware); *United Counties Trust Co. v. Mac Lum, Inc.*, 643 F.2d 1140, 1143–44 (5th Cir. 1981) (refusing to enforce lease's designation of Georgia law where transaction had no reasonable relation to that state); *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115, 117 (2d Cir. 1931) (refusing to honor contractual choice of English law where bill of lading was issued in Italy); see also MCCLENDON & GOODMAN, *supra* note 14, at 114–15; Friedler, *supra* note 2, at 477.

¹⁹ Joseph H. Beale, *What Law Governs the Validity of a Contract*, 23 HARV. L. REV. 260, 260–61 (1910).

²⁰ See, e.g., *Sprinzen v. Nomberg*, 46 N.Y.2d 623, 632, 389 N.E.2d 456, 460, 415 N.Y.S.2d 974, 978 (1979).

[I]n the absence of the arbitration provision considerable uncertainty existed at the time of the agreement, and still exists, concerning the law applicable to the resolution of disputes arising out of the contract.

Such uncertainty will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflicts-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction. Furthermore, such a provision obviates the danger that a dispute under the agreement might be submitted to a forum hostile to the interests of one of the parties or unfamiliar with the problem area involved.²¹

Thus, the Supreme Court recognized many of the advantages that accrue from a contractual choice-of-law clause: certainty, predictability, and avoidance of a hostile forum.²²

Because of these advantages, the American judiciary now generally accepts that parties are free to choose the law that will govern their transactions, albeit with certain limitations.²³ Part IV of this article provides a fuller explanation of the current state of the law with respect to the limitations that exist on the parties' choice of applicable law.

²¹ *Scherk*, 417 U.S. at 516 (footnotes omitted); *see also* *Northrop Corp. v. Triad Int'l Mktg. S.A.*, 811 F.2d 1265, 1270 (9th Cir. 1987).

²² *See* LEW, *supra* note 2, at 79–80 (explaining in detail the importance of certainty, predictability, and uniformity in international commercial arbitration).

²³ *See* Friedler, *supra* note 2, at 478. For examples of federal court cases enforcing choice-of-law clauses in commercial contracts, *see* *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 55 (1995); *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972); *Milanovich v. Costa Crociere, S.P.A.*, 954 F.2d 763, 767–68 (D.C. Cir. 1992); *Northrop Corp.*, 811 F.2d at 1265, 1267–69; *Medimatch, Inc. v. Lucent Techs. Inc.*, 120 F. Supp. 2d 842, 862 (N.D. Cal. 2000). According to a recent study of 697 cases involving choice-of-law clauses done by Professor Ribstein, courts enforced the choice-of-law clauses in approximately 85% of the cases. *See* Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 374–75 (2003). Professor Ribstein noted that “these totals do not include cases dealing only with choice of *forum* and arbitration, which raise distinct issues.” *Id.* at 375 n.38.

B. Freedom to Choose the Applicable Law in International Commercial Arbitration versus Domestic Commercial Arbitration

Scherk v. Alberto-Culver Company involved an international arbitration,²⁴ a context in which acceptance of the parties' freedom to choose the applicable law is particularly well established.²⁵ In fact, many international arbitration rules expressly state that the parties are free to choose the law to be applied to their agreement and that their choice is to be respected by the arbitrator(s).²⁶ One of the primary incentives for parties to agree to arbitration in the international business context is to avoid being subjected to a potentially hostile foreign forum and an unfamiliar legal system.²⁷

Just as in the international context, significant advantages can be gained through a choice-of-law clause in a domestic commercial transaction. Different states' laws may vary significantly and may be unfamiliar to one or more of the parties.²⁸ Some states' laws may be considered more business friendly.²⁹ Some states may have a more developed system of

²⁴ *Scherk*, 417 U.S. at 516.

²⁵ See, e.g., RICHARD GARNETT ET AL., A PRACTICAL GUIDE TO INTERNATIONAL COMMERCIAL ARBITRATION 23 (Oceana Publications, Inc., 2000); LEW, *supra* note 2, at 71–72, 582; ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 94–95 (3d ed., London, Sweet and Maxwell 1999); W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION 137 (1992).

²⁶ UNITED NATIONS, COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL ARBITRATION RULES art. 33.1 (1976) (“The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute.”); INTERNATIONAL CHAMBER OF COMMERCE, RULES OF ARBITRATION, art. 17.1 (1998) (“The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute.”); AMERICAN ARBITRATION ASSOCIATION, INTERNATIONAL ARBITRATION RULES, 2000, at 28 (2000) (“The tribunal shall apply the substantive law(s) or rules of law designated by the parties as applicable to the dispute.”); ARBITRATION INSTITUTE OF THE STOCKHOLM CHAMBER OF COMMERCE, RULES art. 24 (1999); NETHERLANDS ARBITRATION INSTITUTE, ARBITRATION RULES art. 45 (2001). However, most domestic arbitration rules are silent on the issue.

²⁷ See REDFERN & HUNTER, *supra* note 25, at 99; Rachel Engle, Note, *Party Autonomy in International Arbitration: Where Uniformity Gives Way to Predictability*, 15 TRANSNAT'L LAW. 323, 324 (Spring 2002).

²⁸ For an example, see *supra* Part I.

²⁹ For example, Delaware is known for its well-developed corporation law. See William J. Woodward, Jr., *Contractual Choice of Law: Legislative Choice in an Era of Party Autonomy*, 54 SMU L. REV. 697, 698–700 (2001) (discussing different states' laws that are designed to attract different businesses and persons).

law in certain areas.³⁰ Just as in international arbitration, some parties may want a neutral law to apply. Certain states also may not be geographically convenient for one or more of the parties, as some are farther away from one another than many foreign countries are from each other.³¹ For these reasons, it is useful for parties to a commercial transaction to be able to select the law that will apply to any dispute that may arise between them.

III. LEGAL AND POLICY REASONS SUPPORTING RESPECT FOR THE PARTIES' CHOICE OF LAW IN COMMERCIAL ARBITRATION

Although arbitration has some public law components,³² arbitration is essentially a creature of contract.³³ Arbitration would not occur but for the agreement of the parties to submit certain disputes to the arbitrator(s) for resolution.³⁴ As a result, an arbitrator's authority to hear and decide disputes is both

³⁰ For example, New York is renowned in legal circles for its well-developed body of maritime law, whereas Kansas, being landlocked, would not be expected to have a well-developed body of law in this area.

³¹ See Woodward, *supra* note 29, at 699–700.

³² For example, in the United States, enforceability of arbitration agreements and awards is made possible though the FAA, which is a federal statute. See 9 U.S.C. § 1 *et seq.* (2000).

³³ Smith Barney, Harris Upham & Co. v. Luckie, 85 N.Y.2d 193, 201, 647 N.E.2d 1308, 1312, 623 N.Y.S.2d 800, 804 (1995) (stating “arbitration is manifestly a matter of contract”); Davis v. Chevy Chase Fin. Ltd., 667 F.2d 160, 165 (D.C. Cir. 1981) (“Arbitration is, however, a matter of contract, and the contours of the arbitrator's authority in a given case are determined by reference to the arbitral agreement.”); see also STEPHEN K. HUBER & E. WENDY TRACHTE-HUBER, ARBITRATION: CASES AND MATERIALS 1 (1998); REISMAN, *supra* note 25, at 6. The jurisdictional theory of arbitration posits that arbitration is not so different from litigation because the validity of the arbitration agreement and the enforcement of the award depend on the law of the enforcing state. See LEW, *supra* note 2, at 52–54. However, this theory was largely followed in socialist countries and does not represent the prevailing view today. See *id.* at 54–61. Other scholars suggest a mixed theory of arbitration recognizing that arbitration contains elements of both public and private law. See *id.* at 57–58. Under this theory, the parties' agreement, including their choice of law, is respected unless it is contrary to the public policy of the forum. See *id.* at 58; see also Carlo Croff, *The Applicable Law in an International Commercial Arbitration: Is It Still a Conflict of Laws Problem?*, 16 INT'L LAW. 613, 617–20 (1982) (summarizing various theories of arbitration and party autonomy).

³⁴ There may exist some forms of court-ordered “arbitration,” but such proceedings are not within the traditional definition of arbitration and are therefore outside the scope of this article. For a traditional definition of arbitration, see *supra* note 1.

derived from,³⁵ and limited by, the arbitration agreement.³⁶ Arbitrators are not free to substitute their own view as to what the parties “should have agreed to for what the parties actually agreed to.”³⁷ Instead, the arbitrators are confined to interpreting the parties’ agreement,³⁸ and have no jurisdiction to decide issues that are not within the agreement’s scope.³⁹ Although arbitrators’ opinions are typically neither required to be written nor reasoned⁴⁰ and are rarely overturned,⁴¹ should they go

³⁵ *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1323 (5th Cir. 1994) (“It is well-settled that the arbitrator’s jurisdiction is defined by both the contract containing the arbitration clause and the submission agreement.”); *Szuts v. Dean Witter Reynolds Inc.*, 931 F.2d 830, 831 (11th Cir. 1991) (“The power and authority of the arbitrators in an arbitration proceeding is dependent on the provisions of the arbitration agreement under which the arbitrators were appointed.”); *see also* LEW, *supra* note 2, at 83; REISMAN, *supra* note 25, at 6.

³⁶ *Washington-Baltimore Newspaper Guild, Local 35 v. Washington Post Co.*, 621 F. Supp. 998, 1002 (D.D.C. 1985) (“An arbitrator’s authority is confined to interpreting and applying the collective bargaining agreement, and he may not ‘dispense his own brand of industrial justice’ by substituting his view of what the parties to an agreement should have agreed to for what they parties actually agreed to.” (quoting *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 597 (1960))); *Totem Marine Tug & Barge, Inc. v. North Am. Towing, Inc.*, 607 F.2d 649, 651 (5th Cir. 1979) (“[A]rbitrators are restricted to those issues submitted. . . . Arbitration is contractual and arbitrators derive their authority from the scope of the contractual agreement.”).

³⁷ *Washington-Baltimore Newspaper Guild*, 621 F. Supp. at 1002. Various international arbitral rules recognize this principle, requiring that arbitrators make their decisions in accordance with the terms of the contract. *See, e.g.*, UNITED NATIONS, COMMISSION ON INTERNATIONAL TRADE LAW, *supra* note 26, at art. 33.3 (1976) (“In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract”); INTERNATIONAL CHAMBER OF COMMERCE, *supra* note 26, at art. 17.2 (1988) (“In all cases the Arbitral Tribunal shall take account of the provisions of the contract”); AMERICAN ARBITRATION ASSOCIATION, *supra* note 26, at art. 28.2 (2000) (“In arbitrations involving the application of contracts, the tribunal shall decide in accordance with the terms of the contract”); CHINA CHAMBER OF INTERNATIONAL COMMERCE, CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION (CIETAC) ARBITRATION RULES art. 53 (2000) (“The arbitration tribunal shall independently and impartially make its arbitral award on the basis of facts, in accordance with the law and the terms of the contracts, with reference to international practices and in compliance with the principle of fairness and reasonableness.”).

³⁸ *Coast Trading Co. v. Pac. Molasses Co.*, 681 F.2d 1195, 1197 (9th Cir. 1982). *But see* *Hackett v. Milbank, Tweed, Hadley & McCloy*, 86 N.Y.2d 146, 155, 654 N.E.2d 95, 100, 630 N.Y.S.2d 274, 279 (1995) (stating that an arbitral award would not be vacated, even if the arbitrator “disregards the plain words of the parties’ agreement, . . . unless the court concludes that [the award] is totally irrational or violative of a strong public policy”).

³⁹ *Tatibouet v. Ellsworth*, 54 P.3d 397, 406 (Haw. 2002).

⁴⁰ *See* DOMKE, *supra* note 1, § 34:6.

⁴¹ *Id.* § 38:1.

beyond the scope of the written agreement, their awards may become vulnerable to the court's scrutiny.⁴² For example, arbitrators may not award remedies that are not permitted by the arbitration agreement.⁴³ In light of the contractual nature of arbitration, parties to a commercial arbitration agreement ought to be assured that their choice of the applicable law will be respected as well.

The contractual nature of arbitration serves to distinguish it from litigation.⁴⁴ Unlike judges, who are appointed or elected by law, arbitrators are appointed by the private agreement of the parties, and their allegiance should be to seeing that the terms of that private agreement are carried out.⁴⁵ The arbitrator's duty to respect the wishes of the parties as expressed in their written agreement extends to respect for the parties' choice of law in a commercial transaction.⁴⁶

⁴² See *Banco de Seguros del Estado v. Mut. Marine Office, Inc.*, 344 F.3d 255, 262 (2d Cir. 2003) ("The Federal Arbitration Act ('FAA') permits vacatur of an arbitral award where the arbitrators 'exceeded their powers.'") (quoting 9 U.S.C. § 10(a)(4)); *Bull HN Info. Sys., Inc. v. Hutson*, 229 F.3d 321, 330 (1st Cir. 2000) ("Section 10 of the FAA lists the circumstances in which a court has the authority to vacate an award, including certain types of misconduct by the arbitrator or where the arbitrator 'exceeded [his] powers.'") (quoting 9 U.S.C. § 10(a)(4)) (alteration in original); *Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 165 (D.C. Cir. 1981) ("[A]n arbitral award regarding a matter not within the scope of the governing arbitration clause is one made in excess of authority, and a court is precluded from giving effect to such an award."); see also HUBER & TRACHTE-HUBER, *supra* note 33, at 488.

⁴³ See *Am. Eagle Airlines, Inc. v. Air Lines Pilots Ass'n, Int'l*, 343 F.3d 401, 410 (5th Cir. 2003); *Coast Trading*, 681 F.2d at 1198.

⁴⁴ Arbitration differs from litigation in a number of other ways. For example, in arbitration, parties may choose where to arbitrate and who the decision-makers will be. By contrast, rules regarding proper subject matter, personal jurisdiction and venue dictate where lawsuits may be brought; court rules and practices dictate the assignment of the presiding judge. See OEHMKE, *supra* note 1, § 1:5 (stating that arbitrators are "not bound by the formal rules of procedure or evidence").

⁴⁵ As two respected scholars of international arbitration put it:

[Unlike national courts, a]n international arbitral tribunal does not owe allegiance to a particular national system of law. Its appointment is not due to the state, but to the agreement of the parties; and in applying the law chosen by the parties, an arbitral tribunal is simply carrying out their agreement.

REDFERN & HUNTER, *supra* note 25, at 95; see also LEW, *supra* note 2, at 81, 535.

⁴⁶ *Am. Eagle Airlines*, 343 F.3d. at 406 (stating "an 'arbitrator may not ignore the plain language of the contract'") (quoting *United Paperworks Int'l. Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987)); *Smith Barney, Harris Upham & Co. v. Luckie*, 85 N.Y.2d 193, 200-01, 647 N.E.2d 1308, 1312, 623 N.Y.S.2d 800, 804 (1995); see also DOMKE, *supra* note 1, § 30:4; OEHMKE, *supra* note 1, § 3:17.

The FAA recognizes the private contractual nature of arbitration, as it provides a right to obtain an order directing that “arbitration proceed in the manner provided for in [the arbitration] agreement.”⁴⁷ Construing this language, the Supreme Court has held that “the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.”⁴⁸ This policy of enforcing agreements according to their terms includes the parties’ choice of governing law.⁴⁹ As a result, parties are free “to include a choice of law provision in their agreement, and the parties’ choice will be honored unless the chosen law creates a conflict with the terms of, or policies underlying, the FAA.”⁵⁰

If arbitrators routinely respect the parties’ choices as reflected in the arbitration agreement, more parties will be encouraged to use arbitration as an alternative method of dispute settlement because the parties will know that they can control the process and gain many of the advantages of arbitration. These advantages include both public and private benefits, such as facilitating commerce by resolving disputes more quickly and efficiently than through litigation;⁵¹ freeing up court dockets, thereby saving public resources; and promoting more efficient regulation of cross-border activity, thereby maximizing human welfare.⁵² For these reasons, public policy should encourage parties to use arbitration as a method of dispute settlement. If, however, arbitrators do not respect the

⁴⁷ 9 U.S.C. § 4 (2000); *see also* *Smith Barney*, 85 N.Y.2d at 201, 647 N.E.2d at 1312, 623 N.Y.S.2d at 804 (quoting *Volt Info. Scis. v. Leland Stanford Junior Univ.*, 489 U.S. 468, 475 (1989)).

⁴⁸ *Volt*, 489 U.S. at 476.

⁴⁹ *See id.* at 479; *Hackett v. Milbank, Tweed, Hadley & McCloy*, 86 N.Y.2d 146, 154, 654 N.E.2d 95, 100, 630 N.Y.S.2d 274, 279 (1995). As one scholar states, “An arbitrator would frustrate the expectations of the parties were he to disregard their choice [of law].” Croff, *supra* note 33, at 622.

⁵⁰ *Smith Barney*, 85 N.Y.2d at 201, 647 N.E.2d at 1312, 623 N.Y.S.2d at 804 (citation omitted); *see also* *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (citing *Volt*, 489 U.S. at 479). The FAA “declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.” *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). Thus, the FAA will preempt state law to the extent that state law conflicts with the FAA. *See Volt*, 489 U.S. at 477; *Perry v. Thomas*, 482 U.S. 483, 489–90 (1987).

⁵¹ *See, e.g.*, Howard M. Holtzmann, *Arbitration: An Indispensable Aid to Multinational Enterprise*, 10 J. INT’L L. & ECON. 337, 337 (1975).

⁵² *See* Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L.J. 883, 884, 914–15 (2002); Ribstein, *supra* note 23, at 366.

parties' choices, many of the advantages associated with arbitration will cease to exist because the manner in which the arbitration will proceed will become less certain and predictable.⁵³

Absent overriding public policy considerations,⁵⁴ reviewing courts also should respect party autonomy pursuant to two well-established doctrines. First, respecting party autonomy in arbitration furthers the federal policy in favor of arbitration as reflected in the FAA.⁵⁵ As stated above, the FAA creates the right to have the arbitration proceed in accordance with the parties' wishes.⁵⁶ If the parties know that courts will uphold arbitration awards that are made in accordance with the parties' wishes, the parties will be even more likely to resort to arbitration as an alternative means of dispute resolution. Routine respect for the parties' agreement makes the process more certain and predictable, thus allowing business persons to better plan their business and legal dealings and relationships.⁵⁷

⁵³ From a business perspective, arbitrators will usually want to respect the choices made by the parties in order to have satisfied customers who will then be more likely to use those arbitrators again in the future. *See* Lawrence W. Newman & David Zaslowsky, *Cultural Predictability in International Arbitration*, N.Y. L.J., May 25, 2004, at 3 (stating that if arbitrators do not follow the parties' agreement, the arbitrators can be terminated).

⁵⁴ *See infra* Part V.B. for a discussion of public policy considerations in this area.

⁵⁵ *Perry*, 482 U.S. at 489 (“[The FAA] is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.”) (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)); *Smith Barney*, 85 N.Y.2d at 200–01, 647 N.E.2d at 1312, 623 N.Y.S.2d at 804.

In enacting the FAA, Congress established a Federal policy favoring arbitration agreements, which is to be advanced by rigorous judicial enforcement of arbitration agreements and by resolution of any “ambiguities as to the scope of the arbitration clause itself in favor of arbitration.”

... [T]he policy established by the FAA is to ensure that private agreements to arbitrate are enforced according to their terms. Accordingly, the parties are at liberty to include a choice of law provision in their agreement, and the parties' choice will be honored unless the chosen law creates a conflict with the terms of, or policies underlying, the FAA.

Id. (internal citations omitted).

⁵⁶ 9 U.S.C. § 4 (2000).

⁵⁷ *See Ribstein, supra* note 8, at 247–55.

Second, respecting the agreement of the parties is consistent with the general policy favoring freedom of contract.⁵⁸ When courts are deciding disputes arising out of contractual relationships, the intent of the parties is generally controlling. Likewise, an arbitral tribunal is bound to effectuate the intent of the parties.⁵⁹ These same principles should be applied to require enforcement of contractual provisions reflecting the choice of law made by the parties. Thus, if a court is reviewing an arbitral award where the arbitrators have failed to respect the parties' choice of law, the court should vacate that award because the arbitrators have exceeded their powers.⁶⁰

IV. WHAT CONFLICT OF LAWS RULES GOVERN COURTS AND WHY DO THEY MATTER FOR ARBITRATION?

Despite the sound legal and policy reasons for party autonomy, in the author's experience there have been limited occasions when one party became dissatisfied with the choice of law made by the parties to the arbitration agreement and sought to have that choice nullified by the arbitrators.⁶¹ In such cases,

⁵⁸ See *Milanovich v. Costa Crociere, S.P.A.*, 954 F.2d 763, 767 (D.C. Cir. 1992) ("Under American law, contractual choice-of-law provisions are usually honored.") (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971)); see also *Intamin, Inc. v. Figley-Wright Contractors, Inc.*, 595 F. Supp. 1350, 1351 (N.D. Ill. 1984).

⁵⁹ *Deprenyl Animal Health v. Univ. of Toronto Innovations Found.*, 297 F.3d 1343, 1358 (Fed. Cir. 2002).

⁶⁰ The FAA provides that one of the grounds for vacation of an arbitral award is "[w]here the arbitrators exceeded their powers." 9 U.S.C. § 10(a)(4). Despite this language, at least one scholar, Thomas Carbonneau, suggested that arbitrators have certain inherent authority implied by their designation as arbitrators to manage and conduct the proceedings and that this authority may include the power to overrule the parties' choice of law in the "best interests of the process." See Thomas E. Carbonneau, *The Ballad of Transborder Arbitration*, 56 MIAMI L. REV. 773, 814, 820–21 (2002). He argued that in choosing arbitration, the parties bargained for a "workable process" in exchange for placing "enormous authority and trust in the arbitrator." *Id.* at 815. While it is true that arbitrators are vested with certain inherent authority to manage the arbitral process, this author believes that the arbitrators' inherent authority is limited to matters that the parties have not expressly agreed upon, i.e., to fill in gaps. Where the parties have expressly bargained for and agreed upon a contractual term, the arbitrator lacks the power to overrule the parties' agreement.

⁶¹ For example, a party may seek to undo the previous agreement as to the applicable law where a dispute has arisen and the party discovers that the law originally chosen is not favorable to that party's position in the particular dispute. Unfortunately, because most arbitrations are private and arbitral awards are generally not published, it is not possible to investigate and determine exactly how

the party may argue that the choice-of-law clause in the arbitration agreement is invalid because it lacks a reasonable or substantial relationship to the parties or underlying transaction under judicial conflict of laws rules.⁶² If the arbitral panel agrees to examine the matter, it is likely to look to the law of the forum or seat of arbitration to determine the appropriate result. The arbitrators are likely to take this approach because, absent a specific choice-of-law clause, the designation of the place of arbitration traditionally has been treated as consent to the procedural law of that place, and is often considered to be persuasive evidence that local substantive law applies.⁶³ Another alternative would be for the arbitrators to apply the conflict of laws rules that accompany the substantive law chosen by the parties. However, where the challenge is to the applicability of the chosen law, the arbitrators may be hesitant to use that state's conflict of laws rules, and may instead turn to the forum's rules to help it decide whether the choice of law made by the parties is valid. This analysis assumes, of course, that the law chosen by the parties is different from the law of the forum. In any event, regardless of which state's law the arbitrators apply, to the extent that the arbitrators apply *any* state's conflict of laws rules in lieu of following the choice of law originally made by the parties, a review of such rules is in order.

frequently this situation occurs. Julian Lew's treatise provides a few examples of international commercial arbitrations in which the parties' choice of law was not respected or was found to be an insufficient manifestation of the parties' intent. See LEW, *supra* note 2, at 132–35. However, in general, Lew considers these examples to be exceptions to the general rule in favor of party autonomy in international commercial arbitration. See *id.* at 132. Another scholar, Corinne Truong, also suggests that parties rarely object to the application of a law to which they had previously consented. Cam Quyen Corinne Truong, *The Law Applicable to the Merits in International Distribution Contracts: An Analysis of ICC Arbitral Awards*, 12 ICC INT'L CT. ARB. BULL. 37 (Spring 2001).

⁶² According to Ribstein's study: "Courts rarely enforce choice-of-law clauses when enforcement is contested without some connection between the parties or the transaction and the designated state." Ribstein, *supra* note 23, at 376.

⁶³ See DOMKE, *supra* note 1, § 30:3; OEHMKE, *supra* note 1, § 48:27. Although applying the conflict of laws rules of the seat of arbitration is the traditional approach, some scholars suggest that more modern practice includes a determination of the proper law of the contract based on the contacts between the parties and the transaction and the various legal systems. See Julian D.M. Lew, *Relevance of Conflict of Law Rules in the Practice of Arbitration*, in PLANNING EFFICIENT ARBITRATION PROCEEDINGS: THE LAW APPLICABLE IN INTERNATIONAL ARBITRATION 447, 453–55 (Albert Jan Van Den Berg ed., 1996).

A. *The General Rule in Favor of Party Autonomy*

The general rule in the United States is that parties are free to choose the law applicable to their disputes and that agreement will be honored.⁶⁴ As one court stated:

Where two commercial concerns enter into a major contract (not one of adhesion, but representing at least substantially equal bargaining power), no reason would appear to compel the disregard of their arms-length bargain that a particular law applied to their agreements. . . . Why should such parties not have the right to define their own legal standards, and to look to a court to honor that choice if one of the parties breaks its promise?⁶⁵

The Restatement (Second) of Conflicts of Law (“Restatement”) provides the following rationale for the general rule in favor of freedom of choice:

Prime objectives of contract law are to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract. These objectives may best be attained in multistate transactions by letting the parties choose the law to govern the validity of the contract and the rights created thereby. In this way, certainty and predictability of result are most likely to be secured. Giving 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.⁶⁶

As demonstrated below, the rule in favor of party autonomy is reflected in numerous legal sources—including the Restatement as already mentioned, the Uniform Commercial Code, various state statutes, and state and federal case law. However, there are also significant limitations on the rule.

⁶⁴ *Milanovich v. Costa Crociere, S.P.A.*, 954 F.2d 763, 767 (D.C. Cir. 1992); *Medimatch, Inc. v. Lucent Tech. Inc.*, 120 F. Supp. 2d 842, 862 (N.D. Cal. 2000); see also Friedler, *supra* note 2, at 478.

⁶⁵ See *Intamin, Inc. v. Figley-Wright Contractors, Inc.*, 595 F. Supp. 1350, 1351 (N.D. Ill. 1984). This case dealt with a choice of law involving the Uniform Commercial Code (UCC), which itself expressly recognized the parties' freedom to choose the applicable law in UCC § 1-105, provided that the law chosen bears a reasonable or appropriate relationship to the transaction. *Id.*

⁶⁶ RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. e (1971).

B. Restatement (Second) of Conflicts of Law

Section 186 of the Restatement provides that the starting point for any choice of law analysis is the law chosen by the parties: "Issues in contract are determined by the law chosen by the parties in accordance with the rule of § 187 and otherwise by the law selected in accordance with the rule of § 188."⁶⁷ Section 187 reaffirms the general rule set forth in § 186,⁶⁸ but creates certain exceptions to the general rule.⁶⁹ The § 187(2) exceptions essentially create three hurdles that must be overcome.⁷⁰

First, the party challenging the applicability of the chosen law must demonstrate that there is no substantial relationship between the law chosen and either the parties or the contract itself.⁷¹ With respect to this first hurdle, it would seem fairly obvious that the law of a state that has a substantial relationship to the parties or the contract could be applied since that state's law could apply in the absence of any choice by the parties.

Second, the challenging party must demonstrate that there is no other reasonable basis for the parties' choice of law.⁷² Since most businesspersons are presumed to behave in a rational manner to maximize profit, it is sensible to assume that there is

⁶⁷ *Id.* § 186.

⁶⁸ *Id.* § 187(1) ("The 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."). Examples of issues that the parties cannot resolve by agreement include "capacity, formalities and substantial validity." *See id.* § 187 cmt. d.

⁶⁹ *See Ribstein, supra* note 8, at 262 (suggesting that the general rule in favor of party autonomy is "seriously weakened" by these exceptions).

⁷⁰ *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2).

(2) 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 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.

Id.

⁷¹ *Id.* § 187(2)(a).

⁷² *Id.*

a reasonable basis for the law chosen by the parties.⁷³ Thus, as one commentator suggested: "It is not clear why any choice the parties mutually agree to is not prima facie 'reasonable.'"⁷⁴ Of course, if the chosen state's law has some substantial relationship to the parties or the contract, the parties will be held to have made a reasonable choice.⁷⁵

The more difficult question arises where there is little or no connection between the parties to the contract and the law that is chosen. In such cases, how does one demonstrate that the parties were reasonable in choosing some other law to govern? Parties to an international business transaction may agree upon the law of a third neutral country rather than the law of one of their home countries to avoid either party gaining the advantage of having its own familiar law apply. The commentary to the Restatement also provides another possible answer. It suggests that parties contracting in a legal system that is foreign or immature may choose a law that is better known and developed and therefore will provide more certainty with respect to their contractual rights and duties.⁷⁶ This possible answer may explain a choice of a particular country's law in the international context, but may be less helpful in the domestic context when parties are choosing between the laws of various states in the United States, all of which have reasonably well-known and developed legal systems. However, even within the United States, some states may have a more well-developed body of law than other states in a particular area. Examples of this include Delaware's corporation law and New York's maritime law. Thus, even in a domestic context, parties may wish to choose a particular state's law over another state's law because one system is more familiar and mature than the other.

The third hurdle to overcome is the potential conflict with "a fundamental policy of a state which has a materially greater interest than the chosen state."⁷⁷ Difficulties here include defining when another state has a "materially greater interest" in the transaction and defining what types of public policy are

⁷³ "Contracts are entered into for serious purposes and rarely, if ever, will the parties choose a law without good reason for doing so." *Id.* § 187 cmt. f.

⁷⁴ Ribstein, *supra* note 8, at 264.

⁷⁵ See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. f.; *see also* *Comerio v. Beatrice Foods Co.*, 595 F. Supp. 918, 923 (E.D. Mo. 1984).

⁷⁶ See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. f.

⁷⁷ *Id.* § 187(2)(b).

considered so “fundamental” that they should override the rule in favor of party autonomy.⁷⁸

Despite the Restatement’s apparent general approval of party autonomy, the above-described exceptions sometimes have been interpreted by courts so as to substantially limit the parties’ freedom to choose the governing law.⁷⁹ As suggested above, courts have not treated *any* choice of law as reasonable within the meaning of § 187(2)(a); rather, they have usually looked for some relationship between the law chosen and the parties to the transaction. In addition, courts have used subsection (b) of § 187(2) to invalidate choice-of-law clauses where another state’s public policy is implicated.⁸⁰ As a result, there are a number of cases in which the parties’ choice of law was not upheld.⁸¹

Ironically, if the arbitrators disregard the parties’ choice of law, it is even less likely that a court will overturn that decision in an action seeking to vacate the award. Because there is a strong policy in favor of enforcing arbitration awards,⁸² judicial review of such awards is extremely limited⁸³ and courts will

⁷⁸ For examples of courts that have struggled with these issues, see *Morgan Guar. Trust Co. v. Republic of Palau*, 693 F. Supp. 1479, 1494–95 (S.D.N.Y. 1988); *Comerio*, 595 F. Supp. at 921.

⁷⁹ As one commentator has stated, some “American courts seem to pay only lip service to party autonomy.” Friedler, *supra* note 2, at 478.

⁸⁰ Ribstein’s study suggests that nonenforcement of choice-of-law clauses is most common in two particular categories of cases: noncompetition clauses in employment agreements and franchise agreements. Ribstein, *supra* note 23, at 376.

⁸¹ See *supra* note 18 and accompanying text. A complete survey of the relevant case law is beyond the scope of this article. The intent here is to show that commercial parties’ choice of law is not always respected despite the general rule in favor of party autonomy.

⁸² See 9 U.S.C. §§ 9–10 (2000); see also *supra* notes 50, 55 and accompanying text.

⁸³ *Banco de Seguros del Estado v. Mut. Marine Office, Inc.*, 344 F.3d 255, 260 (2d Cir. 2003) (“The scope of the district court’s review of an arbitral award is limited.”); *Teamsters Local Union No. 61 v. United Parcel Serv., Inc.*, 272 F.3d 600, 604 (D.C. Cir. 2001) (stating “judicial review of arbitral awards is extremely limited”) (quoting *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1178 (D.C. Cir. 1991)); *Bull HN Info. Sys., Inc. v. Hutson*, 229 F.3d 321, 330 (1st Cir. 2000) (noting that judicial review of an arbitration award is “extremely narrow and exceedingly deferential.”) (quoting *Wheelabrator Envirotech Operating Servs. Inc. v. Mass. Laborers Dist. Council Local 1144*, 88 F.3d 40, 43 (1st Cir. 1996)); *Coastal Oil of New England, Inc. v. Teamsters Local A/W*, 134 F.3d 466, 469 (1st Cir. 1998) (“[J]udicial review of an arbitration award is among the narrowest known to the law.”) (quoting *Maine Cent. R.R. Co. v. Bhd. of Maint. of Way Employees*, 873 F.2d

sometimes enforce awards even where the arbitrators' have ignored the rule in favor of party autonomy.⁸⁴ In some cases, courts have refused to vacate arbitral awards as representing an excess of authority⁸⁵ despite the fact that the arbitrators ignored the parties' choice-of-law clause, unless there was a violation of public policy or a decision that is "totally irrational."⁸⁶ This practice represents a blind application of the policy favoring the enforceability of arbitral awards, without consideration of the equally valuable competing policies in favor of freedom of contract and party autonomy in arbitration. Where an arbitrator's actions are contrary to express contractual provisions, such actions should not be respected on judicial review⁸⁷ absent an overriding and fundamental public policy concern.⁸⁸

C. *Uniform Commercial Code*

The Uniform Commercial Code ("UCC") also has long contained a presumption favoring the ability of commercial parties to choose the law applicable to their transaction.⁸⁹ Section 1-105 of the UCC permits the parties to designate the law applicable to their transaction subject to the limitation that

425, 428 (1st Cir. 1989)); *Executone Info. Systems, Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994) ("Our review of the arbitrator's award itself . . . is very deferential.").

⁸⁴ See Engle, *supra* note 27, at 325 ("[M]ost national courts defer to the arbitrators' rulings on the subject [of choice of law].") (citing Gary B. Born, *Choices of Law in International Arbitration*, in *INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES, COMMENTARY AND MATERIALS* 98, 99-100 (1994)).

⁸⁵ Despite the limited scope of judicial review, courts retain the power to vacate an arbitral award where the arbitrator has exceeded his powers under 9 U.S.C. § 10(a)(4). See *Bull*, 229 F.3d at 330.

⁸⁶ *Revson v. Hack*, 239 A.D.2d 169, 169, 657 N.Y.S.2d 51, 52 (1997); see also *Hackett v. Milbank, Tweed, Hadley & McCloy*, 86 N.Y.2d 146, 155, 654 N.E.2d 95, 100, 630 N.Y.S.2d 274, 279 (1995); *Silverman v. Cooper*, 61 N.Y.2d 299, 308, 461 N.E.2d 1261, 1266, 473 N.Y.S.2d 774, 779 (1984). A discussion of the extent of the arbitrators' duty to take into account a state's public policy may be found in Part V, *infra*.

⁸⁷ *McDonald v. Rodriguez*, 184 B.R. 514, 517 (S.D. Tex. 1995) ("Actions of an arbitrator contrary to express contractual provisions will not be respected on judicial review.").

⁸⁸ See *infra* Part V.B.

⁸⁹ With the exception of Louisiana, all states and the District of Columbia have adopted some version of the UCC. See U.C.C. 1 U.L.A. 1 (Supp. 2003) (providing a Table of Jurisdictions where the Code has been adopted.).

there be a reasonable or appropriate relation between the state whose law is chosen and the transaction.⁹⁰

The Official Comments to § 1-105 had reflected a somewhat mixed view of the parties' true freedom in this regard. On the one hand, the Official Comments stated that, "Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs."⁹¹ However, the Official Comments also appeared to allow for exceptions to the requirement that there be reasonable relation between the transaction and the law chosen. The Comments stated that "an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen."⁹²

In 2001, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved

⁹⁰ Section 1-105(1) of the UCC states:

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.

U.C.C. § 1-105(1) (2001). Subsection (2) contains additional limitations on the parties' ability to choose the applicable law with respect to specific transactions that may be governed by other Articles of the UCC. In this regard, the Official Comments explained: "Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings." *Id.* at cmt. 5.

⁹¹ *Id.* at cmt. 1.

⁹² *Id.* The United States District Court for the Northern District of Illinois examined this language in the *Intamin* case. *See Intamin, Inc. v. Figley Wright Contractors, Inc.*, 595 F. Supp. 1350 (N.D. Ill. 1984). This case involved a contract dispute relating to the construction of a roller coaster in the state of Illinois. The defendant argued that the parties could not agree to be governed by a substantive body of law that did not bear an appropriate relationship to the underlying transaction. *Id.* at 1351. The court rejected this argument, quoting the same language from the Official Comments to the UCC quoted above and stating: "In plain English that would permit the parties to apply the Illinois UCC even without a 'reasonable relation' to their deal." *Id.* at 1352. Ultimately, however, the court did not have to decide whether parties could choose a law that was entirely foreign to the transaction to govern their relationship since there were contacts between the transaction in that case and the state of Illinois. *Id.* Despite this fact, the *Intamin* court's language provides support for the idea that parties may even choose a law unrelated to their transaction to govern their dispute under the former UCC.

Revised Article 1 of the UCC.⁹³ Revised Article 1 significantly changes the UCC's choice-of-law provision to expressly allow parties to a domestic transaction to choose a state's law to govern their transaction, regardless of whether the transaction bears a relation to the state chosen.⁹⁴ The Official Comments to Revised Article 1 state that it "represents a significant rethinking of choice of law issues" and "affords greater party autonomy than former Section 1-105, but with important safeguards protecting consumer interests and fundamental policies."⁹⁵

With respect to this last comment, Revised Article 1 contains several important exceptions to the general rule favoring party autonomy. First, parties to a domestic transaction are only permitted to choose the law of a state of the United States to govern their transaction, and are not allowed to choose the law of a foreign country.⁹⁶ Domestic transactions are defined as those that do not bear a reasonable relation to a country other than the United States.⁹⁷

Second, Revised Article 1 makes a distinction between "consumer" transactions and "non-consumer transactions, such as 'business to business' transactions."⁹⁸ If a consumer is a party

⁹³ See National Conference of Commissioners on Uniform State Laws, UCC Article 1, General Provisions (2001), at <http://www.nccusl.org/nccusl/uniformacts-alphabetically.asp> (last visited Jan. 8, 2005).

⁹⁴ Revised Article 1 states in relevant part:

Except as otherwise provided in this section: (1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, *whether or not the transaction bears a relation to the State designated.*

U.C.C. § 1-301(c)(1) (2002) (emphasis added) [hereinafter Revised Article 1]. Subsection (c)(2) provides for party autonomy with respect to international transactions. *Id.* at (c)(2).

⁹⁵ *Id.* at introductory cmt. The Official Comments also note in more than one place that the change is intended to reflect "emerging international norms." *See id.*; *see also id.* at cmt. 2.

⁹⁶ *See id.* at § 1-301(c)(1); *id.* at cmt. 2, 4. If the underlying transaction bears a reasonable relation to a foreign country, the parties may choose the law of any state or foreign country to govern their transaction, regardless of whether there is any relation between the transaction and the law chosen. *Id.* § 1-301(c)(2). The Official Comments explain this different treatment as follows: "The ability to designate the law of any country in non-consumer international transactions is important in light of the common practice in many commercial contexts of designating the law of a 'neutral' jurisdiction or of a jurisdiction whose law is well-developed." *Id.* at cmt. 5.

⁹⁷ *Id.* § 1-301(a).

⁹⁸ *Id.* at introductory cmt.

to the transaction, the transaction must bear a reasonable relation to the state or country whose law is chosen.⁹⁹ Additionally, application of the law must not deprive the consumer of the benefit of laws enacted specifically for the purposes of consumer protection.¹⁰⁰

The next exception provides that a choice of law will not be effective to the extent that application of the chosen law would contradict basic policies of the state or country whose law would have applied in absence of the agreement.¹⁰¹ The last exception provides that the general choice of law rule found in § 1-301(c)(1) is subject to the specific choice-of-law rules found in other articles of the UCC, similar to the former UCC § 1-105(2).¹⁰²

Since the approval and adoption of UCC Revised Article 1, several states have introduced legislation to adopt it.¹⁰³ Both Virginia and Texas have enacted such legislation, but neither chose to adopt the new rule regarding party autonomy contained in Revised Article 1-301(c)(1).¹⁰⁴

UCC Revised Article 1 is an important step in the right direction, but fails to go far enough in one respect. There is no valid reason for refusing to permit parties to a domestic business transaction to choose the law of a foreign country if they so desire. Since consumer interests and fundamental policies of the states are specifically protected, there is no basis to deny parties to domestic commercial transactions even greater autonomy.

⁹⁹ *Id.* § 1-301(e)(1).

¹⁰⁰ *Id.* § 1-301(e)(2).

¹⁰¹ *Id.* § 1-301(f). The Official Comments provide some guidance as to what would constitute a “fundamental policy”:

[A] court should not refrain from applying the designated law merely because application of that law would lead to a result different than would be obtained under the local law of the State or country whose law would otherwise govern. Rather, the difference must be contrary to a public policy of that jurisdiction that is so substantial that it justifies overriding the concerns for certainty and predictability underlying modern commercial law as well as concerns for judicial economy generally.

Id. § 1-301 cmt. 6. The comment continues by quoting an opinion of Judge Cardozo from *Loucks v. Standard Oil Co. of New York*, 224 N.Y. 99, 108–11, 120 N.E. 198, 201–02 (1918).

¹⁰² U.C.C. § 1-301(g) (2002); *see also supra* note 90.

¹⁰³ *See* National Conference of Commissioners on Uniform States Laws, *A Few Facts About the Revised Uniform Commercial Code Article 1, General Provisions* (2001), at http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ucc1.asp (last visited Jan. 9, 2005).

¹⁰⁴ VA. CODE ANN. § 8.1A-301 (Michie Supp. 2004); H.B. 1394, 78th Reg. Sess. (Tex. 2003).

Using a variation on the hypothetical set forth at the beginning of this article, assume that instead of a ship repair contract, the underlying contract involves the purchase of several hundreds of thousands of dollars of materials needed for the ship repair. This change in the hypothetical would cause the contract to fall within the provisions of the UCC because it now involves the sale of goods. Assume further that Penn Ocean solicits bids from manufacturers in the United States and abroad, this time using a standard form contract that it used in a previous transaction with an English supplier. This form contract calls for the arbitration of any disputes under the laws of the United Kingdom (U.K.).

Ultimately, Penn Ocean enters into a contract with a Louisiana supplier, which will provide the necessary materials at the appropriate times during the several weeks that the ship is in the shipyard undergoing repair. Some materials will be supplied from manufacturers in the United States and others will be supplied from foreign manufacturers. Penn Ocean decides the contract should retain the clause calling for the application of U.K. law because England has well-developed commercial and maritime law and is another common law jurisdiction, as opposed to a civil law jurisdiction like Louisiana. Negotiations ensue and the Louisiana supplier ultimately agrees to this proposal.

Once again, why should these two commercial entities not be allowed to choose a foreign law to govern their transaction if they so desire? Both sides appear to have made an informed and conscious choice and had the opportunity to consult legal counsel. Thus, there should be no concern that one party is able to take advantage of the other. Surely, the United States cannot be so ethnocentric as to believe its legal system to be the best and most developed in the world in every respect. If either the states of Pennsylvania or Louisiana had a fundamental policy at stake, that policy would already be protected by Revised Article 1-301(f). Therefore, there is no reason to limit even greater party autonomy to only international transactions as Revised Article 1-301(c)(1) currently does.

D. State Law

As previously mentioned, all fifty states, with the exception of Louisiana, have adopted some form of the former UCC § 1-

105.¹⁰⁵ A handful of states, however, have modified the traditional choice of law rules by adopting statutory provisions that expressly permit parties to choose that state's or another state's law to govern their transaction. This is true even though there is no connection between the state chosen and the parties or the underlying transaction under certain conditions. These statutes are briefly described below.¹⁰⁶

New York was the first state to adopt such a provision. Its law states that the parties to any contract worth at least \$250,000 "may agree that the law of this state shall govern their rights and duties in whole or in part, *whether or not such contract, agreement or undertaking bears a reasonable relation to this state.*"¹⁰⁷ New York's law excludes any contracts: "(a) for labor or personal services, (b) relating to any transaction for personal, family or household services, or (c) to the extent provided to the contrary in subsection two of section 1-105 of the uniform commercial code."¹⁰⁸

Illinois¹⁰⁹ and California¹¹⁰ have statutory provisions that are similar to New York's. All three require that the underlying

¹⁰⁵ See *supra* note 89.

¹⁰⁶ See *infra* notes 109–24. State law in this area is changing rapidly. Therefore, there may be other state statutes that grant greater party autonomy enacted between the time this article is written and the time of publication.

¹⁰⁷ N.Y. GEN. OBLIG. LAW § 5-1401 (Consol. Supp. 2002) (emphasis added). This statutory provision was originally enacted in 1984.

¹⁰⁸ *Id.* § 5-1401(1).

¹⁰⁹ The Illinois statute states:

The parties to any contract, agreement, or undertaking, contingent or otherwise, in consideration of or relating to any obligation arising out of a transaction covering in the aggregate not less than \$250,000, including a transaction otherwise covered by subsection (1) of Section 1-105 of the Uniform Commercial Code [810 ILCS 5/1-105], 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 bears a reasonable relation to this State. This Section shall not apply to any contract, agreement, or undertaking (i) for labor or personal services, (ii) relating to any transaction for personal, family, or household services, or (iii) to the extent provided to the contrary in subsection (2) of Section 1-105 of the Uniform Commercial Code [810 ILCS 5/1-105]. Nothing contained in this Section shall be construed to limit or deny the enforcement of any provision respecting choice of law in any other contract, agreement, or undertaking.

735 ILL. COMP. STAT. 105/5-5 (2003).

¹¹⁰ The California statute, in relevant part, states:

Notwithstanding Section 1646, the 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),

transaction be worth a minimum of \$250,000, which makes it reasonable to presume that the persons making the contractual choice of law have at least a minimum level of sophistication with business transactions.¹¹¹ In addition, these statutory provisions expressly exempt three categories of transactions: contracts for labor or personal services; contracts for personal, family or household services; and contracts which are excluded from the general choice of law rule contained in UCC § 1-105.¹¹²

Delaware law also permits parties an increased amount of freedom in choosing the law applicable to their contracts. The parties may agree that the laws of Delaware will govern, provided that the underlying written contract, agreement, or transaction is worth at least \$100,000 and provided that the parties are subject to the jurisdiction of the courts of, or

including a transaction otherwise covered by subdivision (1) of Section 1105 of the Commercial Code, 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, or (c) to the extent provided to the contrary in subdivision (2) of Section 1105 of the Commercial Code.

CAL. CIV. CODE § 1646.5 (Deering 1994).

¹¹¹ The legislative history and other background material relating to the New York statute support this presumption. For example, a report by the Committee on Foreign Affairs and Comparative Law states:

By including only large non-consumer transactions, the proposal reduces the likelihood that any party agreed to a governing law through fraud, mistake, overreaching or unequal bargaining power. It also is probable that the parties to a sizable commercial transaction will have been represented by counsel during the negotiation process. These factors guarantee, as much as possible, that the parties focused on the choice-of-law provision and carefully considered the consequences of their choice of New York law.

Committee on Foreign and Comparative Law, *Proposal for Mandatory Enforcement of Governing-Law Clauses and Related Clauses in Significant Commercial Agreements*, 38 REC. ASS'N. BAR CITY OF N.Y. 537, 543 (1983).

¹¹² Contracts excluded from the general choice of law rule of UCC § 1-105 are those that are governed by particular choice of law rules contained in other sections of the UCC, namely UCC §§ 2-402 (rights of creditors against sold goods), 2A-105-06 (leases), 4-102 (bank deposits and collections), 4A-507 (funds transfers), 5-116 (letters of credit), 6-103 (bulk sales), 8-110 (investment securities), and 9-103 (secured transactions). U.C.C. § 1-105 (2). Many state statutes recognize these exclusions in their own choice of law provisions. *See, e.g.*, CAL. CIV. CODE § 1646.5 (Deering 1994); 735 ILL. COMP. STAT. ANN. 105/5.5 (West 2004); N.Y. GEN. OBLIG. LAW § 5-1401 (1) (McKinney 2001).

arbitration in, Delaware so that they may be served with legal process.¹¹³

Texas likewise provides a significant degree of party autonomy with respect to choice of law, but its statute is more restrictive in that it only applies to “qualified transaction[s,]” defined as transactions involving at least \$1,000,000.¹¹⁴ On the other hand, Texas law provides greater respect for party autonomy by allowing fundamental or public policy to be overridden by the parties’ choice, but only if the transaction bears a reasonable relation to the jurisdiction chosen.¹¹⁵

The Florida legislature appears to have attempted to follow in New York’s footsteps, but it has placed so many limitations on its choice-of-law statute that it may not change the general rule

¹¹³ The relevant portion of the Delaware statute states:

The parties to any contract, agreement or other undertaking, contingent or otherwise, may agree in writing that the contract, agreement or other undertaking shall be governed by or construed under the laws of this State, without regard to principles of conflict of laws, or that the laws of this State shall govern, in whole or in part, any or all of their rights, remedies, liabilities, powers and duties if the parties, either as provided by law or in the manner specified in such writing are, (i) subject to the jurisdiction of the courts of, or arbitration in, Delaware and, (ii) may be served with legal process. The foregoing shall conclusively be presumed to be a significant, material and reasonable relationship with this State and shall be enforced whether or not there are other relationships with this State.

DEL. CODE ANN. tit. 6, § 2708(a) (2002). For further explanation of the Delaware statute, see Larry E. Ribstein, *Delaware, Lawyers, and Contractual Choice of Law*, 19 DEL. J. CORP. L. 999, 1003–04 (1994).

¹¹⁴ Subject to certain limited exemptions, Texas law provides that, for transactions, contracts, or agreements worth at least \$1,000,000:

[I]f the parties to a qualified transaction agree in writing that the law of a particular jurisdiction governs the interpretation or construction of an agreement relating to the transaction or a provision of the agreement, the law, other than the conflict of laws rules, of that jurisdiction governs that issue regardless of whether the transaction bears a reasonable relation to that jurisdiction.

TEX. BUS. & COM. CODE ANN. § 35.51(a)(2) & (c) (Vernon 2002).

¹¹⁵ Subsection (b) of § 35.51 of the Texas statute provides that:

[I]f the parties to a qualified transaction agree in writing that the law of a particular jurisdiction governs an issue relating to the transaction, including the validity or enforceability of an agreement relating to the transaction or a provision of the agreement, and the transaction bears a reasonable relation to that jurisdiction, the law, other than conflict of laws rules, of that jurisdiction governs the issue regardless of whether the application of that law is contrary to a fundamental or public policy of this state or of any other jurisdiction.

Id. § 35.51(b).

for many transactions.¹¹⁶ Other states that have enacted choice-of-law statutes recognizing some form of party autonomy include Alabama,¹¹⁷ Ohio,¹¹⁸ Oregon,¹¹⁹ and Louisiana.¹²⁰

¹¹⁶ The Florida choice-of-law statute states in relevant part:

(1) The parties to any contract, agreement, or undertaking, contingent or otherwise, in consideration of or relating to any obligation arising out of a transaction involving in the aggregate not less than \$250,000, the equivalent thereof in any foreign currency, or services or tangible or intangible property, or both, of equivalent value, including a transaction otherwise covered by s. 671.105(1), may, to the extent permitted under the United States Constitution, agree that the law of this state will govern such contract, agreement, or undertaking, the effect thereof and their rights and duties thereunder, in whole or in part, whether or not such contract, agreement, or undertaking bears any relation to this state.

(2) This section does not apply to any contract, agreement, or undertaking:

(a) Regarding any transaction which does not bear a substantial or reasonable relation to this state in which every party is either or a combination of:

1. A resident and citizen of the United States, but not of this state; or
2. Incorporated or organized under the laws of another state and does not maintain a place of business in this state;

(b) For labor or employment;

(c) Relating to any transaction for personal, family, or household purposes, unless such contract, agreement, or undertaking concerns a trust at least one trustee of which resides or transacts business as a trustee in this state, in which case this section applies;

(d) To the extent provided to the contrary in s. 671.105(2); or

(e) To the extent such contract, agreement, or undertaking is otherwise covered or affected by s. 655.55.

FLA. STAT. ANN. § 685.101 (West 2003). Section 655.55 deals with the “[l]aw applicable to deposits in and contracts relating to extensions of credit by a deposit or lending institution located in [Florida].” FLA. STAT. ANN. § 655.55 (West 2004).

¹¹⁷ Alabama law only permits parties to transactions involving funds transfers to select the law of a particular jurisdiction to govern their transaction, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction. *See* ALA. CODE § 7-4A-507 (2003). Interestingly, this statutory provision is not limited to permitting parties to choose Alabama law even if Alabama law is unconnected to the funds transfer. Parties may choose any law they wish. Alabama’s statute also has no minimum dollar amount that must be met for the transaction to qualify. The official comment to Alabama’s statute explains this freedom of choice:

Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties.

Id. § 7-4A-507 cmt.3. Several provisions of the U.C.C. also contain very permissive choice-of-law rules for certain financial transactions. *See* U.C.C. §§ 4A-507(b) (funds transfers), 5-116(a) (letters of credit), 8-110(d) (securities) (2003).

¹¹⁸ The Ohio statute provides in relevant part:

The legislative history of New York's choice-of-law statute provides some indication as to why some states are leaning towards greater party autonomy. New York's expressed purpose in enacting its choice-of-law provision was to "secure and augment its reputation as a center of international commerce."¹²¹ The legislative history underlying the statute is replete with statements indicating a concern that, without this provision, New York's status as a major financial and commercial capitol could be eroded. This concern is grounded in the legislature's uncertainty as to whether contracts choosing New York law would be enforceable in New York courts.¹²²

(A) Except as provided in division (C) of this section, any person may bring a civil action in a court of this state against an individual, corporation, or other person who is a resident of, incorporated under the laws of, or otherwise engaged in the conduct of business in a foreign nation or a province, territory, or other political subdivision of a foreign nation, against a foreign nation, or against a province, territory, or other political subdivision of a foreign nation upon a cause of action that arises out of or relates to a contingent or other contract, agreement, or undertaking, whether or not it bears a reasonable relation to this state, if the contract, agreement, or undertaking contains both of the following provisions:

- (1) An agreement by the parties to be governed in their rights and duties under the contract, agreement, or undertaking, in whole or in part, by the law of this state;
- (2) An agreement by the parties to submit to the jurisdiction of the courts of this state.

OHIO REV. CODE ANN. § 2307.39 (Anderson 2001). Because this choice-of-law provision is contained in Ohio's long-arm statute and only applies to suits brought in Ohio courts, it would not apply to agreements to arbitrate, unless perhaps if one party to the agreement sought enforcement of the arbitration agreement or the award in court.

¹¹⁹ The Oregon statute provides in relevant part that, "Except as specifically provided by ORS 81.105, 81.110, 81.112, 81.115 or 81.125, the contractual rights and duties of the parties are governed by the law or laws that the parties have chosen. The choice of law may extend to the entire contract or to part of a contract." OR. REV. STAT. § 81.120 (2003). The statute makes several exceptions, excluding contracts for real property, personal services, franchises, licensing, and agency, among others. *See id.* § 81.135; *see also id.* §§ 81.105, 81.110, 81.112, 81.115, 81.125.

¹²⁰ The Louisiana statute contains the general rule that "[a]ll other issues of conventional obligations are governed by the law expressly chosen or clearly relied upon by the parties, except to the extent that law contravenes the public policy of the state whose law would otherwise be applicable under Article 3537." LA. CIV. CODE ANN. art. 3540 (West 1994). However, there are several exceptions. *See, e.g., id.* arts. 14, 3515, 3537.

¹²¹ *Radioactive, J.V. v. Manson*, 153 F. Supp. 2d 462, 470 (S.D.N.Y. 2001) (quoting *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 136 (S.D.N.Y. 2000)).

¹²² Memorandum of Legislative Representative of City of New York Ch. 421, 1984 N.Y. Laws 3288; Memorandum of Sen. John J. Marchi and Assemblyman

Proponents of the bill recognized that the law would result in more cases on New York courts' already crowded dockets, but nevertheless argued that "the number of multi-jurisdiction contracts which actually result in litigation is a tiny fraction of all such contracts," and that "the professional and economic benefits to be gained from fostering New York's status as a world financial and legal capital [sic] outweigh the risk of some slight increase in the case load of New York courts."¹²³ Other states have similarly recognized the potential economic benefit of such statutes.¹²⁴

As the above survey demonstrates, a few states have taken steps towards allowing parties to select the law of a state to govern their transaction, even where there is no relation between the parties or the transaction and the state whose law is chosen. In each such case, the state has placed limitations upon the parties' ability to select the law of an unrelated jurisdiction. These limitations are designed to ensure that only parties to relatively large commercial transactions—often worth a certain minimum dollar amount between \$100,000 and \$1,000,000—will qualify. Limitations such as those found in New York's statute are therefore appropriate because they alleviate concerns that consumers or unsophisticated businesspersons might be forced to litigate or arbitrate under unfair or unfamiliar circumstances. However, when two businesspersons or entities are involved and a reasonably large amount of money is at stake, it is fair to assume that they have access to legal counsel, that they will read any contract they sign, and that they will be knowingly and consciously agreeing to the arbitration and to the choice of law

Stegel, Bill Jacket, ch 421, L. 1984, at 1–2; Letter from Assemblyman Mark Alan Siegel to Gerald C. Crotty, Counsel to the Governor, dated Jul. 24, 1984, Bill Jacket, L. 1984, ch 421; Letter of Edward I. Koch, Mayor of the City of New York, dated July 10, 1984, Bill Jacket, L. 1984, ch 421; Letter from James P. Murphy, Executive Vice President of the New York Bankers' Association, to Gerald C. Crotty, Counsel to the Governor, dated July 11, 1984, Bill Jacket, L. 1984, ch. 421.

¹²³ Committee on Foreign and Comparative Law, *supra* note 111, at 550; see also Memorandum of Legislative Representative of City of New York, *supra* note 122, at 3289; Memorandum of Sen. John J. Marchi and Assemblyman Stegel, *supra* note 122. These legislators also suggest that the law could result in "off-setting efficiencies—for example, in the form of reduced court time devoted to presently-existing motion practice litigating the issue of proper forum and other issues addressed by the amendment." *Id.*

¹²⁴ For an explanation of some of the economic implications of such statutes, see Ribstein, *supra* note 113, at 1000.

made in the written agreement. Accordingly, all fifty states should enact statutes such as UCC Revised Article 1 that provide greater respect for party autonomy.¹²⁵ Such enactment would make it even less likely that arbitrators would fail to respect party autonomy, because they would know that the states' choice of law rules would dictate following the parties' wishes.

V. THERE ARE NO CONSTITUTIONAL OR OTHER CONCERNS THAT JUSTIFY A FAILURE TO RESPECT THE PARTIES' CHOICE OF LAW IN DOMESTIC COMMERCIAL ARBITRATION

A. *Potential Constitutional Limitations*

Some commentators have suggested that allowing parties to choose a law that does not have an appropriate, reasonable, or substantial connection with the underlying transaction or parties would be unconstitutional.¹²⁶ In particular, these commentators have suggested that such a practice may violate the Due Process Clause¹²⁷ and the Full Faith and Credit Clause¹²⁸ of the Constitution. The following discussion explains these issues and why they should not be a concern in the context of domestic commercial arbitration.

In construing due process requirements in the context of a choice of law analysis, the Supreme Court has focused on whether the parties could reasonably have anticipated that the law chosen by the court would be applied.¹²⁹ The leading case, *Allstate Ins. Co. v. Hague*,¹³⁰ involved a suit against an insurance company by the widow of an insured who died in a motorcycle accident in Wisconsin while commuting between his work in

¹²⁵ As discussed above, in adopting UCC Revised Article 1, states should amend it slightly to allow parties to purely domestic transactions to choose foreign law if they so desire. *See supra* text following note 104.

¹²⁶ *See, e.g.*, Greenstein, *supra* note 8, at 1172–73; Rashkover, *supra* note 8, at 227–28. *But see* Sedler, *supra* note 8, at 67 (arguing that “the due process and full faith and credit clauses do not operate to impose any significant limitations on the power of state courts to make choice of law decisions.”).

¹²⁷ The Due Process Clause of the Fourteenth Amendment provides: “No State shall . . . deprive any person of life, liberty, or property, without due process of law.” U.S. CONST. amend. XIV, § 1.

¹²⁸ The Full Faith and Credit Clause states: “Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.” U.S. CONST. art. IV, § 1.

¹²⁹ *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 308 (1981) (plurality opinion).

¹³⁰ *Id.*

Minnesota and his home in Wisconsin. In a plurality opinion, the Supreme Court upheld the Minnesota court's application of Minnesota law, stating:

In deciding constitutional choice-of-law questions, whether under the Due Process Clause or the Full Faith and Credit Clause, this Court has traditionally examined the contacts of the State, whose law was applied, with the parties and with the occurrence or transaction giving rise to the litigation. In order to ensure that the choice of law is neither arbitrary nor fundamentally unfair, the Court has invalidated the choice of law of a State which has had no significant contact or significant aggregation of contacts, creating state interests, with the parties and the occurrence or transaction.¹³¹

The Court continued by stating that "for a State's 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."¹³² Thus, the plurality opinion lumps together the analysis under the Due Process and Full Faith and Credit Clauses.¹³³

Justice Stevens wrote a concurring opinion to draw attention to the distinction between the requirements of the Due Process and Full Faith and Credit Clauses in the context of a

¹³¹ *Id.* at 308 (citations and footnote omitted). This quote makes clear that the majority of the Supreme Court believed it is not necessary to use a different analysis for due process violations and full faith and credit violations in the context of choice-of-law clauses. *See also id.* at 332–33 (Powell, J., dissenting):

My disagreement with the plurality is narrow. I accept with few reservations Part II of the plurality opinion, which sets forth the basic principles that guide us in reviewing state choice-of-law decisions under the Constitution.

... [T]he Court has recognized that both the Due Process and the Full Faith and Credit Clauses are satisfied if the forum has such significant contacts with the litigation that it has a legitimate state interest in applying its own law.

Id.; *see infra* note 133.

¹³² *Allstate*, 449 U.S. at 312–13 (1981) (plurality opinion). The Court then applied that test and found sufficient contacts between the parties and Minnesota that made the application of Minnesota's law constitutionally permissible. *See id.* at 320.

¹³³ The dissenters agreed that the "touchstone" for the constitutional inquiry is the "reasonable expectation of the parties." *See id.* at 333 (Powell, J., dissenting). They further agreed that in this case, the parties' expectations were not compromised. *See id.* at 336. However, they believed that there were no significant contacts with Minnesota that would create a legitimate state interest. *See id.* at 337.

choice of law analysis.¹³⁴ In Justice Stevens' view, the Full Faith and Credit Clause may prevent the state whose law is chosen from applying that law if doing so would unjustifiably infringe on the sovereignty of another state.¹³⁵ By contrast, the Due Process Clause may prevent the state whose law is chosen from applying that law because of fairness concerns.¹³⁶ Justice Stevens would measure the fairness of the decision by the "justifiable expectations" of the parties at the time of contracting.¹³⁷ Regardless of which *Allstate* opinion is the most persuasive, none of them place a heavy constitutional burden on choice of law analyses.¹³⁸ Moreover, the constitutional concerns raised in *Allstate* are not seriously implicated by the proposal advocated herein for at least two reasons.

First, *Allstate* did not involve an express choice-of-law provision agreed to by the parties. Rather, it involved a choice of law made by a court after the occurrence of an incident with connections to two states. Because of those multiple connections, the Supreme Court said it was reasonable and should not surprise the parties that more than one state's law could apply to the matter. Where two parties have mutually agreed to have their dispute governed by a particular law, neither can reasonably argue surprise when the law chosen is the very one that they agreed to. To the contrary, it likely would be quite surprising to the parties if their choice of law was not applied given the strong policies in favor of freedom of contract and party autonomy. Thus, the case for applying the choice of law made by the parties to an arbitration agreement is far stronger than the case in *Allstate* and should not raise due process concerns. Enforcement of the law chosen by the parties is clearly "fair"¹³⁹

¹³⁴ See *id.* at 320 (Stevens, J., concurring).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.* at 327, 331.

¹³⁸ See Sedler, *supra* note 8, at 74 (stating that the Court placed only "minimal limitations on the power of state courts to make choice-of-law decisions").

¹³⁹ See *Allstate*, 449 U.S. at 308. This analysis assumes that there are no extenuating circumstances, such as fraud or overweening bargaining power. In such an unusual case, exceptions to the general rule of applying the law chosen by the parties could certainly be made. In fact, the FAA states that "corruption, fraud, or undue means" are grounds for vacation of an award. 9 U.S.C. § 10(a)(1) (2000).

since it reflects the justifiable “expectations of the parties at the time of contracting.”¹⁴⁰

Second, because arbitration is generally private in nature it does not implicate the public interests reflected in the Full Faith and Credit Clause. The purpose of the Full Faith and Credit Clause is to ensure equality among the states of the union and respect for one another's laws.¹⁴¹ These principles are usually not implicated in a decision by a private arbitrator because the arbitrator does not stand in the shoes of one state assessing whether to respect another state's laws. Moreover, to the extent that the Full Faith and Credit Clause may be implicated, some legal scholars have suggested that the parties' mere selection of a particular state's law will create the required contact with the state to meet the constitutional concerns expressed in *Allstate*.¹⁴² One such scholar suggested that the Supreme Court may have endorsed this approach in the *Burger King* case,¹⁴³ when it affirmed that a choice-of-law clause is a significant contact with a jurisdiction.¹⁴⁴

B. Potential Public Policy Concerns

Another concern that some scholars have expressed is that party autonomy can operate to undermine important public policies.¹⁴⁵ Parties may opt out of state laws that might otherwise be applicable, thereby making that state's public policies also inapplicable to the transaction.¹⁴⁶ Because of this

¹⁴⁰ *Allstate*, 449 U.S. at 331 (Stevens, J. concurring); *see id.* at 333 (Powell, J., dissenting).

¹⁴¹ *Magnolia Petroleum Co. v. Hunt*, 320 U.S. 430, 439 (1943); *Nastro v. D'Onofrio*, 822 A.2d 286, 290–91 (Conn. App. Ct. 2003); *see also* Sedler, *supra* note 9, at 96–97.

¹⁴² *See, e.g.*, Friedler, *supra* note 2 at 498–500; Linda S. Mullenix, *Another Choice of Forum, Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 *FORDHAM L. REV.* 291, 350 (1988).

¹⁴³ *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

¹⁴⁴ Friedler, *supra* note 2, at 498–500. It must be pointed out, however, that *Burger King* dealt with the issue of whether there were sufficient contacts with the forum state for the proper exercise of personal jurisdiction, not for purposes of choosing the applicable law. The Supreme Court has suggested that there is a difference between these two analyses. *See Allstate*, 449 U.S. at 320–21 n.3 (Stevens, J., concurring).

¹⁴⁵ *See, e.g.*, Greenstein, *supra* note 8, at 1159–60; McConnaughay, *supra* note 8, at 257–58; Woodward, *supra* note 29, at 273–74.

¹⁴⁶ Woodward suggests that in the commercial context, important public policies are reflected in laws regarding usury, limitations on liquidated damages,

concern, both the Restatement and the UCC contain exceptions to the general rule in favor of party autonomy where application of the chosen law would be contrary to a fundamental policy of the state whose law would have applied in the absence of the parties' agreement.¹⁴⁷

Professor Philip McConnaughay has criticized party autonomy specifically on the ground that it carries a substantial risk of under-regulation because parties are likely to choose a law with lesser regulation than the forum's law would provide, thereby leading to the occurrence of some harm the forum law was intended to prevent.¹⁴⁸ There are several responses to this argument. First, this argument assumes that the parties are familiar with many systems of law and would choose the least burdensome one, a questionable and unsupported assumption. While a party may develop a familiarity with a particular forum's law as a result of doing business there, the party is unlikely to be familiar with most legal systems, especially where the law is ambiguous or complicated.¹⁴⁹ Second, as Professor Larry Ribstein argued, allowing parties to avoid application of a particular state's law may be more efficient because it allows parties to avoid the application of inefficient mandatory rules that were created to benefit small yet well-coordinated interest groups rather than overall social welfare.¹⁵⁰ Particularly in the context of two commercial entities negotiating a sizable business deal, it is reasonable to assume that the parties are sufficiently sophisticated to protect themselves and do not need as much protection from the legislature.

Moreover, the concern that parties may exempt themselves from important public policies does not carry the same weight in arbitration as it does in litigation. Arbitration is largely a matter of private contract and arbitrators are appointed by way of that contract. Therefore, unlike judges, arbitrators do not owe

and restrictions on unconscionable contracts. See Woodward, *supra* note 29, at 213. These types of laws are often enacted to protect less knowledgeable parties. As explained herein, such protection is not needed where the parties involved are sophisticated commercial entities engaged in sizeable transactions.

¹⁴⁷ RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971); UCC § 1-301(f) (2004).

¹⁴⁸ See McConnaughay, *supra* note 8, at 257.

¹⁴⁹ See LEW, *supra* note 2, at 103.

¹⁵⁰ See Ribstein, *supra* note 23, at 366. *But see* Woodward, *supra* note 29, at 275–84 (offering some criticisms of Ribstein's economic analyses).

loyalty to a particular state's public policy and should not invalidate the parties' choice of law merely because the arbitrators believe that some other state's laws and policies are being undermined. Rather, the arbitrators owe their loyalty to seeing that the parties' wishes are carried out according to the terms of the contract.

Arbitrators do, however, have a duty to the parties to render an award that is enforceable. If the arbitrators render an award that is contrary to the public policy of the forum or of the place of enforcement, the award may be unenforceable, leaving the prevailing party without an adequate remedy.¹⁵¹ Likewise, if the law of the forum prohibits arbitration of certain kinds of disputes, the court is likely to take jurisdiction and refuse to stay proceedings pending arbitration.¹⁵² Therefore, a prudent arbitrator will take public policy into account even if the arbitrator does not owe allegiance to that public policy in the same way that a judge might.¹⁵³

By contrast, a court called upon to review an arbitration award does have a duty to respect his or her state's public policies as reflected in the laws of that state. Although the FAA does not state that arbitral awards may be vacated because they violate public policy,¹⁵⁴ the U.S. Supreme Court has created a ground for vacatur where the public policy is "well defined and dominant" and may "be ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.'"¹⁵⁵ Several courts have also recognized a public policy ground for vacatur under state law as well.¹⁵⁶ Thus, a

¹⁵¹ See *infra* note 154 and accompanying text.

¹⁵² See LEW, *supra* note 2, at 536–37.

¹⁵³ See *id.*; see also Woodward, *supra* note 29, at 270.

¹⁵⁴ The grounds for vacatur of an arbitral award under the FAA are found in 9 U.S.C. § 10 and do not include a public policy ground. By contrast, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards does permit a court to refuse recognition and enforcement of an arbitral award if "recognition or enforcement of the award would be contrary to the public policy of that country." Compare FAA, 9 U.S.C. § 10 (2000), to U.N., U.N. CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS, art. V(2)(b) (June 10, 1958), 21 U.S.T. 2517, 330 U.N.T.S. 3, *codified at* 9 U.S.C. § 201 *et seq.*

¹⁵⁵ W.R. Grace & Co. v. Local Union 759, Int'l Union of the United Rubber, Cork, Linoleum and Plastic Workers of Am., 461 U.S. 757, 766 (1983) (quoting *Muschany v. United States*, 324 U.S. 49, 66 (1945)); see also *E. Associated Coal Corp. v. United Mine Workers of Am.*, 531 U.S. 57, 62 (2000).

¹⁵⁶ See, e.g., *Am. and Nat'l Leagues of Prof'l Baseball Clubs v. Major League Baseball Players Ass'n*, 130 Cal. Rptr. 626, 628 (Ct. App. 1976); *1745 Wazee LLC v.*

reviewing court that believes an arbitral award to be contrary to a fundamental public policy of the state may refuse to recognize and enforce the award.

The relevance of the forum's public policy is one aspect of domestic commercial arbitration that differs from international commercial arbitration. Scholars who advocate for party autonomy in international commercial arbitration sometimes do so on the basis that international commercial arbitration is independent of any one sovereign nation-state.¹⁵⁷ This theory of independence reinforces the idea that arbitrators of international disputes owe their allegiance to the agreement creating their appointment rather than to any national legal system. By contrast, in domestic commercial arbitration, all of the contacts are with one sovereign nation-state. Therefore, an argument can be made that the arbitrators in a domestic commercial arbitration owe allegiance to U.S. law.

United States law and policy regarding arbitration is reflected in the FAA.¹⁵⁸ The FAA directs arbitrators and courts to abide by the agreement of the parties, including the parties' choice of law.¹⁵⁹ Therefore, even if arbitrators in a domestic commercial arbitration owe allegiance to the law of the United States, that law directs the arbitrators to respect party autonomy. In addition, just as arbitrators in international commercial arbitration would have to choose between the laws of competing sovereign nation-states, arbitrators in domestic commercial arbitration involving contacts with more than one state must choose between the laws of equal and competing states of the United States. Thus, despite certain differences between domestic and international commercial arbitration, the similarities may still outweigh them. As such, theories supporting party autonomy in an international commercial arbitration are applicable to support party autonomy in domestic commercial arbitration by way of analogy.

Castle Builders, Inc., 89 P.3d 422, 425–26 (Colo. Ct. App. 2003); Int'l Bhd. of Police Officers v. Town of Windsor, 483 A.2d 626, 628 (Conn. Super. Ct. 1984); City of Harvey v. Am. Fed'n of State, County and Mun. Employees (AFSCME), 776 N.E.2d 683, 689, (Ill. App. Ct. 2002); United Fed'n of Teachers, v. Bd. of Educ., 1 N.Y.3d 72, 78–80, 801 N.E.2d 827, 831–33, 769 N.Y.S.2d 451, 455–57 (2003); Ohio Council 8 v. Trumbull Mem'l Hosp., 124 F. Supp. 2d 482, 486 (N.D. Ohio 2000).

¹⁵⁷ See Croff, *supra* note 33, at 618–20.

¹⁵⁸ 9 U.S.C. § 1 *et seq.*

¹⁵⁹ See *supra* Part III.

Finally, some critics may also argue that parties should not be allowed to choose a law to govern their arbitration agreement if it has no connection to the parties or the transaction, because that state's resources should not be expended to resolve a dispute in which it has no interest. While it is possible that a chosen state's resources could be implicated in resolving the dispute, one of the purposes of arbitration is to resolve the dispute privately without using state resources. Thus, the state's judicial system is not utilized unless a party fails to comply with the agreement to arbitrate and a court order is needed to enforce the arbitration agreement, or if a party goes to court to vacate or confirm an arbitral award. In addition, if states with major commercial centers like New York, Illinois, and California have examined the issue and have decided that the benefits of respecting party autonomy outweigh the slightly increased burden on the state's resources, there is truly no reason not to enforce that choice.

CONCLUSION

Arbitration is an attractive method of dispute resolution for commercial parties because it allows the parties a great deal of choice and control over the process. It also promotes certainty and predictability in business relations, thereby making commerce more efficient. Allowing commercial parties the greatest freedom of choice possible and requiring arbitrators and courts to respect the choices made by the parties will encourage the use of arbitration because it will allow the parties to obtain the benefits of arbitration. As a society, we want to encourage resolution of disputes through arbitration because arbitration facilitates commerce and frees up court dockets and associated public resources. Therefore, arbitrators, courts, and legislatures should adopt and follow rules that require respect for party autonomy in domestic commercial arbitration, just as is done in international commercial arbitration.