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Chapter 11

ENFORCEMENT OF CHOICE OF LAW CLAUSES

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Table of Sections

WESTLAW Electronic Research

See WESTLAW Electronic Research Guide preceding the Summary of Contents.

§ 11.1 Scope Note

This chapter provides a general discussion of the enforcement of choice of law clauses (also known as "governing law" clauses) in New York State courts, including: the reasons for selecting a particular law to govern contractual disputes, the applicable law when a choice of law clause is absent, and the limits on the enforcement of such clauses. The chapter also discusses the impact a choice of law clause has on arbitration, and statutory and other authority relevant to choice of law clauses. Finally, the chapter concludes with a representative clause and the procedures for raising or objecting to the enforcement of choice of law clauses.

Library References:

West's Key No. Digests, Contracts ⇐129(1).

§ 11.2 Preliminaries

A dispute arising out of a contract with interstate or transnational contacts requires the court of the forum in the first instance to choose the substantive law of the appropriate state or nation to apply to the transaction. In the absence of a provision in the contract specifying the applicable law, the court will resort to the forum state's choice of law rules, the application of which may defeat the expectations of one of the parties. Therefore, contracting parties do well to designate in their contracts the law that they intend to govern in the event of a dispute. Such choices are important not only to insure certainty but also uniformity in multi-state transactions such as franchising agreements. "Giving parties this power [to choose which law will govern their disputes] 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." [1] Even where parties have agreed to use arbitration for the resolution of disputes, a choice of law clause is important because of the varying rules among the states with respect to the scope of arbitration, such as the power of arbitrators to award punitive damages.

As a general rule, courts will enforce choice of law provisions. The law of New York is particularly permissive in allowing parties to certain contracts to designate New York law even where the contact of the transaction with New York is non-existent. In *Credit Francais v. Sociedad Financiera*,[2] Justice Greenfield, in discussing the validity of a New York choice of law clause contained in a multi-jurisdictional contract, expressed this seemingly New York-centered view of the world:

> New York, as the center of international trade and finance, has expressly recognized as a service to the business community, that its courts will be hospitable to the resolution of all substantial contractual disputes in which the parties have agreed beforehand that our neutrality and expertise should govern their relationships. Just as the dollar has become the international standard for monetary transactions, so may parties agree that New York law is the standard for international disputes.[3]

Before parties decide to include a choice of law clause when drafting their contract, or before parties attempt to enforce such a clause,[4] they must give careful consideration to the implications of their choice of law. Is the designated law the most advantageous for disputes which are

1. *Restatement (Second) Conflict of Laws* § 187 cmt. e (1971).

2. 128 Misc.2d 564, 490 N.Y.S.2d 670 (Sup.Ct., N.Y. County, 1985).

3. 120 Misc.2d at 570, 490 N.Y.S.2d at 676.

4. Parties may waive their right to enforce a choice of law clause contained in an agreement. *See infra* § 11.8.

likely to arise under the contract? Given the unpredictability and difficulty in forecasting disputes which may arise, such an analysis may not be possible or practical. Thus, parties may wish to consider other factors, apart from the advantages which the laws of a particular state may provide, in selecting a choice of law. One possible consideration is the extent to which the law in a particular jurisdiction has developed with respect to the subject of the contract. In jurisdictions where the law defines the parties' rights and liabilities more clearly, the outcome of the parties' dispute, should one arise, is likely to be more predictable.

The parties' right to choose the applicable law is, however, subject to certain limitations which are the principal subject of this chapter. Those drafting such clauses must be aware of them and also the risk inherent in selecting a state's law without limitation, only to find a court enforcing that state's choice of law rules before applying the substantive law. Similarly, those litigating contracts containing choice of law clauses should not lightly assume that the mere presence of such a clause precludes a challenge.

Library References:

West's Key No. Digests, Contracts ⇐129(1).

(a) Choice of Forum Clauses Distinguished

Forum selection clauses, which often accompany choice of law clauses, designate the forum where disputes arising out of the contract will be heard. These clauses are *prima facie* valid and will be honored "unless unreasonable under the circumstances," [5] or "unless [the clause] is the result of overreaching, unequal bargaining power, or causes acute inconvenience." [6]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

(b) Forum *Non Conveniens* Distinguished

Under the doctrine of *forum non conveniens*, codified in CPLR 327, courts will allow New York to serve as the forum of litigation unless "it can be demonstrated that there is a better and more appropriate forum elsewhere. In such cases, New York may continue to entertain the action unless important policy considerations dictate otherwise, even if there is a minimal nexus between the parties and facts of the action and New York." [7] Where parties to a contract have stipulated that New York law shall govern disputes arising under the agreement and designate New York as the forum in which disputes shall be heard, a

5. M/S Bremen v. Zapata Off–Shore Co., 407 U.S. 1, 10, 92 S.Ct. 1907, 1913, 32 L.Ed.2d 513 (1972).

6. Credit Francais v. Sociedad Financiera, 128 Misc.2d 564, 568, 490 N.Y.S.2d 670, 675 (Sup.Ct., N.Y. County, 1985). *See supra* Chapter 10 "Enforcement of Forum Selection and Arbitration Clauses."

7. Credit Francais v. Sociedad Financiera, 128 Misc.2d 564, 567, 490 N.Y.S.2d 670, 674 (Sup.Ct., N.Y. County, 1985)(citations omitted).

defendant will be precluded from raising a *forum non conveniens* defense.[8]

Library References:

West's Key No. Digests, Courts ⇐28; Venue ⇐52.

(c) Applicable Law When Choice of Law Clause Absent

Absent a choice of law clause, courts must ascertain which law governs an agreement when the nature of the transaction implicates the laws of more than one state or nation. To do so, courts look to the circumstances surrounding the agreement, including the place where the contract is made, and the place of performance. The most relevant factors used to determine which jurisdiction's law applies are which jurisdiction has the greatest interest in the litigation and what purpose is served by the law in conflict. New York has adopted an approach which analyzes the grouping of contacts between the controversy and the relevant jurisdictions. Under this approach, New York courts apply the "law of the jurisdiction having the greatest interest in the litigation." To determine the respective jurisdictions' interests, courts look to those facts and contacts "which relate to the purpose of the particular law in conflict." [9]

In *Intercontinental Planning*, for example, the plaintiff alleged it was entitled to a finder's fee pursuant to a written agreement for its role in the defendants' acquisition of a New Jersey electronics corporation. The Court of Appeals concluded that the writings did not constitute an enforceable agreement in satisfaction of the New York Statute of Frauds, but that the alleged contract would not be barred by New Jersey's Statute of Frauds.

In deciding which state's law applied, the Court noted that traditionally, courts attempted to characterize a conflicting law as substantive or procedural—if substantive, the law of the place of contracting would apply; if procedural, the law of the forum would apply. *International Planning* rejected the traditional approach [10] in favor of the grouping of contacts analysis, stating, "[T]his attempt to characterize the Statute of Frauds as procedural or substantive, concerned as it is with amorphous legal conclusions, does little more than restate the problem and has even less relevance to our modern approach to the conflict of laws." [11]

The Court concluded that New York had the greater interest in the application of its law after examining the legislative history of the New

8. Arthur Young & Co. v. Leong, 53 A.D.2d 515, 383 N.Y.S.2d 618 (1st Dep't), appeal dismissed, 40 N.Y.2d 984, 390 N.Y.S.2d 927, 359 N.E.2d 435 (1976).

9. Intercontinental Planning, Ltd. v. Daystrom, Inc., 24 N.Y.2d 372, 382, 300 N.Y.S.2d 817, 825, 248 N.E.2d 576 (1969).

10. The court did note that its conclusion would have been the same even if it had applied the traditional approach, since if the Statute of Frauds were deemed procedural, a court sitting in New York would apply its own law; if the Statute of Frauds were deemed substantive, New York law would still apply, since New York's interest was paramount. 24 N.Y.2d at 381, 380 N.Y.S.2d at 825.

11. 24 N.Y.2d at 381, 380 N.Y.S.2d at 824–25.

York Statute of Frauds, New York's position as an international business center, and the contacts which New Jersey and New York had with the controversy "in relation to the policies and purposes to be vindicated by the conflicting laws." [12]

In *Auten v. Auten*,[13] the grouping of contacts test resulted in the application of the law of England. That case involved an action to recover support and maintenance payments due under a separation agreement executed in New York. The parties had been married in England and lived there with their two children until the husband allegedly deserted his wife and obtained a Mexican divorce. The wife came to New York, where the parties executed a separation agreement.

The Court of Appeals held that the law of England controlled, since that jurisdiction had the most significant contacts with the dispute. In justifying the grouping of contacts approach, the Court of Appeals noted that:

> Although this "grouping of contacts" theory may, perhaps, afford less certainty and predictability than the rigid general rules, the merit of its approach is that it gives to the place "having the most interest in the problem" paramount control over the legal issues arising out of a particular factual context, thus allowing the forum to apply the policy of the jurisdiction "most intimately concerned with the outcome of [the] particular litigation." [14]

Library References:

West's Key No. Digests, Contracts ⇐2, 144.

§ 11.3 The Validity of Choice of Law Provisions

When the parties to a contract have designated a choice of law in their agreement, and that choice bears a reasonable relationship to the parties' agreement, it will generally be upheld, and the grouping of contacts analysis will not be applied.

In *A.S. Rampell, Inc. v. Hyster Co.*,[15] the Court of Appeals held that where the parties have included a choice of law clause and their choice bears "a reasonable relation" to the underlying contract, it will be enforced. *Rampell* involved an action by a truck dealer-distributor against one of its employees, an Oregon manufacturer and one of the manufacturer's employees for damages as a result of the defendants' alleged interference with the distribution contract. The contract provided for Oregon law to control construction of the contract. Based on the choice of law clause, the Court of Appeals held Oregon law applicable.

A choice of law clause which is alleged to exist in an *oral* contract will, of course, require an evidentiary showing that such a choice was

12. 24 N.Y.2d at 382, 300 N.Y.S.2d at 826.

13. 308 N.Y. 155, 124 N.E.2d 99 (1954).

14. 308 N.Y. at 161 (citations omitted).

15. 3 N.Y.2d 369, 381, 165 N.Y.S.2d 475, 486, 144 N.E.2d 371 (1957).

made. In *Freedman v. Chemical Construction Corp.*,[16] the Court of Appeals affirmed the Appellate Division's award of summary judgment in favor of a defendant who was alleged to have violated an oral contract to pay a finder's fee, based on the New York Statute of Frauds. The plaintiff alleged that the oral agreement "included an understanding that Saudi law would apply." [17]

In affirming the Appellate Division's grant of the defendants' summary judgment motion, the Court of Appeals noted that the plaintiff's bare allegation, without any evidentiary support, of a Saudi choice of law clause did not create a triable issue precluding summary judgment. The Court noted that even if it were clear that the parties had agreed to the application of Saudi law, it was not clear that it would be applied:

> As a general matter, the parties' manifested intentions to have an agreement governed by the law of a particular jurisdiction are honored. It is as though the law of the selected jurisdiction were incorporated into the agreement by reference. But where, as with the Statute of Frauds, the issue arguably cannot be controlled by voluntary agreement, there is some question whether, in the absence of a reasonable basis for choosing the law of the jurisdiction designated by the parties, their choice of law will be honored.[18]

The *Freedman* Court relied in part on the *Restatement (Second) Conflicts of Law*[19] for the proposition that, notwithstanding the presumptive validity of choice of law clauses, parties may not stipulate to particular issues, such as the Statute of Frauds. The Court, however, left unanswered the question of which issues cannot be stipulated to by contract.

Library References:

West's Key No. Digests, Contracts ⇐129(1).

(a) What Constitutes a Sufficiently "Reasonable Relationship" for Choice of Law Purposes?

As noted above, the general rule is that a choice of law clause will be honored where the parties' choice bears a reasonable relationship to the dispute in question. Much litigation has revolved around this reasonable relationship test.

In *Culbert v. Rols Capital Co.*,[20] the plaintiff brought an action against a New York partnership to declare a loan agreement entered into between the parties void as against New York's usury laws, despite his agreement to a New Jersey choice of law clause. The Court denied summary judgment for the defendant, ruling that while New Jersey law

16. 43 N.Y.2d 260, 401 N.Y.S.2d 176, 372 N.E.2d 12 (1977).

17. 43 N.Y.2d at 264, 401 N.Y.S.2d at 179.

18. 43 N.Y.2d at 266, 401 N.Y.S.2d at 179–80.

19. *See infra* § 11.3(d).

20. 184 A.D.2d 612, 585 N.Y.S.2d 67 (2d Dep't 1992).

would be applied "[u]nder ordinary circumstances," a factual question existed as to whether the defendant was nominally operating in New Jersey only to avoid New York's usury laws. The Court stated that a choice of law provision will not be honored where the specified jurisdiction has no reasonable relation to the agreement or would violate New York's fundamental public policy.

In *Gambar Enterprises, Inc. v. Kelly Services, Inc.*,[21] one of the plaintiffs entered into an agreement pursuant to which he acted as the defendant's agent in providing temporary business services in New York. The contract stated that it was to be construed under Michigan law. The agreement was for a fixed term, but allowed the parties to terminate it upon the occurrence of specified conditions. After the plaintiff-agent assigned his rights under the contract to the plaintiff-corporation (which he solely owned), the defendant informed the agent that it was terminating the contract. The plaintiffs subsequently started an action to prevent the defendant from terminating the contract without good cause, as Michigan law required for fixed term contracts. In resolving a dispute as to whether New York or Michigan law should apply, the Court honored the Michigan choice of law clause, finding that Michigan had sufficient contacts with the contract to meet the reasonable relation test.[22]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

(b) New York General Obligations Law and Statutory Amount in Controversy

Under General Obligations Law § 5–1401, parties to certain contracts may agree to have their disputes governed by New York law, regardless of whether the agreement bears a reasonable relation to New York, provided the amount in controversy is at least $250,000.[23] Under § 5–1402, parties to certain contracts may likewise agree to submit to the jurisdiction of New York courts where the parties have included a

21. 69 A.D.2d 297, 418 N.Y.S.2d 818 (4th Dep't 1979).

22. The court found, *inter alia*, that the defendant's home office was in Michigan and that several of the duties to be performed by the defendant originated in Michigan. 69 A.D.2d at 303–04, 418 N.Y.S.2d at 822.

23. General Obligations Law § 5–1401 provides:

1. The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1–105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state. This section shall not apply to any contract, agreement or undertaking (a) for labor or personal services, (b) relating to any transaction for personal, family or household services, or (c) to the extent provided to the contrary in subsection two of section 1–105 of the uniform commercial code.

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

New York choice of law clause and the obligations of the contract amount to at least $1,000,000.[24] This act of the Legislature reflects the recognition of the significant role of New York as an international financial and commercial center. Absent such a statute, parties to significant commercial transactions would be unable to stipulate to the application of New York law unless their agreement bore a reasonable relationship to New York.

Under GOL § 5–1401, parties may not raise a defense based on the court's lack of personal jurisdiction if they have agreed to have their contract governed by New York law. Thus, in *Banco do Commercio e Industria de Sao Paolo S.A. v. Esusa Engenharia e Construcoes S.A.*,[25] the First Department held that guarantors of a promissory note who consented to the jurisdiction of the courts in New York and the application of New York law in the guarantee could not complain of the "burden" cast upon them or the court.

Sections 5–1401 and 5–1402 have been interpreted broadly to confer exclusive jurisdiction on New York courts applying New York law and have been held to have retroactive effect.[26] In *Babcock*, the parties agreed to submit to the jurisdiction of the state and federal courts of New York and agreed to have New York law govern their contract. The plaintiffs sought a declaration that any claims the defendant had against them had to be brought in New York and that the claims asserted by the defendants in a pending Ohio action should be barred as a matter of New York law. In granting the plaintiffs' motion enjoining the defendant from prosecuting the Ohio action, the Court looked to GOL §§ 5–1401 and 5–1402, found the statutes had retroactive application, and held that the choice of forum and choice of law clauses were mandatory, rather than permissive. The Court held that the rule of comity, which ordinarily prevents one jurisdiction from interfering with proceedings in another jurisdiction, was inapplicable, since the Ohio action was brought for impermissible reasons.[27]

24. General Obligations Law § 5–1402 provides:

1. Notwithstanding any act which limits or affects the right of a person to maintain an action or proceeding, including, but not limited to, paragraph (b) of section thirteen hundred fourteen of the business corporation law and subdivision two of section two hundred-b of the banking law, any person may maintain an action or proceeding against a foreign corporation, non-resident, or foreign state where the action or proceeding arises out of or relates to any contract, agreement or undertaking for which a choice of New York law has been made in whole or in part pursuant to section 5–1401 and which (a) is a contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate, not less than one million dollars, and (b) which contains a provision or provisions whereby such foreign corporation or non-resident agrees to submit to the jurisdiction of the courts of this state.

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

25. 173 A.D.2d 340, 569 N.Y.S.2d 708 (1st Dep't 1991).

26. Babcock & Wilcox Co. v. Control Components, Inc., 161 Misc.2d 636, 614 N.Y.S.2d 678 (Sup.Ct., N.Y. County, 1993).

27. 161 Misc.2d at 645, 614 N.Y.S.2d at 683–84.

The rule of comity was also held inapplicable in *Propulsora Ixtapa Sur, S.A. v. Omni Hotels Franchising Corp.*[28] There, the contract had a New York choice of law clause and also provided that any contractual disputes would be resolved by arbitration in New York County. Propulsora commenced an action in Mexico asserting that the contract was invalid under Mexican law; Omni served Propulsora with a notice of intention to arbitrate their dispute in New York, and Omni subsequently commenced an arbitration pending the outcome of the Mexican litigation. By petition, Propulsora sought to stay the New York arbitration pending the outcome of the Mexican litigation, but Omni moved to dismiss Propulsora's petition as untimely. The Appellate Division, held that Propulsora's petition to stay arbitration was untimely under New York law and that comity did not, "of its own force, compel" the trial court to stay the arbitration.

Library References:

West's Key No. Digests, Contracts ⇐129(1); Courts ⇐25.

(c) UCC § 1–105(1)

UCC § 1–105(1) does little more than codify the general common law rule that parties may agree to the law to govern construction of their contracts:

> 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.

Under that section, the parties' choice should be honored if the transaction bears a reasonable relation to both New York and another jurisdiction, and the law of one of the two jurisdictions has been selected. Comment 1 to the section explains that whether a reasonable relation exists depends on whether "a significant enough portion of the making or performance of the contract is to occur or occurs...." UCC 1–105(1) is merely permissive, and does not conflict with GOL § 5–1401, which extends the application of New York law to certain transactions which may bear no reasonable relation to New York.[29]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

(d) *Restatement (Second) Conflict of Laws*

Section 187 of the *Restatement (Second) Conflict of Laws* appears to reflect New York law. It provides, in relevant part:

> (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.

28. 211 A.D.2d 546, 621 N.Y.S.2d 569 (1st Dep't 1995).

29. *See supra* § 11.3(b).

(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.

Comment a to the Section makes it clear that the rule of the *Restatement* applies where it has been established, "to the satisfaction of the forum," that the parties chose the law to govern their controversy. Comment b states that the choice of law provision will not be given effect when one of the parties obtained the consent of the other through improper means, such as misrepresentation, duress, undue influence or mistake, and that it is for the forum to decide if consent was obtained through improper means.

In *Bossier Plaza Associates Limited Partnership v. Pierson*,[30] the plaintiff brought a declaratory judgment action seeking a declaration that the defendant had breached a real estate limited partnership subscription agreement which provided for the application of New York law. Despite the choice of law clause, the defendant argued for the application of the Louisiana Deficiency Judgment Act, which would have barred a deficiency. The First Department affirmed the Supreme Court's order granting the plaintiff summary judgment, citing the *Restatement*. The Court reaffirmed the rule that, as long as sufficient contacts exist between the dispute and the choice of law, the parties' designated choice will be honored.[31]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

§ 11.4 Limitations on the Enforcement of Choice of Law Clauses

Courts will not honor a choice of law clause where to do so would

30. 156 A.D.2d 246, 548 N.Y.S.2d 507 (1st Dep't 1989).

31. *See also* North American Bank, Ltd. v. Schulman, 123 Misc.2d 516, 474 N.Y.S.2d 383 (Westchester County Ct., 1984)(applying *Restatement* to void choice of law where enforcement would have violated New York public policy); Freedman v. Chemical Construction Corp., 43 N.Y.2d 260, 266, 401 N.Y.S.2d 176, 179–80, 372 N.E.2d 12 (1977)(citing the *Restatement* for the proposition that where an issue such as the Statute of Frauds cannot be controlled by voluntary agreement, the parties' choice of law may not be honored absent a reasonable basis for the parties' choice).

violate New York public policy. In *Fox v. Ashland Oil, Inc.*,[32] the Court held that a contract in violation of GOL § Law 5–322[33] would be void as against public policy and "the courts of this state will not enforce it even though the contract provides for interpretation of its terms under Kentucky law."[34]

In *Clifton Steel Corp. v. General Electric Co.*,[35] the parties' contract specified that it was to be construed and enforced according to Connecticut law and that the plaintiff waived its right to file a mechanic's lien on the property. The Court ruled that because New York law prohibits the waiver of the right to file a mechanic's lien as against public policy, "the issue as to whether or not the contract was governed by Connecticut law is academic."[36]

The public policy exception has gained some currency in the usury context. In *North American Bank, Ltd. v. Schulman*,[37] the Court refused to enforce a loan agreement made in New York, which provided for the application of Israeli law, and which would have resulted in an interest rate charged to the defendant of over 18%. Citing the *Restatement,* the Court noted that although choice of law clauses are generally enforceable, this rule is inapplicable where the law of the chosen jurisdiction has no substantial relationship to the parties or transaction, or where application of the chosen law would violate a fundamental policy of a state with a materially greater interest than the chosen state. The Court took notice of New York's public policy prohibiting usury, holding:

> to permit a contract executed in New York State to be governed by the laws of a jurisdiction which has apparently chosen not to outlaw usury at all ... would, in this Court's view, fly in the face of time-honored public policy.[38]

The public policy exception is a narrow one, however, and a party must establish an explicit violation of New York public policy before a court will refuse to honor a choice of law clause. In *Monsanto v. Electronic Data Systems Corp.*,[39] for example, an employee brought a wrongful discharge and breach of contract action after his employment was terminated. The contract, which did not contain a fixed duration of employment, stipulated that Texas law applied to contractual disputes. The plaintiff argued that Texas law should not be applied, since the contract violated New York public policy. The Court rejected this argument, noting that under both Texas and New York law, where an

32. 134 A.D.2d 850, 521 N.Y.S.2d 594 (4th Dep't 1987).

33. Under that statute, contracts for the construction, alteration, repair or maintenance of a structure which purport to indemnify the promisee against liability for personal or property damage caused by the promisee's negligence are void as against public policy.

34. 134 A.D.2d at 850, 521 N.Y.S.2d at 595.

35. 80 A.D.2d 714, 437 N.Y.S.2d 734 (3d Dep't 1981).

36. 80 A.D.2d at 715, 437 N.Y.S.2d at 735.

37. 123 Misc.2d 516, 474 N.Y.S.2d 383 (Westchester County Ct., 1984).

38. 123 Misc.2d at 520–21, 474 N.Y.S.2d at 387.

39. 141 A.D.2d 514, 529 N.Y.S.2d 512 (2d Dep't 1988).

employment contract does not fix a term of employment, the employee is deemed to be an employee at will, and can be terminated at any time.

Although New York state courts have not spoken definitively on the issue, apart from public policy considerations, choice of law clauses are likely to be invalidated if contained in a contract of adhesion or in a contract which is the product of fraud or undue influence.[40]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

§ 11.5 Actions in New York Where Foreign Law Has Been Chosen

Although there is little case law on point, it appears that New York courts, when faced with a choice of law clause which specifies the law of a jurisdiction other than New York, will first apply traditional *New York* conflict of law rules to determine whether the transaction has sufficient contacts with the foreign jurisdiction. If it finds the clause valid under New York law, the court will then apply the substantive law of the jurisdiction specified in the choice of law clause.[41] Thus, in the example given by Gruson, if a New York court is faced with an agreement specifying Colorado law as controlling, the New York court will determine whether the choice of law provision is valid under New York law; that is, whether there is a reasonable relationship between the contract and Colorado. If there is, the court will then apply the substantive law only of Colorado.[42]

In *Sears, Roebuck & Co. v. Enco Associates, Inc.*,[43] the plaintiff sought damages for breach of contract and tort. The contract contained a Michigan choice of law clause. The issue was whether the New York or Michigan Statute of Limitations applied to the tort claims. If New York law applied, the plaintiff's remedy would be limited to contractual damages, since the New York Statute of Limitations for the plaintiff's tort claims had expired. In contrast, if the Court applied Michigan's Statute of Limitations (the law specified in the choice of law clause), the plaintiff possibly could have recovered under both contract and tort theories.

The Court concluded that the Michigan *substantive* law applied, but not Michigan's Statute of Limitations, which the Court held to be

40. *Restatement (Second) Conflict of Laws* § 187 cmt. b (1971); Joseph A. Kilburn & Jeffrey M. Winn, *The Rules of Construction in Choice-of-Law Cases in New York*, 62 St. John's L. Rev. 243, 257–58 (1988).

41. Michael Gruson, *Governing Law Clauses in Commercial Agreements—New York's Approach*, 18 Colum. J. Transnat'l L. 322, 364 & n.15.

42. Gruson's criticism of this approach is well-reasoned. As he points out, the parties to the agreement likely specified Colorado law on the advice of Colorado counsel, based on their wish to have Colorado substantive law applied. It is highly improbable that their Colorado attorneys would have investigated or foreseen the possibility that a court in New York, or any other jurisdiction, could strike down the designation of Colorado law as invalid under the law of the forum. *Id.*

43. 43 N.Y.2d 389, 401 N.Y.S.2d 767, 372 N.E.2d 555 (1977).

procedural. The Court noted that another reason not to apply Michigan's Statute of Limitations was because to do so would "be an instance of *renvoi*," a doctrine not followed in New York.[44]

In *Hurwitz v. Hurwitz*,[45] the law designated by the parties was not that of another state or country, but was religious law. In that case, the plaintiffs, the stepchildren of the defendant, sought to evict her from the residence their father owned at the time of his death. The defendant based her right to remain in the house on the parties' Jewish marriage contract. Although it does not appear that the contract contained a choice of law clause, it did make reference to the "Jewish laws of Israel and Moses."

The Court held that a trial was required to ascertain the circumstances surrounding the execution of the contract and the intent of the parties. The Court stated:

> If the parties in a written agreement duly bound themselves to conform to the provisions of these Jewish laws and the husband granted to the defendant wife rights or privileges defined in these laws, I think the wife may assert them so far as they are not contrary to our own law.[46]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

§ 11.6 Arbitration, Preemption and Choice of Law

Ordinarily, where parties have agreed to submit their disputes to arbitration under the laws of a designated jurisdiction, New York courts will, as a general rule, honor their choice to have a particular jurisdiction's arbitration law applied. In *I.S. Joseph Co. v. Toufic Aris & Fils*,[47] the contract contained an arbitration clause providing for the arbitration in New York of any controversy arising out of the contract "under the laws of the State of New York." Based on the choice of law clause and the Court's conclusion that the transaction bore a reasonable relation to New York,[48] the First Department rejected the petitioner's contention that the matter should be governed by the laws of Louisiana, which was alleged to be the state with the most significant contacts with the controversy. The Court stated that it was not clear in any event that application of Louisiana law to the issues involved in the case would have dictated a different result than application of New York law.

44. 43 N.Y.2d at 398, 401 N.Y.S.2d at 772.

45. 216 A.D. 362, 215 N.Y.S. 184 (2d Dep't 1926).

46. 216 A.D. at 365, 215 N.Y.S. at 187.

47. 54 A.D.2d 665, 388 N.Y.S.2d 1 (1st Dep't 1976).

48. The court also based its application of New York law on the holding in a 1914 opinion authored by Judge Cardozo which stated that:

> [a]n agreement that all differences arising under a contract shall be submitted to arbitration relates to the law of remedies, and the law that governs remedies is the law of the forum.

I.S. Joseph, 54 A.D.2d at 666, 388 N.Y.S.2d at 3 (citing Meacham v. Jamestown, 211 N.Y. 346, 352, 105 N.E. 653, 655 (1914).)

Regardless, the Court applied New York law, and ordered the arbitration to go forward.

Once a court determines that the parties' choice of arbitration law is valid, however, it still must determine whether the federal arbitration law preempts the parties' choice. In *Matter of Merrill, Lynch, Pierce, Fenner & Smith, Inc. (Henderson)*,[49] an investor commenced an arbitration against Merrill Lynch, claiming that the securities she was urged to invest in were unsuitable for her objectives.[50] In response, Merrill Lynch filed an application in the New York Supreme Court pursuant to CPLR 7502 and 7503 for a stay of the arbitration, alleging that the Statute of Limitations had expired.

The Court held that the Federal Arbitration Act ("FAA"), which provides that the applicability of the Statute of Limitations should be decided by the arbitrator, preempted New York law. In explaining its reasoning, the Court noted that "where the FAA applies, all questions of interpretation, construction, validity, revocability and enforceability of arbitration agreements are governed by federal law," and that the FAA also "controls the allocation of functions between the court and the arbitrator." [51]

Customer agreements in the securities industry invariably include arbitration clauses calling for the application of the law of a particular state—frequently New York. These clauses have been the subject of an evolving jurisprudence which has addressed such issues as the availability of punitive damages,[52] and whether the court or the arbitrator should determine whether a claim is barred by the Statute of Limitations.[53] Two cases to address choice of law clauses in the context of arbitration proceedings deserve particular attention: *Mastrobuono v. Shearson Lehman Hutton Inc.*[54] and *Smith Barney, Harris Upham & Co. v. Luckie.*[55]

In *Mastrobuono*, the customer agreement required the parties to arbitrate all disputes, and stated that such disputes were to be governed by New York law. The issue was whether this clause barred an award of punitive damages, which may not be granted by arbitrators under New York law. The Supreme Court held that private agreements to arbitrate are enforceable according to their terms, and that the choice of law clause—which did not explicitly set out the New York law barring punitive damages—did not preclude such an award. In part, the Court based its holding on a provision in the contract which authorized

49. N.Y.L.J., 6/20/93, p. 23, col. 2.

50. The customer agreement contained an arbitration clause providing for the application of New York law.

51. Matter of Merrill, Lynch, N.Y.L.J.,6/20/93, p. 23, col. 2.

52. The New York Court of Appeals has held that New York law does not allow arbitrators to award punitive damages. *See* Garrity v. Lyle Stuart Inc., 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976).

53. Under CPLR 7502(b), in an application to the court, a party may assert that a claim brought against it in an arbitration proceeding is barred by the Statute of Limitations.

54. ___ U.S. ___, 115 S.Ct. 1212, 131 L.Ed.2d 76 (1995).

55. 85 N.Y.2d 193, 623 N.Y.S.2d 800, 647 N.E.2d 1308 (1995). *See supra* § 10.2(c)(4).

arbitration in accordance with the rules of the National Association of Securities Dealers, which permits arbitrators to award "damages and other relief." Thus, the Court found that the contract was ambiguous as to whether punitive damages were available, and construed the ambiguity against the drafter.

In deciding *Mastrobuono*, the Court purported to distinguish a prior decision, *Volt Information Sciences Inc. v. Board of Trustees of Leland Stanford Junior University*.[56] In *Volt*, the parties entered into a contract containing an arbitration clause pursuant to which resolution of their disputes was to be governed by California law. California law permits courts in certain circumstances to stay arbitration pending the judicial resolution of related litigation. Subsequently, Volt sought arbitration of a dispute with Stanford; in response, Stanford brought a state court action against Volt and two third parties. Volt then moved to compel arbitration, while Stanford moved to stay arbitration pursuant to state law. The Supreme Court held that the FAA, which would have required the arbitration to go forward, did not preempt the California state law which permitted the Court to stay arbitration, and that parties which agreed to be governed by state rules of arbitration are bound by those rules.

In *Luckie*, the New York Court of Appeals, citing *Volt*, held that a New York choice of law provision in a customer agreement permitted parties to seek a court order barring arbitration on the ground that the Statute of Limitations had run, as permitted by CPLR 7502(b). The Court held that the FAA did not preempt the provision of New York law permitting courts to determine whether the Statute of Limitations had run, despite the fact that absent a New York choice of law provision, the FAA would require the arbitrator to decide whether the claim was timely. The Court further held that application of the CPLR was consistent with the FAA's goal of ensuring that parties' agreements to arbitrate are enforced according to their terms.

Mastrobuono, which was decided less than two weeks after *Luckie*, throws the Court of Appeals decision into serious question. It is difficult to conceive why New York statutory law should be applied to resolve Statute of Limitations issues when New York decisional law cannot be applied for purposes of punitive damage awards.

The clear lesson from these two decisions is that parties who wish to ensure that their disputes will be governed by the substantive law of a particular state must do more than merely insert boilerplate language as to which jurisdiction's law is to be applied. Instead, the parties must make it abundantly clear that they are knowingly consenting to the substantive rules they wish to have applied to their disputes.

56. 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989). The Court made an unconvincing attempt to distinguish Volt by noting that greater deference is accorded to a state court reviewing its own state law. "In the present case [Mastrobuono], by contrast, we review a federal court's interpretation of this contract, and our interpretation accords with that of the only decisionmaker arguably entitled to deference—the arbitrator." 115 S.Ct. at 1217 n.4.

Library References:

West's Key No. Digests, Arbitration ⇐2.2.

§ 11.7 Representative Clause

A choice of law clause providing for the application of New York law could read as follows:

> *Governing Law.* This agreement shall be governed by and construed in accordance with the laws of the State of New York, without regard to New York's principles of conflicts of law.

This clause is designed to insure that, should any conflicts arise under the parties' contract, a court would apply the substantive law of New York to the dispute, but would not first look to New York's conflicts of law rules.

Practitioners should bear in mind the limits of such a clause, however. After *Mastrobuono*, it seems apparent that despite the parties' agreement that New York law will govern their disputes, a court may not find that parties agreed to waive certain rights (*e.g.*, the right to recover punitive damages) based on the general language of a choice of law clause. Where such rights are at issue—and the rights which may be affected cannot be known until the jurisprudence further develops—the courts will not lightly infer a waiver.

Library References:

West's Key No. Digests, Contracts ⇐129(1), 206.

§ 11.8 Procedures for Raising or Objecting to a Choice of Law Clause and Waiving Its Enforcement

A choice of law clause is *prima facie* valid.[57] Therefore, a party relying on such a clause need only identify it in its pleading or motion. It is unlikely that the parties will dispute the existence of the clause; disputes are more likely to arise, if at all, as to the validity of the clause.

However, parties may waive enforcement of a choice of law clause by their conduct. In *Bombardier Capital, Inc. v. Richfield Housing Center, Inc.*,[58] for instance, the plaintiff and two of the defendants entered into a security agreement which contained a Vermont choice of law clause. The plaintiff, however, brought an action on the contract in New York, and all of the parties "based their briefs and arguments on ... New York law." [59] When none of the parties addressed the choice of law issue in their papers, the Court asked them to state their positions on the subject. Only two parties responded to the Court's request, and both of

57. *See* 600 Grant Street Associates v. Leon-Dielmann Investment Partnership, 681 F.Supp. 1062 (S.D.N.Y.1988)(federal court applying state law held that choice of law clauses are "prima facie valid under New York law," and denied defendants' motion to dismiss complaint for lack of jurisdiction).

58. Nos. 91-CV-750, 91-CV-502, 1994 WL 118294 (N.D.N.Y. Mar. 21, 1994). The court, in a diversity action, applied New York State law.

59. *Id.* *3.

them expressly waived the Vermont choice of law clause. As a result, the Court concluded that the parties, by failing to assert the applicability of Vermont law, manifested their intent to have New York law apply.

The general rule that a choice of law clause is *prima facie* valid of course assumes that the choice was agreed upon by the parties. In *Davidson Extruded Products, Inc. v. Babcock Wire Equipment Ltd.*,[60] the plaintiff placed an order to purchase machinery which stated that shipment of the order by the defendant constituted acceptance of the terms of the purchase order in their entirety, and that no additional terms proposed by the defendant were acceptable to the plaintiff. The defendant, upon shipping the order, sent a letter of tender reflecting the defendant's "Conditions of Contract." Included among the conditions were clauses providing for the arbitration of any disputes in London and the application of English law. The Court held that the defendant's arbitration and choice of law clauses "materially altered" the contract, were not agreed to by the plaintiff, and therefore were not binding on the plaintiff.[61]

Library References:

West's Key No. Digests, Contracts ⇐129(1).

60. 138 Misc.2d 118, 523 N.Y.S.2d 338 (Sup.Ct., Nassau County, 1987).

61. *Id.* at 341. Similarly, in American Construction Machinery & Equipment Corp. v. Mechanised Construction of Pakistan Ltd., 659 F.Supp. 426, 428–29 (S.D.N.Y.1987), involving a motion to confirm an arbitration award, a federal court upheld an arbitrator's ruling that the parties' Supplementary Agreement—which contained a choice of law clause designating the application of Pakistani law—was invalid under both Pakistani and New York law. Thus, the court ruled that the Pakistani choice of law clause was invalid.