

CHOICE OF LAW: SIGNIFICANT RELATIONSHIPS AND THE PARTY AUTONOMY RULE

The requirements for a valid contract are essentially the same in all jurisdictions. One party makes an offer, the other party accepts the terms of the offer, consideration is exchanged and the contract documents are executed and delivered with the intent that it be mutual and binding.¹ The elements of written and oral contracts are the same and are necessary for the contract to be binding.² The key point of a contract is that it must set out the key material terms and be sufficiently certain to define the nature and extent of the parties' duties and obligations to each other.³ Courts will not enforce a contract if it cannot determine and fix each party's obligations and duties because Courts cannot create a contract when one does not exist.⁴

To avoid uncertainty and to make business dealings predictable (and products, services and financing available at a lower cost), Courts have enforced the "party autonomy rule", which is a contract principle that allows parties to specify what jurisdiction's law will apply and allows contracting parties to protect their expectations under the agreement.⁵ Examples of the party autonomy rule permeate every contract when the parties to a contract set out clauses dealing with exclusive jurisdiction to hear the dispute, use of jury waiver or arbitration clauses to determine how the disputes will be dealt with, or limiting the potential liability with limitation of liability clauses or which states' law will apply to enforce the contract by using a choice of law clause.

The party autonomy rule has been limited in many jurisdictions by a variety of statutes governing the conspicuousness of the particular clauses or whether the amount exceeds a certain amount to trigger specific statutory protections.⁶ Significantly, choice

of law provisions expressly establishing which jurisdiction's law will apply to enforce the contract has been tempered as well by the imposition of the significant relationships test.⁷ Almost all equipment leases and loan documents contain a choice of law clause setting out which jurisdiction's law will govern construction and enforcement of the contract. This is especially important when the parties reside in or expect the contract to be performed (or assigned to someone) in multiple jurisdictions or have a nationwide practice because keeping up and complying with laws in all 50 states can add uncertainty into a company's business model and expectations.

The Restatement (Second) of Conflicts of Laws § 187 (1) states that 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 directed to that issue.⁸ 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, the Restatement (Second) of Conflicts of Laws § 187 (2) states that the law of the state chosen by the parties will govern unless either:

- (a) The chosen state has no substantial relationship to the parties or the transaction and there is no 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 Restatement 2d Conflict of Laws § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

These sections balance the underlying rationale of the party autonomy rule and acknowledges, in contrast to other areas of the law that persons are free within broad limits to determine the nature of their contractual obligations subject to a reasonable basis for a parties' choice on issues the parties did not or could not have determined by explicit agreement. When a chosen jurisdiction has a substantial basis such as place of performance, where one of the parties is domiciled or where the place of contracting took place, the parties' will be held to have made a reasonable choice.

Parties to a multistate contract may have a reasonable basis for choosing a particular jurisdiction where there is no substantial relationship, especially in cases where international transactions are involved or the law of the country is relatively undeveloped making business certainty difficult. Occasionally, the law of the jurisdiction chosen by the parties will invalidate the contract and therefore, the choice of law clause will not be applied because to do so will invalidate the parties' expectations and it can be assumed that the choice of a law that invalidated the contract was chosen by mistake.⁹ When a substantial basis does not exist, the significant relationship test set out in Restatement (Second) of Conflicts of Laws § 188 applies, but must be read in conjunction with §§ 6 and 187 of the Restatement (Second) of Conflict of Laws to determine which law applies. More importantly, Section 187 makes it clear that just because one state would resolve an issue differently than another state is not sufficient to overturn the parties' choice of law.¹⁰ Application of the parties' chosen law will only be reviewed and overturned when absolutely necessary to protect a fundamental policy of a particular state provided that this state has a materially greater interest than the chosen state.¹¹

In the absence of an effective choice of law by the parties, the relevant factors to determine the choice of law are: (a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied.¹² In addition, various contacts of the parties are to be taken into account with respect to each particular issue when applying the factors listed above to determine the law applicable to a particular issue including the following: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.¹³

Obviously, it would be impossible to go through all the permutations that could affect a choice of law analysis based on the above factors. However, the point of this paper is to encourage business people and their counsel to periodically re-evaluate the choice of law clause in contracts being used to make sure the choice made is still helping achieve organizational business goals, and that the jurisdiction chosen has not passed laws limiting or invalidating the choice made. Finding out for the first time in a hotly contested matter in a distant forum that the choice of law clause is no longer valid can devastate a party's expectations.

¹ *Domingo v. Mitchell*, 257 S.W.3d 34, 39 (Tex. App.- Amarillo 2008, no pet.)

² *Hubbard v. Shankle*, 138 S.W.3d 474, 481 (Tex. App.-Fort Worth 2004, pet. denied).

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- ³ *T.O. Stanley Boot Co. v. Bank of El Paso*, 847 S.W.2d 218 (Tex. 1992).
- ⁴ *Lamajak, Inc. v. Frazin*, 230 S.W.3d 786, 793 (Tex. App.-Dallas 2007, no pet.).
- ⁵ *Restatement 2d Conflict § 187*, *Cmt e* sets out the “party autonomy rule.”
- ⁶ *Tex. Bus. & Comm. Code Ann. § 35.53* (governing conspicuousness of forum-selection clauses in contracts under \$50,000); *Tex. Bus. & Comm. Code Ann. Article 2A* (governing enforcement of leases under Texas Uniform Commercial Code).
- ⁷ *Restatement 2d Conflict § 187* entitled Law of the State Chosen By The Parties
- ⁸ *Restatement 2d Conflict § 187*, *Cmt e* sets out the “party autonomy rule.”
- ⁹ *Restatement 2d Conflict § 187 Cmt. on Subsection (2)e*.
- ¹⁰ *See Studebaker-Worthington Leasing Co. v. Texas Shutters*, 243 S.W.3d 737 (Tex. App.—Houston [14th Dist.] 2008, no pet.) (holding forum selection clause was enforceable under New York law and therefore, assignee could exercise personal jurisdiction over and enforce foreign judgment against Texas resident).
- ¹¹ *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990) (refusing to determine enforceability of covenant not to compete under chosen law of Florida when employee lived and worked in Texas); *see, e.g., Southwest Livestock and Trucking Company, Inc. v. Ramon*, 169 F.3d 317 (5th Cir. 1999) (reversing trial court’s finding of usury under Texas law and reversing trial court who refused to apply Mexican law and recognize Mexican judgment).
- ¹² *Restatement 2d Conflict § 6* entitled “Choice-of-Law Principles.”
- ¹³ *Restatement 2d Conflict § 188*.