Methods and Approaches in Choice of Law: An Economic Perspective

Giesela Ruhl
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By
Giesela Rühl*

I. INTRODUCTION

From an economic point of view, legal orders fulfill two basic functions: first, they provide possessive security and, second, they guarantee transactional security.\(^1\) Possessive security exists where property rights are clearly assigned to individuals and where those individuals can be sure that their rights will be protected against intrusion by third parties. Transactional security exists where individuals are ensured that promises to transfer property rights will be kept. In the context of domestic transactions, the national legal order and the enforcement mechanism of the one involved state usually provide both possessive and transactional security.\(^2\) Special problems, however, occur in the context of international transactions: those transactions, by definition, touch on

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more than one legal order and on the enforcement mechanisms of more than one state. Very often the different legal orders involved define property rights and the requirements for their transfer in different and – worse – incompatible ways. Furthermore, different states may refuse to recognize and enforce property rights that have been created under a different legal order. As a result of the absence of a world state, a world legal order and a world enforcement mechanism, both possessive and transactional security are significantly reduced in international as opposed to domestic transactions.

The deficit in both possessive and transactional security has been discussed by lawyers – albeit under different headings – for more than 800 years. Ever since the Middle Ages it has primarily been tackled by the rules of what today is called private international law or choice of law. Those rules determine the applicable law in cases that involve more than one state and, thus, designate the legal order that will regulate the existence and the transfer of property rights. Down to the present day, private international law has developed into a sophisticated system discussed at length in countless legal treatises, books, commentaries and law review articles. However, compared with other areas of law, it has essentially remained untouched by economic theory. In fact, it has been covered only by a little bit more than a handful of law and economics scholars. And to the extent that it has been covered, the focus has been on


4. Schmidtchen, supra note 1, at 69-70; SCHMIDT-TRENZ, Außenhandel und Territorialität des Rechts, supra note 3, at 31-32; Schmidt-Trenz & Schmidtchen, supra note 2, at 329.

5. In the common law world, the provisions that determine the applicable law are usually referred to as choice of law rules. They are seen as part of the broader area of conflict of laws that additionally encompasses provisions on jurisdiction to adjudicate and recognition and enforcement of foreign judgments. In civil law countries, in contrast, the provisions dealing with the applicable law have been referred to as private international law ever since the field became the object of scholarly writing. In the following article I will use both terms interchangeably. For a discussion of the terminology, see EUGENE F. SCOLES, PETER HAY, PATRICK J. BORCHERS & SYMEON C. SYMEONIDES, CONFLICT OF LAWS 1-3 (2004); SYMEON C. SYMEONIDES, WENDY COLLINS PERDUE & ARTHUR TAYLOR VON MEHREN, CONFLICT OF LAWS: AMERICAN, COMPARATIVE, INTERNATIONAL 3, 6 (2003).

specific topics such as the applicable law in contracts, torts or product liability. The underlying fundamental issues of private international law that determine the general design of choice of law rules and that have been the focus of vigorous legal debates over the last several hundred years have largely been skipped: should choice of law rules of law allow application of foreign law or should they advise courts to adhere to application of forum law? Should choice of law rules determine the applicable law by choosing the law of one of the states involved or by crafting new substantive rules? Should choice of law rules define the spatial reach of different substantive laws or should they assign legal relationships to a particular legal order? Should choice of law rules account for the quality of the substantive law or should they rather ignore the outcome of individual cases? Should choice of law rules provide for legal certainty or rather flexibility?

In this article I will try to answer these questions by looking at choice of law from an economic perspective. More specifically, I will try to determine the efficient design of choice of law rules by analyzing the costs and benefits of existing or proposed approaches to choice of law. However, before going into the details two remarks are in order: first, I will determine the efficient design of choice of law rules from the perspective of a single benevolent and well-informed global legislator that aims for global welfare. I will ignore the fact that choice of law today is a matter of national law and as such subject to strategic interactions within and between states. Although this approach is simplistic, it will provide a first insight into the preferable design of choice of law rules.  

Second, all along the analysis I will assume that international transactions today cannot happen without some form of choice of law rules, i.e., rules that determine the applicable law in cross-border cases. Even though it might be that other means such as uniform substantive rules or private cooperative arrangements are better suited to deal with the problems arising in international transactions from an economic point of view there is no reason to believe or hope that such mechanisms will replace national choice of law rules in the near future. Irrespective of whether a development towards more uniformity of

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7. This approach is taken by most law and economics scholars in choice of law. See, e.g., Guzman, Choice of Law: New Foundations, supra note 6; O'Hara & Ribstein, From Politics to Efficiency in Choice of Law, supra note 6; Schäfer & Lantermann, Choice of Law from an Economic Perspective, supra note 6; Whincop & Keyes, supra note 6.

8. This view is, for example, taken by Schmidtchen, Territorialität des Rechts, supra note 1, at 107; Schmidt-Trenz, AUßENHANDEL UND TERRITORIALITÄT DES RECHT, supra note 3, at 282; Schmidt-Trenz & Schmidtchen, Private International Trade in the Shadow of the Territoriality of Law, supra note 2, at 336.

substantive laws or towards more private cooperative arrangements would be desirable from an economist’s perspective, it is unlikely to happen. As a result, I will presume the need for choice of law rules.

II.
THE STARTING POINT: LEX FORI OR LEX CAUSAЕ?

The first question that any choice of law theory has to answer is whether courts -- when faced with cases that involve the legal orders of more than one country -- should apply their own law or be open towards application of the law of a foreign country. Today, most legal systems follow a lex causae approach which requires courts to make a choice between forum and foreign law. However, throughout the history of private international law a lex fori approach that confines courts to application of their own law has had a substantial number of followers.

A. The Legal Debate

1. The Early Dominance of the Lex Fori

The origins of the lex fori approach can be traced back as far as to the 4th century B.C.\(^1\) At that time the Greek city-states began to engage in trade with one another, which inevitably led to disputes involving members of different city-states. In order to deal with these disputes the Greeks developed several strategies, among them the conclusion of treaties between the city-states and the creation of special courts for commercial and maritime matters. However, due to the basic unity of Greek law, the dominant strategy was a lex fori approach that provided for application of each city-state’s law in its own courts.\(^1\) Application of forum law was also the dominant strategy for cross-border transactions in England in the aftermath of the Norman Conquest. The English common law courts -- that existed next to specialized maritime and commercial courts, which had their own way of dealing with multistate cases\(^1\) -- refused to apply the law of a different country and applied their own law, the common law, instead.\(^1\)


12. See infra Part II.

The reason for this practice was procedural rather than doctrinal. Under the English rules of civil procedure a suit had to be filed in the jurisdiction in which the action had taken place. Therefore, a suit could only be brought in an English court if the action had taken place in England. If this was the case, however, it meant that the rules of the common law applied. At first, English courts stood strictly by these procedural rules: cases that involved foreign facts were dismissed for lack of jurisdiction and the plaintiff, whether foreign or English, was forced to litigate abroad. After some time, however, English courts perceived the denial of jurisdiction in these cases as unjust. Therefore, they eventually allowed plaintiffs to assert that a foreign place such as Hamburg, Brussels or Paris actually was located in England. This, in turn allowed the courts to hear the case and to apply the common law. Objections raised by defendants against this practice were dismissed by pointing to the fact that the law had invented a fiction for the “furtherance of justice”.14

2. The Statutists’ Method: Choosing Between Forum and Foreign Law

The origin of the lex causae approach is commonly assigned to the 12th century.15 Back then, Italian scholars had to face the problems that resulted from the co-existence of different local laws in the city-states of Upper Italy – just like Greek scholars had had to deal with increasing trade between Greek city-states in the 4th century. However, in answering the question of which law to apply in cases involving members from different city-states, they did not – like the Greeks – resort to application of the lex fori approach. Instead, they decided to apply the law of one of the city-states involved, be it forum or foreign law. By allowing, and even requiring, courts to apply the law of another city-state the Italian scholars as well as their French and Dutch successors – who were later called statutists – invented the lex causae approach, which has dominated the choice of law scene ever since. It has survived all attacks by academics, notably those of Carl Georg Wächter.16 In a seminal article that was published in 1841 and 184217 he analyzed the statutists’ method and concluded that they had not managed to develop consistent and generally accepted solutions for problems of

cross-border transactions. He, therefore, proposed to discard the statutists’ *lex causae* approach in favor of a *lex fori* theory that required judges to apply forum law in most of the cases. The immediate impact of his writings, however, was marginal because he did not have any followers at his time.

3. Modern Forms of Forum Favoritism

The fact that Wächter’s *lex fori* theory was not applied in practice during the 19th century does not mean that he had no influence on the development of choice of law theory. To the contrary: his ideas had a remarkable revival during the 20th century, when American scholars rebelled against the then leading American approach to choice of law – the vested rights theory as incorporated in the Restatement (First) of Conflicts. Under the impression of the perceived arbitrary results of the vested rights theory – which followed a *lex causae* approach – several scholars, notably Albert E. Ehrenzweig, asked courts to apply and interpret their own law only. By the same token, Brainerd Currie favored application of forum law, even though his governmental interest analysis did not openly advocate a *lex fori* approach. For some time during the 20th century choice of law approaches such as Ehrenzweig’s *lex fori* theory and Currie’s governmental interest analysis enjoyed great popularity in the United States. Today, however, a *lex fori* approach is not widely-used in practice. In fact, only Kentucky, Michigan and Nevada in the United States apply their own law at the expense of foreign law. And even these three states restrict application of the *lex fori* to torts cases. In all other cases – and in all other jurisdictions – courts do not hesitate to decide a dispute in accordance with foreign law. A *lex causae* approach, therefore, has largely prevailed in both Europe and the United States.


19. von Wächter, Über die Collision der Privatrechtsgesetze verschiedener Staaten, supra note 17, at 236-70.

20. In Europe, a *lex fori* oriented approach did not have many followers. Worth mentioning is only Axel Flessner. According to his theory of “facultative private international law” (*Fakultatives Kollisionsrecht*) courts apply their own law as a rule and resort to the application of foreign law only if requested by either the plaintiff or the defendant. See Axel Flessner, *Fakultatives Kollisionsrecht*, 34 RABELSZ 547-84 (1970); AXEL FLESSNER, INTERESSENJURISPRUDENZ IM INTERNATIONALEN PRIVATRECHT (1990).

21. For a detailed account, see SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 38-43; SYMEONIDES ET AL., CONFLICT OF LAWS, supra note 5, at 167-68.


23. SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 85-86; SYMEONIDES ET AL., CONFLICT OF LAWS, supra note 5, at 299-303.
B. The Economic Perspective

From an economic perspective, the openness towards application of foreign substantive law that can be found in all modern legal systems is surprising: since courts are commonly more familiar with domestic law, it seems that it would be less costly and therefore more efficient for states to follow Wächter's and Ehrenzweig's *lex fori* approach and always require application of forum law. Indeed, next to legal scholars a number of law and economics scholars have argued for general application of forum law. They have essentially taken the view that application of forum law reduces the cost of litigation because the *lex fori* is the law that judges and attorneys know best and for which reference materials will be most easily accessible. Second, they have pointed out that a *lex fori* approach provides for a simple, clear and predictable rule that reduces the parties' compliance costs. Finally, they have indicated that application of forum law creates valuable precedents for future cases—a social benefit that will be lost by application of foreign law. Against the background of these seemingly strong arguments in favor of applying forum law, is there nevertheless an economic reason to resort to foreign law? Essentially four arguments can be made: first, application of foreign law enhances pre-litigation predictability, second, it discourages forum shopping, third, it promotes regulatory competition, and fourth, it preserves the comparative regulatory advantage of foreign jurisdictions.

1. The Predictability of the Law

One of the most prominent arguments in favor of a *lex fori* approach is its alleged simplicity, clarity and predictability. At first sight, this argument seems persuasive: after all, both parties know that the forum will always apply its own domestic law. However, a closer look reveals that a *lex fori* approach enhances predictability only after a suit has been brought. Prior to litigation *lex fori* provides for considerable uncertainty because parties do not know where litigation will take place. They will only be able to determine the eventually applicable law if they have entered into a forum selection agreement or if they know who will be the plaintiff in a future legal dispute and where the plaintiff will sue. In all other cases the parties will be left in the dark about the applicable law with the result that they cannot structure their transactions around a specific substantive law and even avoid the application of inappropriate laws. A *lex*

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25. Ghei & Parisi, supra note 24, at 1372.

causae approach on the other hand enables the parties to ascertain the applicable law well in advance. It allows the parties to adjust their behavior to the respective legal framework and – as the case may be – to avoid its application altogether. As a result, pre-litigation predictability strongly encourages application of foreign law.\(^{27}\)

It could be argued, however, that the pre-litigation predictability ensured by application of foreign law is a false one.\(^{28}\) Under a *lex causae* approach the applicable law depends on the rules of private international law, which vary from state to state and country to country. As a result, the applicable law depends on the place where litigation takes place – just like under a *lex fori* approach. Therefore, it could be argued that pre-litigation predictability under a *lex causae* approach is at best marginally higher than under a *lex fori* approach. In view of the fact that in most cases parties can narrow down the states in which litigation is likely to take place and thus the applicable law, it could even be said that the differences in predictability between both approaches is in fact non-existent.\(^{29}\) However, from the perspective of a global legislator these considerations are not to be taken into account. Instead, differences between national choice of law rules are to be ignored because a well-informed and benevolent global legislator would determine the applicable law in a globally uniform way, thereby eliminating the uncertainty resulting from different private international laws. Under this simplistic assumption, there can be no doubt that a *lex causae* approach trumps a *lex fori* approach in terms of pre-litigation predictability and certainty.

### 2. The Effect of Forum Shopping: Zero-Sum Game or Race to the Courthouse?

Next to fostering prelitigation predictability a *lex causae* approach has been acclaimed for discouraging forum shopping by not providing an additional incentive for choosing a particular forum. However, whether this argues for a *lex causae* approach – and against application of the *lex fori* – depends on whether forum shopping actually should be discouraged. Different reasons have been advanced to underline that this is the case.\(^{30}\) To begin with, it has been argued

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that forum shopping skews the litigation process towards plaintiffs because they can choose the forum ex-post and exclusively based on their own preferences. They can file the suit in a court that is closest to their domicile, that proceeds in their native language, and that applies their favorite procedural law. Under a *lex fori* approach they can additionally choose the substantive law that best supports their case. However, although the purely plaintiff-oriented choice of the forum might produce inefficiencies, it does not necessarily do so: very often plaintiff's benefits will directly correspond to the defendant's losses. For example, the language advantage the plaintiff will have in her home court directly corresponds to the language disadvantage the defendant has in a foreign court. The same holds true for the availability of legal information, the accessibility of legal advice and the substantive law chosen under a *lex fori* approach. Unless the losses incurred by the defendants are lower than the benefits received by the plaintiff, forum shopping will be a zero-sum game that does not cause any efficiency losses. It may even be efficient provided that the plaintiff's gains are higher than the defendant's losses. As a result, it is difficult to say whether the simple fact that forum shopping skews litigation towards the plaintiff causes welfare losses.

Further arguments have been raised to prove the inefficiency of forum shopping. However, like the afore-mentioned argument, they do not make a clear-cut case against plaintiffs' choice of forum. Above all, it has been argued that the possibility of forum shopping is inefficient because it tends to result in litigation far from the "natural" forum, i.e., the forum that is the closest to, most knowledgeable about, or most accessible to the litigants. This argument—which seems to assume an increase in litigation costs as a result of a remote or unconnected forum—is doubtful for at least two reasons: first, it is questionable whether there is a "natural" forum for the litigation of international cases because these cases typically have connections to different legal orders. Second, even if there is a "natural" forum in international cases, the rules on jurisdiction to adjudicate will provide a successful tool to prevent litigation in obviously unconnected and remote fora. In the United States and the common law world.

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33. See Parisi & O'Hara, *Conflict of Laws*, supra note 6, at 390.


in general, the doctrine of *forum non conveniens* as well as the minimum contacts requirement\(^3\) will usually avoid any such outcome. In Europe, the EC Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters\(^3\) provides for a set of jurisdictional rules that requires some connection between the forum and the litigation or the defendant. As a result, it is unlikely that litigation will actually take place in unconnected and remote fora.

In addition, it has been said that forum shopping frustrates the capacities in legal services kept ready in the defendant-friendly states while overburdening the plaintiff-favoring states because it distributes litigation unevenly across jurisdictions.\(^3\) However, whether uneven distribution of litigation actually takes place is doubtful. Considering that the natural defendant in most jurisdictions may file for a declaratory relief before the natural plaintiff has filed a claim and assuming that the natural defendant would file her claim in a defendant-friendly forum, there is no *a priori* bias towards one jurisdiction or the other. But even if natural defendants are less likely to file a claim than natural plaintiffs and uneven distribution of litigation actually takes place on a large scale, this is not necessarily inefficient. To the contrary, it may even turn out to be efficient: the more frequented courts could build up expertise in certain areas and handle corresponding cases more efficiently. Over time, they could establish track records increasing outcome predictability and decreasing litigation.\(^3\) As a result, it is unclear whether uneven distribution of litigation actually decreases efficiency.

Finally, it has been argued that the possibility of forum shopping leads to inefficient substantive laws because states will compete for litigation and enact substantive laws which favor plaintiffs and, therefore, are not likely to be efficient.\(^4\) However, it is not clear whether states actually engage in a competition for litigation. More importantly, it is not clear whether they have any incentive to do so. At least in most Western countries the state does not make money from offering judicial services and entertaining court systems. To make states skew their substantive laws towards plaintiffs they would also have to outweigh the expected losses suffered by domestic defendants. Whether this is actually the case is doubtful. At least, it lacks empirical evidence. What is

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more likely than a conscious, revenue-driven twist of substantive laws towards plaintiffs is that national legislators fall prey to interest group lobbying. Assume, for example, that a party is statistically more likely to be the plaintiff. Then this party will have an incentive to lobby for favorable legislation in the jurisdiction where litigation will most likely take place. The same holds true for local lawyers who wish to attract more plaintiffs. However, it is difficult to say in the abstract how likely there is to be interest group lobbying and how far the resulting substantive laws would actually decrease as a result.

Does this mean that forum shopping from an economic perspective—at least as long as empirical data is lacking—cannot clearly be identified as being efficient or inefficient? Some scholars have indeed argued that way. However, the following considerations indicate that the possibility of forum shopping leads to an increase in litigation costs and therefore most likely to inefficiencies: first, the possibility of forum shopping creates an incentive to engage in a “race to the courthouse” because each party will try to be the first to file a lawsuit as soon as a legal dispute becomes likely. The natural defendant, knowing that the natural plaintiff will strategically choose the forum based on her preferences, will try to preempt the natural plaintiff’s choice of jurisdiction by filing for declaratory relief. The natural plaintiff, in turn, knowing that the natural defendant can file for declaratory relief will try to file her lawsuit in her preferred forum before the defendant has time to do so. As a result, the possibility of forum shopping is likely to induce the filing of lawsuits that may not yet have matured into court claims. At worst, it might even induce the filing of a lawsuit that might have been settled out of court had the threat of the plaintiff’s or the defendant’s choice of jurisdiction not been imminent. Second, in addition to fostering a “race to the courthouse” the possibility of forum shopping increases the chances that parties will argue about the appropriateness of the forum in addition to the merits of the case. As the place of litigation will influence the outcome of the case, both parties will increase their respective expenses and thereby waste valuable resources. The incentive to do so will grow if the potential gains and losses are high, which will be the case if different fora— for example as a result of a lex fori approach— offer different applicable laws. The latter will additionally increase litigation costs because the parties

41. Ghei & Parisi, supra note 24, at 1372-73.
42. Id. at 1392.
45. It has even been said that the applicable law is the most common motive for forum shopping. See Mary Garvey Algero, In Defense of Forum Shopping: A Realistic Look at Selecting a
will have to determine the content of different laws in order to identify the preferred forum. In contrast, a *lex causae* approach offers less incentives to invest in a dispute about the appropriateness of the forum. This is because courts – at least as long it is assumed that the applicable law is determined by a global legislator – will apply the same law around the world and therefore produce less divergent substantive results.

Against this background, it seems that forum shopping indeed should be discouraged. This holds true even though forum shopping may be beneficial to both parties. Litigation in a forum that benefits both parties can be achieved by means other than forum shopping, notably choice of court agreements. Today, under most legal systems parties can choose the forum even in international cases. Although some legal orders restrict the free choice of court in order to protect a perceived weaker party, they usually allow for unrestricted free choice of the forum after a legal dispute has arisen. For example, § 38 (1) of the German Code of Civil Procedure allows *ex ante* free choice of court for certain classes of parties, such as merchants, that are not considered in need of legal protection. Section 38 (3) No. 1 of the German Code of Civil Procedure additionally allows everybody else, i.e., even consumers, to choose the forum after a dispute has arisen. Likewise, Art. 13 No. 1, 17 No. 1 and 21 No. 1 of the EC Regulation on Jurisdiction and Recognition and Enforcement of Foreign Judgments provide for *ex post* choice of court agreements in consumer, insurance and employment cases, while Art. 23 allows *ex ante* agreements in all other cases. And even in the United States, where forum selection clauses traditionally have met with skepticism, party agreements about jurisdiction are now generally accepted. As choice of court agreements avoid the increase in litigation costs likely to be incurred as a result of forum shopping they are the more efficient instruments for moving litigation to the forum beneficial to both parties. Therefore, discouraging forum shopping indeed argues for a *lex causae* approach and strengthens the case against a *lex fori* approach.

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47. See also Parisi & O'Hara, *Conflict of Laws, supra* note 6, at 390; O'Hara & Ribstein, *Conflict of Laws and Choice of Law, supra* note 6, at 634.
3. The Role of Regulatory Competition: Race-to-the-Top or Race-to-the-Bottom?

In addition to fostering pre-litigation predictability and discouraging forum shopping, some scholars have advanced a third argument for the application of a \textit{lex causae} approach. Considering that a \textit{lex causae} approach enhances pre-litigation predictability and allows parties to structure their activities around the law of a particular state, they have argued that states will internalize the costs of inferior laws, thereby promoting competition among jurisdictions for more efficient substantive laws.\footnote{Parisi & O'Hara, \textit{Conflict of Laws}, supra note 6, at 390; O'Hara & Ribstein, \textit{Conflict of Laws and Choice of Law}, supra note 6, at 634; O'Hara & Ribstein, \textit{Interest Groups, Contracts and Interest Analysis}, supra note 6, at 765-74.} However, whether this assertion holds true is difficult to say. It rests on the assumption that states have an interest in having their laws applied which depends on whether states can derive some sort of benefits from application of their laws.\footnote{\textit{EVA-MARIA KIENINGER, WETTBEWERB DER PRIVATRECHTSORDNUNGEN IM EUROPÄISCHEN BINNENMARKT} 312 (2002).} This, in turn, seems to vary with different areas of law: in corporate law, for example, where states obtain revenue from filing fees and – in the United States\footnote{In Europe, only the real seat state can impose franchise taxes. See Council Directive 69/335/EEC of 17 July 1969 Concerning Indirect Taxes on the Raising of Capital, [1969] O.J. L. 249, 25.} – from franchise tax, it goes without saying that states have an interest in extending the application of their laws as far as possible.\footnote{For a detailed analysis of European corporate law, see Jens Christian Dammann, \textit{Freedom of Choice in European Corporate Law}, 29 \textit{YALE J. INT’L. L.} 477, 520-33 (2004).} In other areas, such as contract and tort law, the potential gains are less obvious. However, it seems likely that even in these areas states can derive at least some revenue from attracting foreign businesses and having local lawyers working on the relevant cases.\footnote{For a more skeptical account, see \textit{KIENINGER, supra note 52, at 312-14.}} Additionally, it seems likely that states may at least indirectly benefit from not losing domestic businesses.\footnote{See Roger van den Bergh, \textit{Economic Criteria for Applying the Subsidiarity Principle in the European Community: The Case of Competition Policy}, 16 \textit{INT’L. REV. LAW. \\& ECON.} 363, 366 (1995).} As a result, chances are that states indeed have an interest in having their laws applied and that they will engage in regulatory competition if parties can choose the application of foreign law by agreement or by conduct.

The mere existence of regulatory competition does not mean, however, that more efficient substantive laws will be the result. In corporate law, for example, it has long been discussed whether regulatory competition will lead to a race-to-the-top or to a race-to-the-bottom. In the race-to-the-bottom scenario states compete for corporate charters by skewing their substantive corporate laws one-sidedly towards managers.\footnote{\textit{See, e.g., Lucian Arye Bebchuk, \textit{Federalism, and the Corporation: The Desirable Limits on State Competition in Corporate Law}, 105 \textit{HARV. L. REV.} 1437, 1440 (1992); Lucian Arye Bebchuk \\& Allen Ferrell, \textit{A New Approach to Takeover Law and Regulatory Competition}, 87 \textit{VA. L. REV.} 111, 130 (2001); Lucian Arye Bebchuk \\& Allen Ferrell, \textit{Federalism and Corporate Law: The...}} In the race-to-the-top scenario, in contrast, states
focus on managers' incentives to make the corporation's shares attractive to shareholders and compete for corporate charters by making their substantive corporate laws more beneficial and efficient for both managers and shareholders. Which of the two scenarios actually prevails in practice — in corporate law and outside — depends on a variety of factors whose comprehensive discussion for different areas of laws is beyond the scope of this article. However, it seems clear that — at least in some areas of law — a race-to-the-top, i.e., a development towards more efficient laws, may actually occur if choice of law allows application of foreign law. And even though the prospect of regulatory competition resulting in more efficient substantive laws may be subject to certain conditions, it is sufficiently sound to support, on a general level, application of a lex causae approach.

4. The Benefit of Comparative Regulatory Advantages

A last argument that has been made to support application of foreign law over pertinent application of the lex fori revolves around regulatory competence. A lex fori approach, it has been said, ignores the comparative regulatory advantages foreign laws might have and, therefore, does not always lead to application of the most efficient substantive law. This argument assumes that states have idiosyncratic knowledge about the conditions within their territory and, therefore, can tailor their laws to best suit these conditions. As a result, there is a good chance that their laws will regulate transactions taking place within their territory more efficiently than the laws of other states. The most prominent example for a state's regulatory comparative advantage revolves around a car accident in country A between nationals of countries B and C.
Provided that the legislative status quo in country A mirrors the conditions within its territory without distortion, the tort and accident laws of country A will be designed to encourage an optimal level of care, which in turn will encourage both domestic and foreign nationals to exercise the optimal level of care while driving in country A. Therefore, the tort and accident laws of country A should regulate the accident between the nationals of countries B and C. Application of the laws of countries B and C simply because a lawsuit has been filed in their courts, in contrast, would be inefficient because they are not tailored to the conditions in country A. Therefore, they would not provide for \textit{ex ante} optimal incentives to drive carefully in country A.

To be clear, the concept of comparative regulatory advantages does not mean that courts should always apply foreign law. By the same token, it does not mean that the laws of a state should apply to all transactions taking place within its territory. Rather, the argument behind the concept of comparative regulatory advantage is that there are cases where the law of a foreign state provides for the most efficient solution to an international transaction and that application of forum law in these cases would be inefficient. And in this limited sense it makes a good case for a \textit{lex causae} approach.

III. THE CHOICE BETWEEN METHODS I: SUBSTANTIIVSM OR SELECTIVISM?

If from an economic perspective state courts should not always apply the \textit{lex fori} they face the problem of determining the applicable law in cases that touch on different legal orders. In the history of private international law, essentially two methodological approaches have emerged to solve this problem: first, the substantive method of creating new substantive law and, second, the selectivist method of choosing between existing laws. Up until today, the latter has prevailed in both Europe and the United States. However, the former was applied during Roman times and in England up to the 18\textsuperscript{th} century. Additionally, it was advocated by a number of American and European scholars during the 20\textsuperscript{th} century.

\textbf{A. The Legal Debate}

1. The Roman Praetor Peregrinus and the English Law Merchant

The beginnings of the substantivist approach to choice of law are to be found in Roman times, more specifically in the 3\textsuperscript{rd} century B.C. Back then,
Romans were increasingly engaged in international trade and, therefore, had to face more and more legal disputes involving members of foreign countries. But instead of applying their own law in cases that had connections to foreign legal orders—as the Greeks did—the Romans created a new institution empowered to handle litigation involving non-Romans: the *praetor peregrinus*. Drawing on general legal principles, the notion of good faith as well as his own legal imagination, he solved multistate cases by *ad hoc* crafting new substantive rules especially designed for cross-border transactions. These new substantive rules gradually developed into a separate body of norms, the *ius gentium*, which applied to international disputes only and was distinct from the *ius civile* that regulated disputes between Roman citizens.63

The Roman substantivist method invented by the *praetor peregrinus* died out when the *ius gentium* was incorporated into the *ius civile* and codified in the *Corpus Juris Justinianus*. However, it had a revival in the English commercial and maritime courts several centuries later. These courts, which existed next to the forum-oriented common law courts,64 did not apply the common law, which had been developed to meet the needs of a rural society. Instead they referred to the Roman *praetor peregrinus* and engaged in the *ad hoc* development of a set of new substantive rules especially designed for commercial and maritime cases. These rules that became later known as law merchant and maritime law drew on different historic and geographic sources and claimed universal application.65

However, they met the same fate as the *ius gentium* because they were eventually absorbed by the English common law courts and indistinguishably incorporated into the common law.

2. The Statutists' Method: Choosing Among Existing Laws

The roots of the selectivist method—and thereby the roots of modern choice of law theory—are to be found in the statutists' method developed by Italian scholars in the 12th century.66 When they had to answer the question how...
to solve disputes between members of different city-states they did not develop a new set of substantive rules as the Romans did. Instead, they applied the law of one or the other city-state and thus made a choice between existing laws rather than blending them. In practice, this method of choosing the applicable law from existing laws has prevailed up until today. Even Carl Friedrich von Savigny—who criticized the workings of the statutists’ method insofar as it amounted to a unilateral choice of law theory—did not question that international disputes had to be solved by applying the laws of one of the states involved. However, the substantivist approach formed the basis for some of the most important American approaches to choice of law in the 20th century.

3. Modern Forms of Substantivism

At the beginning of the 20th century, choice of law in the United States was dominated by the vested rights theory. First formulated by the English scholar Albert V. Dicey67 and later brought to the United States by Joseph H. Beale,68 it advanced the idea that courts decided cases according to foreign law if a right had been created abroad. What made the vested rights theory so important, however, was not the theory itself but the reaction it triggered in the academic community when it was eventually incorporated into the Restatement (First) of Conflicts.69 Today known as the American conflicts revolution, conflicts scholars across the country engaged in a vigorous debate about the foundations of choice of law and advocated countless new methodological approaches.70 One of the most important and influential approaches that emerged from this debate was Friedrich K. Juenger’s best law approach. As a reaction to the perceived arbitrariness of the vested rights theory of the Restatement (First), he suggested that courts should not choose between application of existing laws but strive for the application of the best law.71 Arguing that national laws were not suited for the resolution of international disputes he granted courts the right to ad hoc construct new substantive rules especially designed for international cases.72 Juenger’s writings were embraced and enhanced by a number of

67. ALBERT V. DICEY, A DIGEST OF THE LAW OF ENGLAND WITH REFERENCE TO THE CONFLICT OF LAWS (1896).
68. JOSEPH H. BEALE, A TREATISE ON THE CONFLICT OF LAWS (1935).
70. There was no comparative “revolution” in Europe. This is why the development of choice of law during the 20th century was mostly driven by the United States. European scholars took note of this development. However, for the most part they rejected the new approaches and adhered to the classical concept of choice of law. See, e.g., Egon Lorenz, Zur Struktur des internationalen Privatrechts (1977); Klaus Schurig, Kollisionsnorm und Sachrecht (1981).
71. For a more detailed discussion, see SYMEONIDES ET AL., CONFLICT OF LAWS, supra note 5, at 168-69; SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 50 n. 19.
American scholars, notably Luther M. McDougal, Arthur T. von Mehren and Donald T. Trautmann as well as in Europe – Ernst Steindorff. They all promoted – to different degrees and according to different guidelines – the ad hoc crafting and application of new substantive law rules. However, the response from practice was more than faint. In the United States, a substantivist approach was finally rejected in 1969 when the Restatement (Second) of Conflicts was adopted. In Europe, it was never seriously considered as a relevant approach to choice of law.

B. The Economic Perspective

At first glance, it seems economically surprising that the substantive method of creating new substantive laws has not had more followers throughout the history of private international law. It strives for application of the "best substantive rule" in every single case and is, therefore, likely to guarantee the best substantive outcome across the board. In contrast to the selectivist method that calls for application of a pre-existing national legal order, the substantivist method facilitates tailor-made solutions for international disputes which, in the long run, may set incentives for optimal individual behavior in cross-border transactions. Assuming that the best substantive outcome of a case is the one that maximizes the joint benefits of the parties while at the same time minimizing externalities, a substantivist approach seems likely to promote global efficiency. So, why has the substantivist approach not been more successful in practice?

1. The Costs of Compliance and Adjudication

Two reasons can easily be identified. First, the creation of new substantive law on a case-by-case basis provides for a maximum of pre-litigation uncertainty. Before going to court – more precisely, before the rendering of a judgment – parties will not know which legal norms will govern a future dispute. Worse, it seems that the parties do not even have a chance to find out what the applicable legal framework might be. Due to the fact that the court can

75. ERNST STEINDORFF, SACHNORMEN IM INTERNATIONALEN PRIVATRECHT (1958).
76. In fact, only one case has been reported in which the judge considered application of the substantivist approach in the form of what he calls a “national consensus law.” See In re “Agent Orange” Products Liability Litigation, 580 F.Supp. 690, 713 (E.D.N.Y 1984).
77. See also SYMEONIDES, American Choice of Law at the Dawn of the 21st Century, supra note 63, at 15.
apply any existing or nonexistent legal rule or any combination thereof according to what it deems the "best rule" for the case they cannot determine the outcome of litigation in advance and adjust their behavior to the governing law. Unless the newly created substantive law develops into a coherent set of legal norms over time—which may or may not happen—any potential incentive effect of substantive law is effectively destroyed. Second, the substantivist method makes adjudication of international cases complex and difficult. By asking courts to apply the legal framework that is best for the particular case, it requires courts to engage in a complicated search for the best possible law. Taken seriously, it requires courts to scan every single legal system of the world for relevant legal norms, to compare the results of their application and—as the case may be—to create new substantive legal norms to optimally serve the needs of the particular case. Regardless of whether courts are in a position to engage in any such complex investigation—an assertion that can be doubted—7 it is clear that it makes the costs of adjudication soar.

2. International Disputes: The Case for Special Rules?

What does this mean for the overall efficiency of the substantivist method? The answer depends on whether the perceived benefit of having the "best law" applied outweighs the infinite pre-litigation uncertainty and the skyrocketing adjudication costs. This, in turn, depends on whether international cases are so different from domestic cases that their efficient resolution requires the development of new substantive laws. In other words, are international cases so different from domestic cases that they cannot be adequately dealt with by application of domestic law? Some proponents of the substantivist approach have indeed argued that domestic laws are inappropriate for the resolution of cases that involve more than one legal order. 79 And indeed, there are cases that seem to support this view. Take for example an airplane crash or a ship collision on the open sea. Or take an international joint venture consisting of two or more companies from different countries that set out for oil production in a third country. Applying the law of one country as a result of the selectivist method in these cases indeed seems to encounter difficulties. However, does this hold true across the board? Are all cases that involve more than one legal order so different from domestic cases that application of domestic law is inappropriate? Doubts arise when looking to cases that seem to be more ordinary than the ones mentioned earlier. Take for example an accident that occurs in country A between individuals of country B and C. Does this accident require treatment that differs from an accident in country A between nationals of country A? It does not look that way. To the contrary, it seems that application of the domestic law of country A is the most efficient way to handle the dispute. Under the

78. For a more detailed discussion see infra Part VI.B et seq.
79. See, e.g., JUENGER, ZUM WANDEL DES INTERNATIONALEN PRIVATRECHTS, supra note 72, at 25-28; STEINDORFF, supra note 75, at 9, 267-70.
assumption the legislator of country A knows the conditions in country A and the preferences of the population best, and under the assumption that the legislative process in country A is not distorted by public choice problems, the domestic law of country A provides for optimal \textit{ex ante} incentives to avoid accidents in country A. Relative to any other substantive law – foreign or international – the domestic law of country A is generally superior in regulating the conduct of driving cars in country A. Take another example: the sale of computers concluded between nationals from country A and B on the Internet. Does this contract require treatment different from a contract between the nationals of country A on the Internet? Most likely, the legal problems that will arise are the same – delivery of a defective computer, late payment of the contract price and the like. And even though the choice between the law of country A or country B seems more difficult than in the above described accident case, there is no reason to doubt that both the domestic law of country A and the domestic law of country B would be able to tackle the issues arising under this contract.

As a result, it seems that some cases require a special set of substantive rules whereas others can go without. This, in turn, means that in some cases the benefits of a substantivist method may potentially outweigh the legal uncertainty involved with its application, whereas in other cases this potential is lacking. However, for the following reasons this finding does not imply that the substantivist method is generally more efficient. First, the cases in which a substantivist approach may yield profit seem far more exceptional and therefore far less numerous than the cases that are likely to benefit from the selectivist method. Second, a good part of the cases that allegedly call for application of the substantivist method can equally, if not more efficiently, be handled by other means, most importantly party autonomy and private arrangements such as \textit{lex mercatoria}. In fact, allowing the parties to choose the applicable law or to define the legal framework for their transaction on a case-by-case basis – a common practice in international trade these days – seems to enhance global efficiency more than allowing the court to apply whatever it deems the "best law." As a result, it appears that only few cases would actually benefit from the creation of substantive law by courts. This, however, suggests that the substantivist method should not inform the general design of choice of law rules.

\section*{IV. THE CHOICE BETWEEN METHODS II: UNILATERALISM OR MULTILATERALISM?}

If economic analysis suggests that courts in solving choice of law issues

\footnote{80. For a more detailed discussion of public choice and choice of law, see GUZMAN, \textit{supra} note 6, at 900-04; O'Hara & Ribstein, \textit{Interest Groups, Contracts and Interest Analysis}, \textit{supra} note 6; O'Hara, \textit{A Public Choice Analysis of Contractual Choice of Law}, \textit{supra} note 6; O'Hara, \textit{Economics, Public Choice, and the Perennial Conflict of Laws}, \textit{supra} note 6.}
should be open to apply the law of a foreign state — as opposed to pertinent application of the *lex fori* and creation of new international substantive law — another question arises: how exactly should the line between forum and foreign law be drawn? When should courts apply foreign law and when should they be allowed to resort to forum law? Since the selectivist method emerged in the 12th century two approaches have dominated the scene: first, the so-called unilateralist method of defining the spatial reach of legal norms according to their wish to be applied, and, second, the so-called multilateralist approach of assigning a legal relationship to a legal order according to objective criteria. Today, multilateralism provides the basis of most contemporary choice of law systems in both the United States and Europe. However, elements of unilateralism can be found on both sides of the Atlantic.

**A. The Legal Debate**

1. **The Statutists' Method: Defining the Spatial Reach of Legal Norms**

   The unilateralist method goes back to the Italian scholars of the 12th century. When they were faced with the question of which city-states' law to apply in a particular case they decided to tackle the problem by defining the intended spatial reach of the conflicting local laws. To this end, they divided the respective provisions into two basic categories — personal and territorial. Rules that were considered personal applied to cases involving the citizens of that city-state no matter where they were, whereas territorial rules claimed application to everybody, whether citizen or foreigner, who stayed within the city boundaries. To decide which local law fell into which category the Italian scholars — and their French and Dutch successors — at first relied on the wording of the particular substantive rule. Later on, they based the classification on the presumed or apparent legislative intent. However, no matter which criteria the statutists applied to discern the spatial reach of local laws they did not manage to develop generally accepted solutions for cross-border cases. Hence, it is not surprising that the statutists' unilateral method was eventually superseded and replaced by the multilateral method.

2. **Carl Friedrich von Savigny: Assigning the Seat of the Legal Relationship**

   The founding father of the multilateral method — and thereby the modern approach to choice of law — is Carl Friedrich von Savigny. In his legendary treatise on the "System of Current Roman Law", published in 1849, he

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82. See criticism of this fact by von Wächter, *Über die Collision der Privatrechtsgesetze verschiedener Staaten*, supra note 7.

83. **FRIEDRICH CARL VON SAVIGNY, SYSTEM DES HEUTIGEN RÖMISCHEN RECHTS** vol. VIII (1849).
promoted the idea that choice of law rules were meant to guarantee uniform results regardless of the place of litigation. Therefore, he argued, the applicable law had to be determined by looking for the one legal order in which the underlying legal relationship belonged. In his words, the applicable law had to be chosen by looking for the legal order where the relationship had its “seat.” This seat, he claimed, had to be identified by classifying legal relationships into broad categories and then linking those categories with a legal order by means of connecting factors such as the domicile of a person or the place of a transaction. As a result, he developed a system of \textit{a priori} choice of law rules that assigned a legal relationship to one particular legal order regardless of whether that legal order had expressed a wish to be applied. In doing so, he rejected the statutists’ unilateral method of defining the spatial reach of legal rules and promoted what became later known as the multilateral method.\textsuperscript{84}

Today, Savigny’s ideas are still readily identifiable in modern choice of law systems. In Europe, for example, the EC Convention on the Law Applicable to Contractual Obligations (Rome Convention)\textsuperscript{85} assigns a contract to the law of the state, with which it is most closely connected. In the United States, the Restatement (Second) of Conflicts generally provides for application of the law of the state which has the most significant relationship to a dispute. As a result, both the Rome Convention\textsuperscript{86} and the Restatement (Second) apply the multilateral method of assigning a legal relationship to one particular legal order. Moreover, both the Rome Convention and the Restatement (Second) use objective criteria to determine the applicable law that resemble Savigny’s notion of the seat of the legal relationship.\textsuperscript{87}

3. Modern Forms of Unilateralism

That the unilateral approach was eventually replaced by Savigny’s

\textsuperscript{84} However, \textbf{SAVIGNY} did not discard the unilateral method all together. Instead he restricted it to what he called “strictly positive, mandatory laws”, which he defined as rules that expressed a strong public policy based on moral or economic considerations. \textit{See id.} at 34-38, 160-61.


\textsuperscript{86} \textit{Supra} note 85.

\textsuperscript{87} However, just like \textit{Savigny} the EC Convention accepts the unilateral method for certain cases. According to Article 7, when applying the law of a country, effect may be given to the mandatory rules of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract.
multilateral method does not mean that it simply vanished from the choice of law scene. To the contrary: it formed the basis for the most influential approach that arose in the course of the American conflicts revolution: Brainerd Currie's governmental interest analysis. He advanced a modern form of the unilateralist choice of law method in that he – just like the statutists – set out to determine the applicable law by defining the spatial reach of substantive laws. However, instead of classifying laws according to their personal or territorial purport, Currie advocated an ad hoc judicial interpretation of the involved substantive laws based on the policies underlying those laws. Such an interpretation, he argued, would determine a state's interest in having its law applied in a certain case – the "governmental interest" – which in turn would define the laws' intended sphere of operation in terms of space and designate the applicable law.\textsuperscript{88}

Without exaggeration, Currie's governmental interest analysis can be classified as the most important and most influential modern approach to choice of law. In fact, even though a multilateralist approach has prevailed on a large scale both in the United States and Europe, unilateralist elements are present in virtually all contemporary choice-of-law systems. This becomes obvious when looking at the Restatement (Second), which is followed by most of the jurisdictions in the United States. Although it essentially adopts a multilateralist approach by advocating the application of the law of the state that has the most significant relationship with the case in question, it recognizes the concept of state interests as an important factor for the choice of law. Indeed, the process of identifying the state with the most significant relationship comprises, among others, the examination of the relevant policies of both the forum and other interested states.\textsuperscript{89} In Europe, although faithful to multilateralism in general, unilateralists elements can be found in the form of mandatory laws, that are applied to multistate cases simply because of their wish to be applied. According to Article 7 (1) of the Rome Convention,\textsuperscript{90} for example, when applying the law of a country, effect may be given to the mandatory rules of another country, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract.\textsuperscript{91}

\textit{B. The Economic Perspective}

The question of how to draw the line between forum and foreign law lies at the heart of any modern choice of law theory. Answering it from an economic perspective requires a closer look at the working of both unilateralism and

\textsuperscript{88} See CURRIE, supra note 22. For a detailed discussion see BRILMAYER, supra note 22, at 43-108; JOERGES, supra note 22, at 43-50; KAY, supra note 22.

\textsuperscript{89} Section 6 of the Restatement. For a detailed discussion see Symeonides, American Choice of Law at the Dawn of the 21st Century, supra note 63, at 26-41.

\textsuperscript{90} Supra note 85.

\textsuperscript{91} For a detailed discussion, see Symeonides, American Choice of Law at the Dawn of the 21st Century, supra note 63, at 32-34.
multilateralism in practice. Since both methods approach choice of law issues from opposing ends – the unilateral method starts with the substantive law whereas the multilateral approach starts with the legal relationship – it is not surprising that they require courts to make very different inquiries. Under a unilateral approach courts have to proceed in two steps. In the first step, they examine the contending substantive laws in turn, asking whether one or both have pretensions to be applied. As these serial inquiries are independent, it might happen that the laws of more than one state claim application or neither. In the second step, therefore, courts have to determine which of the several laws shall govern the dispute. In contrast, the multilateral method calls for a one-step process only. It requires courts to make a choice between the laws of different states by assigning a legal dispute to the law of one state in accordance with a set of objective criteria. Therefore, a decision to assign a legal dispute to the law of one state is simultaneously a decision not to assign it to another. Against this background, what are the costs and benefits of both a unilateral and a multilateral approach?

1. The Costs of Specification, Compliance and Adjudication

Essentially, a unilateralist approach seems to incur two important benefits. To begin with, it avoids the problem of determining objective criteria for the choice of law necessary under a multilateralist approach. Additionally, in case that only the law of one state claims application – the so-called “false conflict” case – it renders a complicated choice between competing laws obsolete. Therefore, a unilateralist approach does not only seem to incur low specification costs, but also low adjudication costs. However, a closer look reveals that this is not true: first, a unilateral approach needs to define when the substantive law of a state claims application. More specifically, it must identify the criteria – such as the legislative intent or the governmental interest – that determine the spatial reach of legal norms. Therefore, specification costs are not as low as they appear to be at first blush. Second, determination of whether substantive laws wish to be applied requires defining the respective spheres of operation. This, however, calls for a complicated determination of the underlying legislative intent, which is not only difficult but may even be impossible: substantive laws may be silent or ambiguous as to their intended sphere of application. Likewise, a consistent legislative intent may not even exist because states or legislators are not monolithic entities and individual legislators may have very different reasons to pass a law. Furthermore, even if it is possible to determine the intended spatial reach of legal norms there might be cases in which the laws of more than one state – or worse – the laws of no state claim application, the so-called “true conflict” and “no interest” cases. Since unilateralist approaches usually do not

92. BRILMAYER, supra note 22, at 16-17.
specify how to handle these cases\textsuperscript{93} courts have to determine the applicable law without any further guideline. Therefore, a unilateralist approach not only allows adjudication costs to soar, but also brings about the utmost pre-litigation uncertainty and thereby high compliance costs.\textsuperscript{94}

2. The Benefit of Certainty and Uniformity of Results

A multilateral approach, in contrast, keeps both adjudication and compliance costs low. It provides courts with an objective set of criteria to determine the applicable law which spares the courts a complicated – if not impossible – search for the legislative intent behind substantive laws. It also provides guidelines for the decision of all kinds of cases, notably “true conflicts” and “no interests” cases that cause difficulties under a unilateralist approach. As this also fosters prelitigation predictability a multilateral approach incurs significantly lower adjudication and compliance costs than a unilateralist approach. Admittedly, the costs associated with a multilateral approach vary depending on the objective criteria chosen. Take for example the best law approach advocated by Juenger and the characteristic performance rule of the Rome Convention:\textsuperscript{95} both approaches are multilateral in nature because they assign a legal relationship to one particular legal order. However, whereas the best law approach leaves wide discretion to the court, thereby increasing both compliance and adjudication costs,\textsuperscript{96} the Rome Convention’s characteristic performance rule is easy to apply and therefore likely to reduce compliance and adjudication costs.\textsuperscript{97}

In addition to keeping compliance and adjudication costs low, a multilateral approach decreases the chances that parties will engage in a costly race to the courthouse. Since it assigns a legal relationship to one particular legal system according to objective criteria it increases the chances that the result of the choice of law analysis will be the same no matter which court is competent to hear the case. Therefore, parties have no – or a significantly reduced – incentive to engage and invest in forum-shopping. The unilateral method, in contrast, requires a rather complex interpretation of different substantive laws which will almost certainly vary from court to court. Because this will increase the likelihood of differing results the expected gains from forum-shopping will be higher. For this reason, it seems that a multilateral approach to choice of law is generally to be preferred over a unilateral approach.

\textsuperscript{93} For example, see the statutists’ method \textit{supra}. Others, such as Currie’s governmental interest analysis, provide for application of the \textit{lex fori}, which does not appear to be efficient from the outset.

\textsuperscript{94} It has been argued that the most important example of a unilateralist approach, Currie’s governmental interest analysis, additionally leads to systematic overregulation. See Guzman, \textit{supra} note 6, at 908.

\textsuperscript{95} \textit{Supra} note 85.

\textsuperscript{96} For a more detailed discussion of the better law approach see \textit{infra} Part V.B \textit{et seq}.

\textsuperscript{97} For a more detailed discussion of the costs and benefits associated with the characteristic performance rule \textit{infra} Part VI.B \textit{et seq}. 
V.
THE TENSION BETWEEN GOALS: CONFLICTS JUSTICE OR MATERIAL JUSTICE?

If a multilateral approach to choice of law is more efficient than a unilateral one, determination of the applicable law requires an efficient set of criteria that defines both the reach of forum law and the reach of foreign law. This, in turn, requires determination of the goals of private international law. Over the course of history, conflicts scholars have been oscillating between the following two options: conflicts justice and material justice.

A. The Legal Debate

1. The Classical Approaches

The methodological approaches that evolved up until the 20th century differed from one another in many regards. The statutists' method focused on defining the spatial reach of local laws, Savigny concentrated on assigning legal relationships to legal orders and the vested rights theory placed emphasis on rights that had been created abroad. However, in one respect they were on the same footing: they adhered to the assumption that choice of law was about assigning a case to the most appropriate legal order and not about reaching the most appropriate results in individual cases. In other words, the classical theories agreed that choice of law was striving for conflicts justice and not for material justice. However, during the 20th century the assumed solid ground began to shake. Triggered by the incorporation of the vested rights theory into the Restatement (First) and the perceived arbitrary results of its application, American conflicts scholars questioned the wisdom of conflicts justice and began promoting concentration on material justice in individual cases.

2. The American Conflicts Revolution

The first one to leave the confines of the classical concept of choice of law during what became later known as the American conflicts revolution was David F. Cavers.\(^9\)\(^8\) He essentially blamed both the vested rights theory and Savigny's choice of law concept for selecting the applicable law without regard to its content and argued that international cases did not differ from purely national ones in that the court in both cases had to resolve a dispute in a substantively fair and just way. Therefore, he claimed that choice of law was about attaining "material justice" rather than "conflicts justice" and suggested that courts - in making choice of law decisions - should look to the content of the different laws involved and consider the result of their application in the

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\(^9\)\(^8\) For a detailed account SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 50-52.
This approach, which today is known as the material justice approach to private international law, gained more weight later during the 20th century under the influence of Robert Leflar. He developed what he called "choice influencing considerations": a list of five factors to be considered in choice of law cases in order to determine the applicable law. This list differed from similar compilations of decisive factors — among them the principles of preference prepared by Cavers — in that it allowed courts to apply what they perceived as the "better law." And even though Leflar stressed that the quality of the law was only one out of five factors to be considered, most courts paid no or little attention to the first four criteria — predictability of results, maintenance of interstate and international order, simplification of the judicial task, advancement of the forum's governmental interests. Instead, they resorted quickly to application of what they perceived as the better law, which was more often than not the law of the forum. As a result, Leflar's list of choice influencing considerations became soon generally known as the "better law approach."

Today, no contemporary choice of law system applies a better law approach as suggested — or at least supported — by Leflar. In Europe it was never seriously under discussion, although it was appreciated by some scholars as a subsidiary rule, notably Konrad Zweigert. In the United States, it was rejected with the adoption of the Restatement (Second) of Conflict of Laws: according to Section 6 courts must determine the applicable law with regard to a number of factors designed to find the legal order with the most significant relationship to the dispute. However, while the list of these factors includes most of Leflar's choice influencing factors, any reference to the quality of the law or the outcome of individual cases is missing.

100. For a detailed account see BRILMAYER, supra note 22, at 64-66; EDWIN SCOTT FRUEHWALD, CHOICE OF LAW FOR AMERICAN COURTS. A MULTILATERALIST METHOD 27-29 (2001); SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 52-58.
103. See, e.g., Heath v. Zellmer, 151 N.W.2d. 664 (Wis 1967); Milkovich v. Saari, 295 Minn. 155, 203 N.W. 2d. 408 (Minn. 1973). For a detailed discussion of the problem see SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 53-54.
105. Section 6 mentions the following factors: (1) the need of the interstate and international systems, (2) the relevant policies of the forum, (3) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (4) the protection of justified expectations, (5) the basic policies underlying the particular field of law, (6) certainty, predictability, and uniformity of result, and (7) ease in the determination and application of the law to be applied.
B. The Economic Perspective

From an economic perspective a material justice approach appears to incur at least one important benefit: it determines the applicable law by looking to the substantive outcome on a case-by-case basis. In contrast to a conflicts justice approach it strives for finding the “proper result” in individual cases and, therefore, it is likely to generate what is perceived as “material justice.” Under the assumption that “material justice” can be equated with the maximization of the joint benefits of the parties and the absence of externalities, looking for material justice is likely to enhance global efficiency. Why then did the material justice approach – just like the substantivist approach – not enjoy lasting popularity?

1. The Costs of Compliance and Adjudication

There are two obvious reasons that explain this finding. First, a material justice approach increases the compliance costs of the parties because it increases uncertainty. Prior to filing a lawsuit – more precisely, prior to the rendering of a judgment – parties will not know which law the court will deem to be the proper one. To adjust their behavior to the applicable law, they will have to seek expensive legal advice. And even if they do, some uncertainty will always remain because the material justice approaches are specifically designed to allow for individual decisions in individual cases. Second, a material justice approach increases the costs of adjudication. This is because choosing the applicable law on the basis of the best substantive fit in individual cases requires determination, evaluation and comparison of the substantive laws involved. Even if courts are actually in a position to compare and weigh different substantive laws – an assertion that must be doubted – any such investigation into the substantive law of a foreign country is extremely complicated and time-consuming. It therefore increases the costs of adjudication.

2. The Negative Effects of Specific Investments

Next to the high compliance and adjudication costs there is a third reason that explains the lack of success of the material justice approach. Different empirical studies have shown that the material justice approaches that emerged during the American conflicts revolution in practice tends to result in the application of the lex fori. In fact, application of the lex fori is more frequent in states that apply a material justice approach than in states that still adhere to

106. See also infra Part VII et seq.
107. See also id.
108. See also infra Part VI.B et seq.
the Restatement (First) or any other approach that strives for conflicts justice. This finding, in turn, suggests that courts in looking for material justice tend to favor their own law over foreign law regardless of the outcome of the individual case. Of course, it might be that the application of the *lex fori* is an expression of a thorough comparison of the substantive laws involved on a case-by-case basis. However, it seems more likely that it is an expression of a forum bias which results from previous investments into acquiring knowledge about the *lex fori*. As a result, it appears that the perceived benefit of a material justice approach—efficiency in individual cases—is not likely to be realized in practice. A material justice approach, therefore, seems to incur considerable costs without resulting in any benefits. Therefore, approaches that aim for conflicts justice rather than material justice are generally to be preferred.111

VI.
THE DEGREES OF PRECISION: LEGAL CERTAINTY OR FLEXIBILITY?

In addition to the dichotomies discussed so far choice of law theory has revolved around a question that concerns the degree of precision, detail or complexity of regulation. Should choice of law rules primarily be designed to provide for legal certainty or should they rather allow for flexibility? In other words: should choice of law provisions be framed as rules or as standards? Until the 20th century there was a strong tendency towards legal certainty triggering the need for rather strict rules in both the United States and Europe. However, during the 20th century the American conflicts revolution produced a number of methodological approaches that favored flexibility. In fact, the desire for more flexibility was one of the driving forces behind the American conflicts revolution.

A. The Legal Debate

1. The European Approach

In Europe, ever since the birth of choice of law in the 12th century, the desire to provide for legal certainty has prevailed. The statutists tried to develop clear cut rules to determine the spatial reach of legal norms, Wächter promoted his *lex fori* approach to ensure more predictability in the choice of law analysis, and Savigny spent much time with the development of clear connecting factors for different categories of legal relationships. Today, a rule-based approach is still dominant in European choice of law methodology. However, under the influence of the American conflicts revolution some adjustments have been made to allow for more flexibility in individual cases. The Rome

110. See also Ghei & Parisi, *supra* note 24, at 1376; Guzman, *supra* note 6, at 896-97.
111. See also Guzman, *supra* note 6, at 897.
Convention,\textsuperscript{112} for example, determines the applicable law with a set of rather strict rules designed to find the law with which the contract is the most closely connected. However, these rules for the most part amount to rebuttable presumptions that can be set aside if a court finds that in individual cases the contract is more closely connected with the law of another state.\textsuperscript{113} As a result, the Rome Convention in principle applies strict rules to make choice of law decisions. However, it allows departure from these rules on a case-by-case basis.

2. The Vested Rights Theory and the Restatement (First) of Conflicts

In the United States, as in Europe, choice of law theory started with a rule-oriented approach: the vested rights theory. It advanced the idea that courts had to decide a case in accordance with foreign law if the right in question had vested abroad. Unfortunately, determination of whether a right had vested abroad was not always easy. Therefore, American courts – and eventually the Restatement (First) of Conflicts – focused on the occurrence of certain events, usually the last act necessary to complete the cause of action.\textsuperscript{114} Not surprisingly, the concentration on the place of the last act did not lead to satisfactory results in every single case. More often than not, application of the vested rights theory was perceived as leading to arbitrary results triggered by strict and mechanical rules. In the middle of the 20\textsuperscript{th} century, American legal scholarship, therefore, took a sharp turn. In order to ensure justice in individual cases a majority of American scholars started to reject rule-based approaches and came up with proposals for flexible choice of law rules. Juenger advocated his best law approach, Cavers advanced his principles of preference, and Leflar prepared his choice influencing factors. With the help of many more American scholars, notably von Mehren and McDougal, they eventually triggered the replacement of the Restatement (First).

3. The Restatement (Second) of Conflicts

The Restatement (First) of Conflict of Laws had met with severe criticism and launched a vigorous academic debate as soon as it was published in 1934. To account for both the most prominent criticism and the new approaches to private international law promoted by legal scholarship, the American Law Institute eventually decided in 1951 to draft a new Restatement. Under the guidance of Willis L. M. Reese, the Reporter for the ambitious project, the

\begin{itemize}
  \item \textsuperscript{112} Supra note 85. For a detailed account, see Mathias Reimann, \textit{Savigny's Triumph? Choice of Law in Contracts Cases at the Close of the Twentieth Century}, 39 VA. J. INT'L L. 571, 586 (1999).
  \item \textsuperscript{113} If the Proposal for a Regulation of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I), COM (2005) 650 final, is enacted, the rebuttable presumptions will be turned into strict rules.
  \item \textsuperscript{114} For a detailed discussion of the vested rights theory see BRILMAYER, \textit{supra} note 22, at 18-22; KAY, \textit{supra} note 22, at 26-28; SCOLES ET AL., \textit{CONFLICT OF LAWS}, \textit{supra} note 5, at 18-22.
\end{itemize}
Institute set out to remedy the perceived flaws of the Restatement (First) by incorporating the best features of modern approaches to choice of law while avoiding their defects. Whether the Restatement (Second) that was finally adopted in 1969 has actually managed to take the good without the bad is still open for discussion. More often than not it has been argued that the blending of different approaches has resulted in a "mishmash" that makes the determination of the applicable law more difficult, if not impossible. One thing, however, can be said with certainty. The Restatement (Second) has accounted for the most important claim of all modern American scholars in that it determines the applicable law by applying a flexible standard: the principle of the most significant relationship. However, just like the Rome Convention has abandoned the European adherence to strict rules, the Restatement has accounted for the need of certainty in international transactions and laid down a set of more specific rules. Because these rules are phrased as rebuttable presumptions it seems that American and European choice of law methodology — after some divergence during the course of the 20th century — have arrived at a very similar point.

B. The Economic Perspective

The discussion about whether choice of law should provide for legal certainty or flexibility finds a close relative in the law and economics literature: the rules versus standards debate. It has been high on the economic agenda for quite some time and produced important insights into the workings and effects of both types of norms. Can these insights provide guidelines for the long-lasting debate in choice of law?

1. Rules versus Standards: The Economic Debate

In economic theory, rules are usually defined as simple and clear legal norms whose precise content is promulgated prior to individuals' behavior. In contrast, standards are usually understood as unclear and fuzzy legal norms whose precise content is determined after the relevant individuals' behavior has taken place. Whether legal norms should be phrased as rules or standards depends on which of the two incurs the least overall specification, compliance

115. For a detailed account of the Restatement (Second), see BRILMAYER, supra note 22, at 67-69; SCOLES ET AL., CONFLICT OF LAWS, supra note 5, at 58-68.
At large, the following general statements can be made: for rules, specification costs are usually high because both initial drafting and subsequent revision require intensive investigation, deliberation and negotiation. For standards, in contrast, the costs of both drafting and revising are usually low because they leave difficult issues for future resolution by the courts and, therefore, require less discussion at the outset. Additionally, standards usually need less revision than rules because they are less sensitive to quick economic and social changes and, therefore, less likely to obsolesce. Therefore, the specification costs for standards are usually much lower than for rules.

Compliance costs, in contrast, are usually low for rules because their simplicity and clarity makes them easily accessible. For standards, in contrast, the costs of determining the content are usually high because individuals have to engage in the difficult, if not at times impossible, prediction of how a court will eventually determine the desired degree and level of conduct. They will either have to study the law and relevant precedents themselves or pay for costly legal advice. And in the end, there will almost always remain some uncertainty about the content of the law and the future decision of a court. As a result, compliance with a standard, in principle, is more complicated and therefore more costly than compliance with a rule. However, it may also be the other way round: although a particular rule may be very simple and therefore easy to understand, it can happen that the entire set of rules necessary to regulate a certain conduct is more complex than a corresponding standard. For example, the above-mentioned speed limit of 65 miles per hour is a clear and simple rule. Nevertheless, the entire traffic code necessary to regulate driving is most probably more complex and difficult to understand than the general requirement of the standard to drive carefully. The process of finding the one clear and simple rule regulating the relevant conduct might, therefore, incur information costs, which may even exceed the information costs under a standard. However, the latter may rather be the exception than the rule so that rules at large indeed seem to incur less compliance costs than standards.

Likewise, the costs of norm adjudication are usually low if legal norms are phrased as rules because their simplicity and clarity allows for easy determination of the content by the adjudicator. For standards, in contrast, these costs are usually high because they leave ample room for judicial discretion. Therefore, unless the system of rules itself is complex, the application costs of a


120. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 61, at 556-57. See also Diver, supra note 118, at 73; Reese, supra note 119, at 316-17.

121. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 61, at 557-58. See also Kaplow, supra note 118, at 593-96.
rule will be lower than the application costs of a standard. The same considerations lead to the result that the costs for monitoring the correct application of a rule are usually lower than the costs of monitoring the application of a standard. The content and of a standard is simply more difficult to determine. Therefore, it is likewise more difficult to determine when adjudicators stay within their boundaries.

In summary, it can be said that rules tend to incur high specification costs and low compliance and adjudication costs, whereas standards lean towards low specification costs and high compliance and adjudication costs. However, this does not mean that rules are generally less costly than standards and, therefore, are generally to be preferred. It is perfectly possible that the total costs involved in specification, compliance and adjudication of a rule exceed the corresponding costs of a standard. Therefore, the choice between rules and standards depends on a comparison of the associated costs on a case-by-case basis. Admittedly, any such comparison will face difficulties resulting from the number of variables responsible for the desirable degree of precision. And any generalization as to when rules are to be preferred over standards is necessarily suspect. Nonetheless, it can be said that formulation as a rule tends to be more appropriate than formulation as a standard if a legal norm will be applied and adjudicated frequently. This is because the additional costs of specification — which will arise only once — will most likely be outweighed by the savings in the costs of compliance and adjudication. In contrast, formulation of a legal norm as a standard seems advisable if a norm is less frequently applied or if the regulated conduct is subject to quick economic and social change.

By the same token, designing a legal norm as a rule seems to be superior, if information about the regulated conduct and the optimal level of regulation are readily available as well as processible for the legislator. Leaving the specification to the courts in these cases would multiply the corresponding costs and thereby lead to a waste of judicial resources. If, however, the relevant information is not readily available, it seems more appropriate to phrase the legal norm as standard and to leave the ultimate decision to the courts.

2. Rules versus Standards: The Implications for Choice of Law

The costs and benefits involved with application of rules and standards may vary from one area of the law to the other. Due to the fact that the costs of

122. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 61, at 557. See also Diver, supra note 118, at 73; Reese, supra note 119, at 317-18.
123. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 61, at 557.
124. Kaplow, supra note 118, at 566-70; POSNER, ECONOMIC ANALYSIS OF LAW, supra note 61, at 556-58.
125. Diver, supra note 118, at 75-76; Sunstein, supra note 117, at 974, 1003-04.
126. Kaplow, supra note 118, at 563, 571-77; Schäfer, supra note 117, at 2; Sunstein, supra note 117, at 1003-04; Ulen, supra note 117, at 356-57.
127. See Schäfer, supra note 117, at 2-3; Sunstein, supra note 117, at 1003.
specification, compliance and adjudication differ according to the context, it might be that rules are less costly in some areas, whereas standards are more beneficial in others. Additionally, even if in a certain area of law rules are generally to be preferred over standards or vice versa, it might be that certain issues within that area require a different treatment. Therefore, the following considerations are to be handled with care. They try to identify the costs and benefits typically incurred with the application of rules and standards in choice of law. However, they are subject to potential modification for certain areas or certain issues within choice of law.

3. The Law of Large Numbers: Norm Specification and Economies of Scale

It has been seen that the costs for initial specification of rules are usually higher than the costs for the initial specification of standards. In this respect, choice of law is no exception. Take for example the better law standard promoted by Leflar and compare it to a rule such as Article 4 (2) of the Rome Convention, which provides that contracts shall be governed by the law of the country where the party who is to effect the performance which is characteristic of the contract has her habitual residence. It seems clear that Leflar’s approach incurs significantly less costs in initial specification than the European characteristic performance rule. It neither requires intensive investigation or empirical research nor does it likely provoke lengthy deliberation and negotiation. Additionally, Leflar’s better law approach is almost immune against social and economic changes and, therefore, less likely to be in need of subsequent revision than the very specific European characteristic performance rule.

The decisive question, therefore, is whether in choice of law savings in compliance and adjudication costs may outweigh the high costs of initial specification for rules. As has been described, the answer to this question turns to a large extent on the frequency with which a particular choice of law rule will be applied and adjudicated in practice. Naturally, it is hard to answer this question on a general level without having regard to specific issues in choice of law. And unfortunately, figures about the frequency of both international transactions and the associated legal problems are not readily available. However the following can be said with some certainty. First, the number of cases that trigger choice of law issues is substantial. Due to increased international commerce, international travel and international migration a growing number of cases have connections to more than one legal order. For example, more and more people travel abroad where they book hotels, rent cars and go shopping. In 1999 alone, 73 million people went from Germany to

128. Supra note 85.
129. For a more detailed economic analysis of the characteristic performance rule, see Schäfer & Lantermann, Choice of Law from an Economic Perspective, supra note 6, at 98-99.
France for business or personal reasons, 59 million to Italy, 89 million to Poland and more than 100 million to the Czech Republic.\(^{130}\) Also, more and more people have access to the Internet, which allows for increased international commerce. In the Federal Republic of Germany, for example, more than 95% of all businesses and around 60% of all private households have Internet access. 52% of all businesses and 43% of all private households with Internet access engage in the exchange of goods and services via the Internet.\(^{131}\) Finally, more and more people leave their home countries to work and live abroad. Germany, for example, counts more than 7 million foreign nationals.\(^{132}\) Additionally, 50,000 foreign nationals get married in Germany every single year.\(^{133}\)

Second, although the fact patterns underlying cases with international connections are usually more diverse than in purely domestic cases, this does not imply that the underlying legal issues are more diverse. In fact, there is no reason to believe that the number and diversity of countries involved renders ex ante regulation impossible. It rather seems that choice of law cases just like cases in any field of substantive law for the most part revolve around a limited number of iterative problems. In contracts, for example, choice of law both in the United States and Europe has traditionally been struggling with the scope of party autonomy, the applicable law in the absence of party stipulation as well as the applicable law in consumer contracts, insurance contracts and employment contracts. In torts, pervasive issues have been, for example, the scope of the lex loci delicti rule, the applicable law in cross-border torts as well as the applicable law in product liability cases. As a result, although choice of law issues "arise in a myriad of factual contexts involving people and events from different places."\(^{134}\) This does not mean that the specific issues in question are equally different and diverse.\(^{135}\) And even though there may be issues in choice of law that arise infrequently, there is some reason to believe that on a large scale the frequency of both international transactions and the recurrence of specific choice of law issues allow and even support formulation of the corresponding legal norms as rules.

4. The Availability of Information: Allocation of Resources and Expertise

Apart from the frequency of application, the availability of information


\(^{134}\) Parisi & O'Hara, Conflict of Laws, supra note 6, at 393.

\(^{135}\) But see id.
about the regulated conduct indicates whether formulation of legal norms as rules or as standards is desirable from an economic point of view. As has been pointed out, formulation of legal norms as rules seems more appropriate if such information is readily available and processible for the legislator, whereas formulation as standards is to be preferred if such information can better be gathered by the courts on a case-by-case basis. In other words: if the legislator is in a better position to gather and process the relevant information, the legislator should provide for precise choice of law rules. If not, the decision should be left to the courts by way of standards. Against this background, what is the situation in choice of law? Who is in a better position to determine the applicable law? The answer to these questions depends to a large extent on issues previously discussed, namely whether choice of law should resort to the selectivist or the substantivist method and whether choice of law should strive for conflicts or material justice. If choice of law were about achieving justice in individual cases it would be rather clear that the courts would be in a better position to determine the applicable law. Likewise, the courts would have superior knowledge if the substantivist method of creating new substantive law based on the legal systems involved in particular cases were to be applied. However, as both the material justice approach and the substantivist method should be rejected, it seems that courts are not in a better position than legislators to determine the applicable law. As a general rule, judges in both civil law and common law countries do not have the expertise to take the policy decisions required under any of the approaches that emerged during the American conflicts revolution. Prior to being raised to the Bench, judges have usually been trained only in their own legal system. Therefore, they do not have sufficient knowledge of foreign legal systems to determine whether the law of a foreign country in a particular case provides for the best law. Neither can they determine the underlying policies of foreign law in order to compare or weigh the governmental interests at stake. And even if judges had sufficient expertise in foreign and comparative law it is unlikely that they would have the time and the resources to engage in the research necessary to take a decision based on a vague standard in a particular case. Indeed, empirical studies have proven that courts that follow any of the modern American approaches tend to apply their own law. And even though it is possible that application of the American lex fori has been the result of a thorough comparison of the different legal systems involved, it seems rather unlikely. Therefore, it appears that legislators are in a better position to determine the applicable law. The availability of information and the ability

136. See Borchers, supra note 109, at 370-74, 377-78; Solimine, supra note 109, at 87-88; see also O'Hara & Ribstein, Conflict of Laws and Choice of Law, supra note 6, at 641-42; Parisi & O'Hara, Conflict of Laws, supra note 6, at 394-95.

137. This is not to say that legislators are in a perfect position to determine the applicable law. Public choice problems, for example, may distort the legislative process and lead to inefficient results. However, for the afore-mentioned reasons, legislators seem to be in a comparatively better position to make choice of law decisions than courts. See O'Hara & Ribstein, From Politics to
to process such information, thus likewise favors rules over standards in choice of law.\textsuperscript{138}

5. The Adjustment of Conduct: Norm Compliance and Uncertainty

As has been seen earlier, the costs of compliance are generally higher for standards than for rules. Again, choice of law does not seem to be an exception. Staying with the comparison between Leflar's better law approach and Article 4 (2) of the Rome Convention it is certainly more difficult for private individuals to find out what the "better" law is that a court might apply to a contract than to determine the habitual residence of the party who is to effect the performance which is characteristic of the contract. Considering that the "characteristic performance" is commonly understood as "non-monetary performance" the provision seems pretty straightforward. Therefore, it seems to keep compliance costs significantly lower than a best law approach. However, does that mean that compliance costs under Article 4 (2) of the Rome Convention are generally lower than under a standards-based approach? Doubts arise from the surrounding provisions that establish exceptions from the general rule. According to Article 4 (3) and (4) of the Rome Convention, the characteristic performance rule does not apply if the subject matter of the contract is a right in immovable property or a right to use immovable property or if the contract is for the carriage of goods. Additionally, Article 4 (5) provides that the characteristic performance rule is generally to be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country. Articles 5 (3) further excludes application of the characteristic performance rule in consumer contracts to the benefit of the law of the country where the consumer has her habitual residence in a few cases: (1) if the conclusion of the contract was preceded by a specific invitation addressed to the consumer or by advertising in the consumer's country of habitual residence, and the consumer has taken all the steps necessary on her part for the conclusion of the contract in that country; (2) if the other party or his agent received the consumer's order in the consumer's country of habitual residence; or (3) if the contract was for sale of goods and the consumer traveled from the country of his habitual residence to another country and there gave his order, provided that the consumer's journey was arranged by the seller for the purpose of inducing the consumer to buy.\textsuperscript{139} Finally, Article 6 (2) exempts individual employment contracts from the characteristic performance rule.

Considering the many exceptions and exclusions, it is evident that

\textit{Efficiency in Choice of Law}, supra note 6, at 1178-79.

\textsuperscript{138} See also Schäfer & Lantermann, \textit{Choice of Law from an Economic Perspective}, supra note 6, at 89-92.

\textsuperscript{139} Art. 5 of the Rome Convention is likely to be changed in the near future. According to the Proposal for a Regulation of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I), COM (2005) 650 final, consumer contracts will be governed by the law of the country in which the consumer has her habitual residence.
application of the Rome Convention's characteristic performance rule is not as simple as it appears to be. Many provisions have to be examined in order to make sure that the law of the country actually applies where the party affecting the characteristic performance has her habitual residence. However, even though the rules of the Rome Convention are more complex than they appear at first glance, determination of the applicable law eventually is possible. Therefore, the parties will be able to adjust their behavior to the legal framework. In contrast, under a standard such as the better law approach, certainty about the future decision of a court will never be reached, no matter how much the parties invest in legal advice. As a result, costly uncertainty remains if legal norms are phrased as standards in choice of law. And even though this is the very nature of standards it seems that the uncertainty created through standards in choice of law is particularly great: application of a standard in choice of law and the resulting uncertainty require the parties to account for the substantive norms of the potentially applicable laws. Assuming that a standard potentially allows for the application of the law of two, three or four countries, this means that parties will have to consider the content of two, three or four different substantive laws to adjust their behavior. Further assuming that the substantive laws of these countries are not crystal clear but leave room for two, three or four different interpretations means that uncertainty is multiplied if choice of law resorts to standards instead of rules. Accordingly, it seems that rules – even if they are complex – incur less compliance costs than standards in choice of law.

6. The Challenges of Application: Norm Adjudication and Discretion

By the same token, the costs of adjudication are generally lower under a rule than under a standard. Take for example Leflar's better law approach and Currie's governmental analysis. Both approaches require a court to engage in a complicated examination and comparison of the substantive laws of the different legal systems involved. And irrespective of whether courts are actually in a position to accomplish any such investigation it seems clear that it requires time and resources which in turn incurs high application costs. Under the rules of the Rome Convention, in contrast, the costs of application are significantly lower. Even though the characteristic performance rule is so intermingled with exceptions that it is not as straightforward as it appears, it does not call for normative determination of the merits of substantive laws or governmental policies. Instead it provides the court with a complex, but still rather clear road map for the determination of the applicable law. Consequently, it incurs less application costs than any of the standards proposed in the course of the American conflicts revolution. Moreover, it decreases adjudication costs on yet another ground: due to the fact that rules do not leave discretion to the courts, it

140. For a detailed analysis of the different modern American approaches Parisi & O'Hara, Conflict of Laws, supra note 6, at 392-93.
is likely that the choice of law analysis will be the same across different courts. Because variances are not to be expected on a large scale, incentives for forum shopping together with the associated costs will decrease. In contrast, under a standard, in particular a standard that requires the comparison of substantive laws, the choice of law analysis and thereby the outcome of a case will almost certainly vary from court to court. This, in turn, will encourage parties to engage in forum shopping and thereby increase the costs of adjudication.\textsuperscript{141} As a result, rules seem to incur less overall costs at the adjudication stage.

7. The Effect of Vagueness: Efficient Judgments or Inefficient Forum Bias?

The preceding considerations allow the following conclusions. First, in choice of law, rules incur higher specification costs than standards. However, the frequency of application of choice of law rules and the \textit{ex ante} availability and accessibility of information are likely to result in subsequent savings, which will outweigh the increased specification costs. Second, the costs of compliance and adjudication of rules are lower than for standards. The foregoing analysis, therefore, seems to suggest that in choice of law, rules should generally prevail over standards. Drawing this conclusion would, however, ignore one of the most important benefits of standards over rules, namely the potential for justice in individual cases.\textsuperscript{142} While rules can easily be over-inclusive or under-inclusive and, therefore, lead to absurd results when applied, standards can generate adequate solutions on a case-by-case basis. For this reason, in weighing the costs of benefits involved with the application of rules and standards, the decisive question is: Can the costs of standards be outweighed by the fact that they allow courts to account for the needs of individual cases? Can the higher costs of compliance and adjudication be outweighed by the benefit of providing for the best choice of law solution on a case-by-case basis? A definite answer seems difficult on an abstract level because the costs and benefits associated with standards may vary with the standard applied.

Nonetheless, the following observations can be made: first, the American standards that emerged in the course of the American conflicts revolution and that require the courts to compare and weigh substantive laws or governmental interests have failed to provide for the envisioned just outcome in individual cases. Instead, they have mostly served as a justification for application of the law that the courts know best. It follows that standards that require a normative determination of the merits of foreign substantive laws or foreign governmental interests are not likely to provide for the benefit of individual justice that might be able to outweigh the high compliance and adjudication costs. Therefore, if

\textsuperscript{141} Ghei & Parisi, \textit{supra} note 24, at 1373-75; Richard A. Posner, \textit{The Federal Courts: Crisis and Reform}, \textit{supra} note 46, at 306. For a more detailed account of the inefficiencies involved with forum shopping, see \textit{supra} Part II.B et seq.

\textsuperscript{142} O'Hara & Ribstein, \textit{Conflict of Laws and Choice of Law}, \textit{supra} note 6, at 635; Parisi & O'Hara, \textit{Conflict of Laws}, \textit{supra} note 6, at 391; Schäfer & Lantermann, \textit{Choice of Law from an Economic Perspective}, \textit{supra} note 6, at 91.
standards are to be applied at all, they should resort to criteria—such as the American criterion of the most significant relationship or the European criterion of the closest connection—that are more objective and do not involve investigation and comparison of foreign law or foreign policies. Second, even if a standard can be found that allows more successfully for generation of just results in individual cases it seems unlikely that the associated benefits will indeed outweigh the high compliance and adjudication costs incurred by any standard. This is because every standard provides courts with an incentive to apply forum law regardless of the particularities of the case and thereby reduce the potential benefits to be gained.

Against this background, economic theory seems to support the view that choice of law should resort to rules rather than standards. But maybe the economically best solution would not be to choose between rules and standards, but rather to combine the two. In practice, combination models can be found in the Restatement (Second) of Conflicts and the Rome Convention on the Law Applicable to Contractual Obligations. Both provide for a set of precise rules which courts have to apply in the first place. These rules, however, are phrased as rebuttable presumptions and can be set aside if courts find that they do not lead to application of the law that has the most significant relationship or the closest connection with the case under discussion. As a result, the idea underlying both the American and the European regimes is the same: courts should decide in the spirit of the general principle, normally applying the specific rules but overriding these rules should the general principle so require. Both regimes, thus, try to combine the virtues of rules with the advantages of standards. And the simple fact that Americans and Europeans have more or less independently arrived at the same model, might be seen as proof that a combination of precise rules and standards is economically the most efficient approach in choice of law.

VII. CONCLUSION

Since the emergence of the law and economics movement in the 1960s, economic theory has been applied to the legal system across the board: to torts, contracts, restitution and property law; to criminal law; to civil, criminal and administrative procedure. Therefore, one would assume that by the year 2005 all areas of law had been the subject matter of a thorough economic analysis. Surprisingly, this is not the case. At least one field of law has essentially remained a hideaway for legal scholarship, more or less untouched by economic

143. See also Schäfer & Lantermann, Choice of Law from an Economic Perspective, supra note 6, at 91-92 (arguing for rules in principle and escape clauses in exceptional cases).
144. Reimann, supra note 112, at 572-73.
theory: choice of law. With little exception\textsuperscript{145} the question of which law is applicable to international transactions that involve more than one legal order has largely been ignored by the economic analysis of law. This is not only surprising against the background of a steadily growing number of international transactions, but also against the background of the methodological state of choice of law which has long been described as "dismal swamp."\textsuperscript{146} Indeed, despite several hundred years of vigorous academic debate and an outburst of legal theories and approaches in the 20\textsuperscript{th} century striving for methodological clarification, the most fundamental questions of choice of law are still under discussion. Should courts apply foreign law at all? Should the law of one of the states involved apply or should multistate substantive law specifically designed for international transactions be created? Should choice of law rules define the reach of both forum and foreign law? Should they be unilateral or rather multilateral? In choosing the applicable law should courts take into account the substance of the law? Should they try to find the "correct" law or the "correct" result? Should they search for material justice or rather for conflicts justice? Should they strive for legal certainty or rather for flexibility on a case-by-case basis?

In this article I have tried to answer these fundamental questions in choice of law from an economic perspective. More specifically, I have tried to determine the globally efficient design of choice of law rules from the perspective of a single benevolent and well-informed global legislator. In doing so, I have argued that choice of law rules should (1) be open towards application of foreign law, (2) apply the law of one of the states involved, (3) determine the reach of both foreign and forum law, (4) strive for conflicts justice, and (5) apply rules instead of standards. With this analysis, I hope to have prepared the ground for further economic discussion about both fundamental and more specific issues in choice of law. I also hope to have shown that economic theory can help to overcome the persisting methodological chaos in choice of law by providing the tools of measurement necessary to guide the discourse, adjudication, legislation and negotiation in choice of law.

\textsuperscript{145} See supra note 6.
\textsuperscript{146} "The realm of the conflict of laws is a dismal swamp, filled with quaking quagmires, and inhabited by learned but eccentric professors who theorize about mysterious matters in a strange and incomprehensible jargon. The ordinary court, or lawyer, is quite lost when engulfed and entangled in it." See William L. Prosser, \textit{Interstate Publication}, 51 Mich. L. Rev. 959, 971 (1953).