

The Market for Contracts

Theodore Eisenberg and Geoffrey Miller¹

Abstract: Legal scholars have focused much attention on the incorporation puzzle—why major firms so heavily favor Delaware as their chartering state. The choice of Delaware incorporation is effectively a decision to select Delaware law to control issues of corporate governance and (less reliably) to select Delaware courts to adjudicate disputes. In this sense the incorporation decision is similar to any contract in which parties select a governing law or designate a forum. This paper considers whether theories about Delaware corporate law apply to the broader market for commercial contracts. After describing how the preconditions for such a market were established during the last half of the Twentieth Century (through the increased enforceability of choice-of-law and forum selection clauses), the paper looks at empirical evidence about major commercial contracts. Although Delaware dominates the market for incorporations, New York is the leading supplier of law and forum in commercial contracts. The paper explores several explanations for New York’s popularity.

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Corporate charters are contracts.² Unusual contracts, to be sure: they last a long time, are not negotiated at arm’s length, are difficult to renegotiate,³ include specialized mandatory terms,⁴ and involve repeated transfers of rights (as shareholders buy and sell) and duties (as directors come and go). But they are contracts nonetheless.

A key element of all such contracts is the identity of the authority granting the privileges of incorporation. By selecting a charter-conferring authority, the promoters subject the rights and duties of the parties to the law of the chartering state and select the chartering state’s courts as a forum for resolving disputes. Viewed in this light,

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² See Roberta Romano, *The Genius of American Corporate Law* 36 (1993).

³ See Henry Hansmann, *Corporation and Contract*, 8 *American Law and Economics Review* 1 (2006).

⁴ Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 *Colum. L. Rev.* 1549 (1989).

chartering is comparable to choice-of-law and forum selection clauses in ordinary commercial contracts.⁵

The similarity between corporate charters and choice-of-law and forum selection clauses suggests the possibility that states may compete for contracts in a way that resembles the much-discussed phenomenon of interstate competition for corporate charters.⁶ But what are the contours of such a market, if it exists? How are party choices of law or forum affected by different legal rules? Do states remain passive and allow contracting parties to come to them, or do they shape their substantive or procedural laws in order to attract (or not lose) contracts? Who benefits when a state succeeds in attracting corporate contracts? Do any states dominate the market, and if so, why? What are the efficiency implications of the competition for contracts?⁷

⁵ For recognition of the similarity between these two issues, see Larry E. Ribstein, *Choosing Law by Contract*, 18 *Journal of Corporate Law* 245, 270 (1993); Erin O'Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 *Vanderbilt Law Review* 1551, 1571 n.98 (2000).

⁶ The vast literature on this issue goes back to William L. Carey, *Federalism and Corporate Law: Reflections on Delaware*, 83 *Yale Law Journal* 663 (1974). Questions of whether and to what extent states compete for corporate charters, and whether such competition represents a socially desirable phenomenon, continue to perplex corporate law theory today. For a partial sampling of recent work, see, e.g., Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 *Journal of Financial Economics* 525 (2001); Lucian Arye Bebchuk and Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 *Journal of Law and Economics* 383 (2003); Lucian Bebchuk and Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Corporate Takeovers*, 99 *Columbia Law Review* 1168 (1999); Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?* 90 *California Law Review* 1775 (2002); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the 'Race' Debate and Antitakeover Overreaching*, 150 *University of Pennsylvania Law Review* 1795 (2002); William Carney, *The Political Economy of Competition for Corporate Charters*, 26 *Journal of Legal Studies* 303 (1997); Randall A. Heron and Wilbur G. Llewellyn, *An Empirical Analysis of the Reincorporation Decision*, 33 *Journal of Financial and Quantitative Analysis* 549 (1998); Marcel Kahan and Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 *Cornell Law Review* 1205 (2001); Mark Roe, *Delaware's Competition*, 117 *Harvard Law Review* 588 (2003); Edward M. Iacobucci, *Towards a Signaling Explanation of the Private Choice of Corporate Law*, 6 *American Law and Economics Review* 319 (2004); Marcel Kahan and Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 *Stanford Law Review* 679 (2002); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 *Journal of Law, Economics and Organization* 32 (2004); Roberta Romano, *The States As A Laboratory: Legal Innovation And State Competition For Corporate Charters*, 23 *Yale Journal on Regulation* 209 (2006).

⁷ A literature, much of it recent in origin, debates the pros and cons of the modern regime of (relatively) free contractual choice of law and forum. Some laud free choice of law and forum as promoting efficiency by maximizing the parties' joint welfare. See, e.g., Bruce H. Kobayashi & Larry E.

This paper explores these and other questions about the market for contracts. We argue that states do in fact compete for contracts, and that the structure and characteristics of this market are similar in many respects to the characteristics of the corporate chartering market. As in the case of corporate charters, firms overwhelmingly select the state where the firm has its principal place of business or some “magnet” state. The magnet state for charters is Delaware; for contracts, it is New York, with Delaware exercising an important but secondary influence. As in the case of corporate chartering, states that participate in the competition for out-of-state business attempt to provide prompt, efficient and reliable procedures and institutions for resolving disputes. As in the case of corporate chartering, the legislatures of states that participate in the competition respond to demands for legal rules desired by their clients. And as in the case of corporate chartering, among the principal beneficiaries of the competition for contracts are lawyers licensed to practice in the law-defining and forum-providing state.

This article is structured as follows. Part I describes how changes in legal doctrine opened up the possibility of a market for contracts – specifically, the reversal of

Ribstein, *Contract and Jurisdictional Competition*, in *Fall And Rise Of Freedom Of Contract* 325 (F.H. Buckley ed., 1999); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, *University of Chicago Law Review* (2000); Larry E. Ribstein, *Choosing Law by Contract*, 18 *Journal of Corporate Law* 245 (1993); Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 *Georgia Law Review* 363 (2003); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 *Theoretical Inquiries in Law* 387 (2001); Paul B. Stephan, *Regulatory Cooperation and Competition: The Search for Virtue*, in *Transatlantic Regulatory Cooperation: Legal Problems and Political Prospects* 167 (George A. Bermann et al. eds., 2000); Michael J. Whincop & Mary E. Keyes, *Statutes' Domains in Private International Law: An Economic Theory of the Limits of Mandatory Rules*, 20 *University of Sydney Law Review* 435, 436, 442-43 (1998). Others less sanguine about free contractual choice of law or forum have argued that party autonomy over these issues can result in the application of inefficient rules because the parties selecting the law may have incentives to adopt inefficient rules. This argument is found in papers critical of free party choice to opt out of U.S. securities regulation. See Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 *Virginia Law Review* 1335 (1999); James D. Cox, *Choice of Law Rules For International Securities?*, 66 *University of Cincinnati Law Review* 1179, 1191 (1998); Darrell Hall, *Note, No Way Out: An Argument Against Permitting Parties to Opt Out of U.S. Securities Laws in International Transactions*, 97 *Columbia Law Review* 57, 59-60 (1997).

rules that once disfavored recognition of choice-of-law and forum selection clauses. Part II compares the observed pattern of chartering decisions with evidence about the market for large commercial contracts. Part III examines evidence that New York actively competes to attract commercial contracts. Part IV briefly evaluates other possible explanations for New York's success. We end with a brief conclusion.

I. Enforceability of Choice of Law and Forum Selection Clauses

A key precondition for any market is that purchasers have a choice of vendor. In the case of corporate charters, the conditions for such a market were in place by the early twentieth century. The rule had long been that the state of incorporation governed a company's internal affairs.⁸ This did not in itself confer party autonomy over corporate law because entrepreneurs needed the power to pick the chartering state. Over the course of the nineteenth century they gradually acquired such power. Charters became available as of right early in the century, thus relieving promoters from the need to seek special legislative authorization to do business in the corporate form.⁹ Firms gained authority to operate nationwide as a result of the Supreme Court's 1869 decision denying states the power to exclude foreign corporations.¹⁰ Final liberation came when states ceased requiring a nexus with a firm's activities as a condition to granting a charter.¹¹ By the early twentieth century incorporators could (a) readily obtain charters; (b) know that internal affairs would be governed by the law of the chartering state; (c) operate in states

⁸ See Jens Damann and Henry Hansmann, Extraterritorial Courts for Corporate Law, Yale ICF Working Paper 05-12 (2005).

⁹ Henry N. Butler, Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges, 14 *Journal of Legal Studies* 129, 135, 138-158 (1985).

¹⁰ *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1869).

¹¹ See Henry N. Butler, Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges, 14 *Journal of Legal Studies* 129 (1985); Christopher Grandy, New Jersey Corporate Chartermongering, 1875-1929, 49 *Journal of Economic History* 677, 681 (1989) (describing how New Jersey granted general permission for New Jersey corporations to operate outside the state).

other than the chartering state; and (d) refrain from operating in the chartering state. The net result was that by the beginning of the last century entrepreneurs enjoyed very broad ability to select the law governing their firm's internal affairs.

The parties' ability to influence the forum was more limited. The state of incorporation would always be open to litigation in which the corporation was a defendant. But states other than the chartering states began to assert jurisdiction over out-of-state corporations during the nineteenth century.¹² If the corporation was a plaintiff or co-defendant, moreover, it would be necessary for the court to obtain jurisdiction over out-of-state defendants, making it more likely that suit would be brought in some other court where these defendants could be found.¹³ Ironically, therefore, as entrepreneurs became more capable of selecting the law governing their firms' internal affairs, they lost assurance as to jurisdiction. Nevertheless, the selection of a state for chartering purposes continued (and continues) to have an important influence on the forum that resolves disputes under the charter.¹⁴

The conditions for the development of a market for contracts took longer to develop. Throughout much of the history of American law, such a market was impracticable due to the interaction of two factors: courts often refused to enforce choice-

¹² See Philip Kurland, *The Supreme Court, the Due Process Clause and the In Personam Jurisdiction of State Courts – From *Pennoy* to *Denckla*: A Review*, 25 *University of Chicago Law Review* 569, 577-86 (1958).

¹³ While chartering states had means for coercing corporate directors to submit to their jurisdiction (for example by requiring consent to jurisdiction as a condition for becoming directors), such efforts were not always undertaken and when undertaken were not always successful. See *Shaffer v. Heitner*, 433 U.S. 186 (1977).

¹⁴ Even in recent years, corporate litigation involving Delaware firms has tended to be brought in Delaware, notwithstanding the theoretical availability of other courts to resolve the dispute. See Roberta Romano, *The Genius of American Corporate Law* 41 (1993). For a critique of the impact of the state of incorporation doctrine in subjecting the firm to litigation in the chartering state, see Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 *Vanderbilt Journal of Transnational Law* 51 (2005).

of-law and forum selection clauses; and even if the courts enforced them, these clauses offered only limited benefits.

Parties seeking to enforce choice-of-law clauses were required to convince the court that their choice was *bona fide*.¹⁵ This meant that the designated law had to have some reasonably close relationship with the contract itself, indicating that the parties had not sought to avoid the authority of an otherwise applicable law. In practice the requirement was strict: parties were limited to place of contracting or place of performance.¹⁶ Underlying the hostility towards choice-of-law clauses was the sense that they represented an impermissible attempt by private parties to displace state power. This was the objection of Joseph Beale, the reporter for the First Restatement of Conflicts of Laws, who condemned choice-of-law clauses as conferring the equivalent of legislative power on the contracting parties.¹⁷

Even if courts enforced choice-of-law clauses, the parties would have obtained only limited benefit. Then-applicable conflict of laws rules sought to impose clear standards for identifying the substantive law to be applied in contract cases.¹⁸ Thus any court's application of choice of law rules was reasonably likely to result in the same

¹⁵ See Joseph Beale, What Law Governs the Validity of a Contract: III. Theoretical and Practical Criticisms of the Authorities, 23 Harvard Law Review 260, 261-62 (1910).

¹⁶ See Joseph Beale, What Law Governs the Validity of a Contract: III. Theoretical and Practical Criticisms of the Authorities, 23 Harvard Law Review 260, 262 (1910).

¹⁷ Joseph Beale, What Law Governs the Validity of a Contract: III. Theoretical and Practical Criticisms of the Authorities, 23 Harvard Law Review 260, 260 (1910).

¹⁸ Under the First Restatement of Conflicts of Laws, issues of contract validity were to be governed by the place of execution of the contract while issues going to the details of performance were to be governed by the place of performance. E.g., Restatement of Conflict of Laws § 446 (law of place of contracting determines extent of contractual obligations); § 358 (law governing performance is that of the place of performance); § 362 (time of performance determined under law of the place of performance); § 370 (breach determined under the law of place of performance). In practice, these categories were sometimes difficult to apply to contracts involving contacts with multiple states. Erin O'Hara, Opting out of Regulation: A Public Choice Analysis of Contractual Choice of Law, 53 Vanderbilt Law Review 1551, 1560 n.40 (2000). Nevertheless, these rules provided some degree of predictability – certainly more than is offered by the Second Restatement approach.

state's law being applied. Even if conflict of law principles selected different laws (or if the courts recognized choice-of-law clauses that excluded conflicts-of-law rules) the effect was likely to be slight. The prevailing view of contract law a body of generally-applicable principles enhanced interstate uniformity.¹⁹ Residual variation among states was checked by the principle of *Swift v. Tyson*,²⁰ which provided that in diversity of citizenship cases commercial questions were to be decided according to general common law. If in a case involving adversaries from different states the contract law of one state deviated from prevailing norms, the litigation was likely to be brought into federal court and there decided under general law. Accordingly, there was typically little benefit to selecting the law of any particular state because the case would be decided according to the same rules regardless of which state was chosen. Choice-of-law clauses would neither increase predictability nor opt into more desirable legal rules.

Forum selection clauses also provided only limited benefits to contracting parties. Such clauses were usually effective to confer personal jurisdiction on the court selected by the parties, on the theory that the party consented to the court's authority.²¹ And courts would enforce judgments or awards entered by tribunals to whose power the parties submitted.²² But most courts refused to enforce forum selection clauses which purported to vest exclusive jurisdiction elsewhere. The theory was that such clauses

¹⁹ See Lawrence M. Friedman, *Contract Law in America* 24, 186 (1965). The concept of a uniform body of contract law was a premise of Williston's influential treatise. See 1 Samuel Williston, *The Law of Contracts* iii (1st ed. 1920) (deeming it desirable "to treat the subject of contracts as a whole, and to show the wide range of application of its principles.").

²⁰ 41 U.S. 1 (1842)

²¹ See Joseph Beale, *The Jurisdiction of Courts over Foreigners*, 26 *Harvard Law Review* 193 (1912).

²² For judgments of courts in other states, recognition is required under the Full Faith and Credit Clause. U.S. Constitution Art. V, Sec. 1. Judicial enforcement of arbitration awards was sometimes qualified with conditions that the arbitration process must be procedurally fair and not clearly erroneous. See Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 4842 (1995).

represented an “ouster” of judicial power.²³ Efforts to circumvent this rule by making submission to the selected tribunal a condition precedent to a suit were generally unavailing.²⁴ Even if a court enforced forum selection clauses, moreover, the effect for the parties would often be slight for reasons already mentioned: the selected tribunal would usually apply the same principles of substantive law as would have been applied in the original forum.

The current salience of choice-of-law and forum selection clauses is due to changes in background rules. Courts became increasingly receptive to choice-of-law clauses. The drafters of the Second Restatement of Conflicts of Law²⁵ and the Uniform Commercial Code²⁶ endorsed them. Courts today enforce choice-of-law provisions unless they bear no reasonable relationship with the state, violate an important public policy, or are otherwise unenforceable under ordinary contract principles.²⁷

Concomitantly with the increasing legal recognition of choice-of-law clauses, courts and legislatures dismantled the framework which previously had provided a degree of certainty and predictability as to applicable law in the absence of party choice. *Erie*

²³ See Michael Gruson, Forum-Selection Clauses in International and Interstate Commercial Agreements, 1982 U. Ill. L.Rev. 133, 138-140 (1982); Glenda Burke Slaymaker, The Legality of Contracts Affecting the Jurisdiction of Courts, 58 Cent. 64, 64 (1904).

²⁴ Meacham v. Jamestown, F. & C.R. Co., 105 N.E. 653 (N.Y. 1914).

²⁵ See Restatement (Second) of Conflicts of Laws §§ 6(2)(d), 187.

²⁶ See U.C.C. § 1-105 (1) (1999).

²⁷ For an example of how far courts will go towards recognizing party choice of law, a number of federal circuits have recognized the power of parties to international contracts to opt out of the United States securities laws, at least when the foreign law selected to govern the transaction provides some protections. See *Lipcon v. Underwriters at Lloyd’s, London*, 148 F.3d 1285, 1292-99 (11th Cir. 1998); *Richards v. Lloyd’s of London*, 135 F.3d 1289, 1292-96 (9th Cir. 1998); *Haynsworth v. Corp.*, 121 F.3d 956, 962-70 (5th Cir. 1997); *Allen v. Lloyd’s of London*, 94 F.3d 923, 928-30 (4th Cir. 1996); *Bonny v. Society of Lloyd’s*, 3 F.3d 156, 159-62 (7th Cir. 1993); *Roby v. Corporation of Lloyd’s*, 996 F.2d 1353, 1360-66 (2d Cir. 1993); *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953, 956-58 (10th Cir. 1992). However, courts still decline to enforce choice-of-law clauses in unusual cases. See, e.g., *Bush v. National School Studios, Inc.*, 139 Wis. 2d 635, 407 N.W.2d 883 (1987) (refusing on public policy grounds to enforce choice-of-law clause in franchise agreement); *Application Group, Inc. v. Hunter Group, Inc.*, 72 Cal. Rptr. 2d 73 (Ct. App. 1998) (refusing to enforce choice of law clause in covenant not to compete); *J.S. Alberici Constr. Co. v. Mid-West Conveyor Co.*, 750 A.2d 518 (Del. 2000) (refusing to enforce choice-of-law clause that would have permitted contractor to avoid liability for negligence).

*RR v. Tompkins*²⁸ rejected the notion of general common law in diversity of citizenship cases, thus removing the safety valve of federal jurisdiction. The number of courts potentially capable of adjudicating disputes multiplied with the expansion of personal jurisdiction under *International Shoe v. Washington*.²⁹ Principles of conflicts of law became less predictable as states began to adopt standard-based approaches such as that contained in the Second Restatement. Thus at around the same time choice-of-law clauses achieved legal recognition, the rationale for adopting them became more compelling. These factors, working in tandem, resulted in the widespread practice of including choice-of-law clauses in major commercial contracts.³⁰

Forum selection clauses also achieved legal recognition during the past century. The first change came in the context of pre-dispute arbitration clauses, rendered enforceable by state statutes beginning in 1920 and federal law in 1925.³¹ Such clauses are now routinely enforced.³² Outside the arbitration context, the enforceability of forum selection clauses remained in considerable doubt until the Supreme Court's 1972 decision in *The Bremen v. Zapata*³³ declaring a selection clause "prima facie valid."³⁴ *Bremen* left open the possibility that a party could contest the clause as unreasonable. However, if a commercial party knowingly and voluntarily agreed to a forum it is hard to see why holding the party to the bargain would be unreasonable. The Supreme Court left little doubt that forum selection clauses would find ready acceptance when, in *Carnival*

²⁸ 304 U.S. 64 (1938).

²⁹ 326 U.S. 310 (1945).

³⁰ See Eisenberg and Miller, *supra* note ____.

³¹ For an account of how the law shifted towards making pre-dispute arbitration clauses enforceable, see notes xx-xx and accompanying text *infra*.

³² See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985); *United Steelworkers v. American Mfg.*, 363 U.S. 564 (1960); *United Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574 (1960); *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 583 (1960).

³³ *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972).

³⁴ *Id.* at 10.

Cruises, it upheld such a clause in a consumer contract of adhesion.³⁵ Most state courts have followed the Supreme Court's lead in enforcing forum-selection clauses,³⁶ but a number still refuse to enforce them, or do so only with significant limitations and qualifications.³⁷

These developments opened up opportunities for contracting parties to select the law and forum to govern their affairs. Limitations remained, however, by virtue of the requirement that there be a relationship between the transaction and the chosen law and forum. The requirement of a nexus between transaction and forum has not yet broken down for ordinary commercial contracts. However, several states have enacted statutes assuring that their law and forum will be available for major contracts regardless of the parties' other connections with the state.³⁸ Although these statutes do not guarantee results (other states may not respect them), they go a long way towards making choice of law and forum just as discretionary for commercial contracts as chartering is for incorporations.

The upshot of this analysis is that the preconditions for a market for contracts are now in place. The following sections explore whether such a market has in fact developed.

II. Patterns of Chartering and Contracting

³⁵ *Carnival Cruise Line v. Shute*, 499 U.S. 585 (1991).

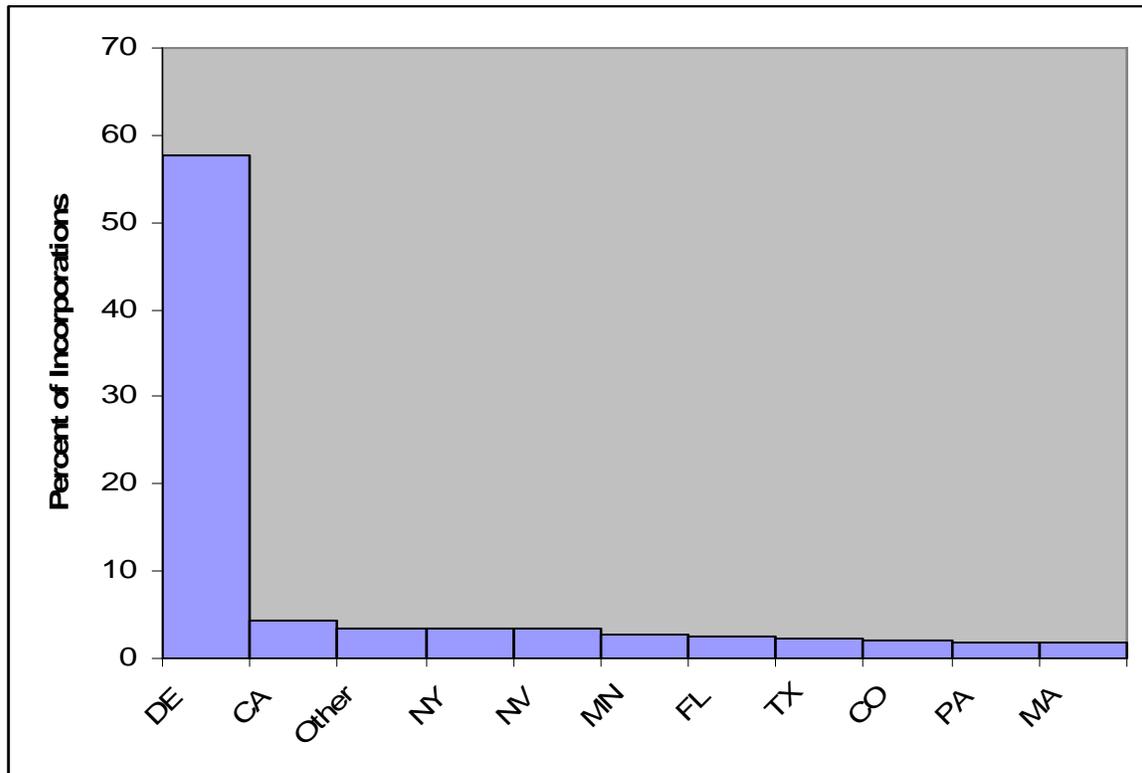
³⁶ Enforcement is generally favored under the Restatement (Second) of Conflicts of Laws § 80, providing that the parties' agreement as to the place of the action is to be given effect unless it is unfair or unreasonable. See also Restatement of Foreign Relations Law § 421, comment h, generally requiring enforcement of forum selection clauses even if the defendant is not otherwise amenable to suit in the jurisdiction.

³⁷ See notes ___ - ___ and accompanying text, *infra*.

³⁸ For discussion, see notes ___ and accompanying text, *infra*.

Delaware's dominance in the market for corporate chartering has been known for many years,³⁹ and shows no signs of abating. In a sample of 6,530 publicly traded firms Bebhuk and Cohen found incorporations distributed as follows:

Figure 1: Distribution of Incorporations Among the States



Source: Lucian Ayre Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, 46 Journal of Law and Economics 383, 391 Table 2 (2002).

Delaware's dominance is obvious, with more than ten times as many firms incorporated in Delaware as in any other state.

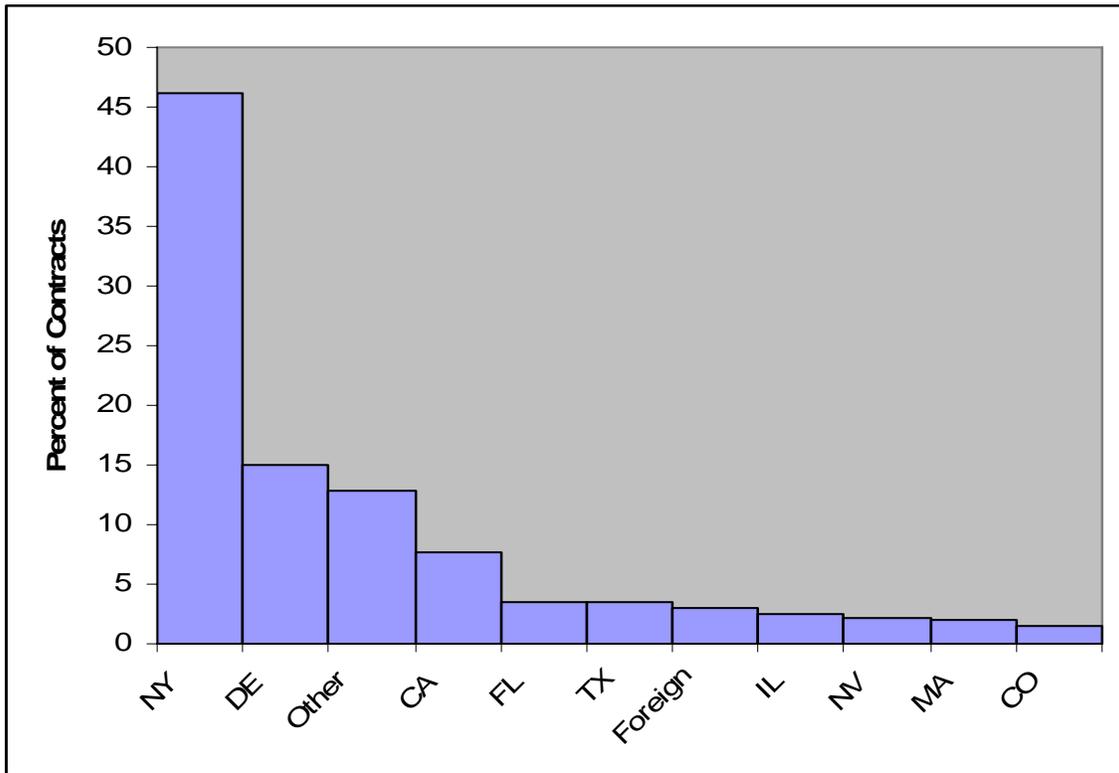
How does the pattern of incorporation compare with the pattern for choice of law?

Eisenberg and Miller studied a data set of contracts attached as exhibits to Form 8-K

³⁹ See William L. Carey, Federalism and Corporate Law: Reflections on Delaware, 83 Yale Law Journal 663 (1974).

current reports filed with the Securities and Exchange Commission in 2003.⁴⁰ These contracts can be assumed to reflect major commercial transactions since they are associated with an event deemed material for an SEC-reporting firm. The leading jurisdictions for choice of law break down as follows.⁴¹

Figure 2: Choices of Law in Major Contracts



Source: Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (forthcoming). N = 2,765.

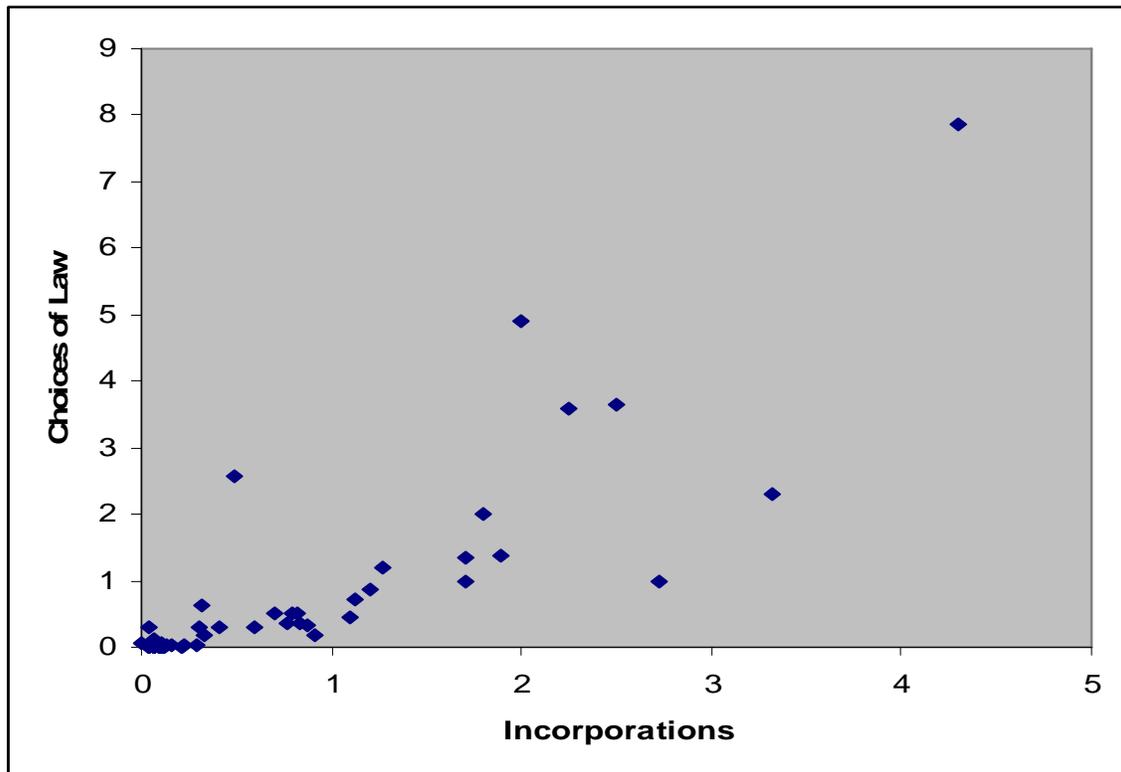
It is readily apparent that New York is the dominant state for choices of law in commercial contracts, with more than three times as many choices as its closest

⁴⁰ Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (forthcoming).

⁴¹ See Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (forthcoming). The results reported here are provisional only, and are subject to revision based on further analysis.

competitor, Delaware. Comparing the contracts and incorporations data, it is also apparent that the provision of both choice-of-law and incorporations is highly concentrated. The five-state concentration ratio for incorporations is 71.6% and the equivalent ratio for choices of law is 75.9%. It is also evident that Delaware and New York aside, firms' choices of incorporation and choices of law are reasonably closely correlated. Figure 3 shows the relationship between incorporations and choice-of-law for all states other than Delaware and New York:

Figure 3: Percent Incorporations and Choice of Law by State, NY and DE Omitted



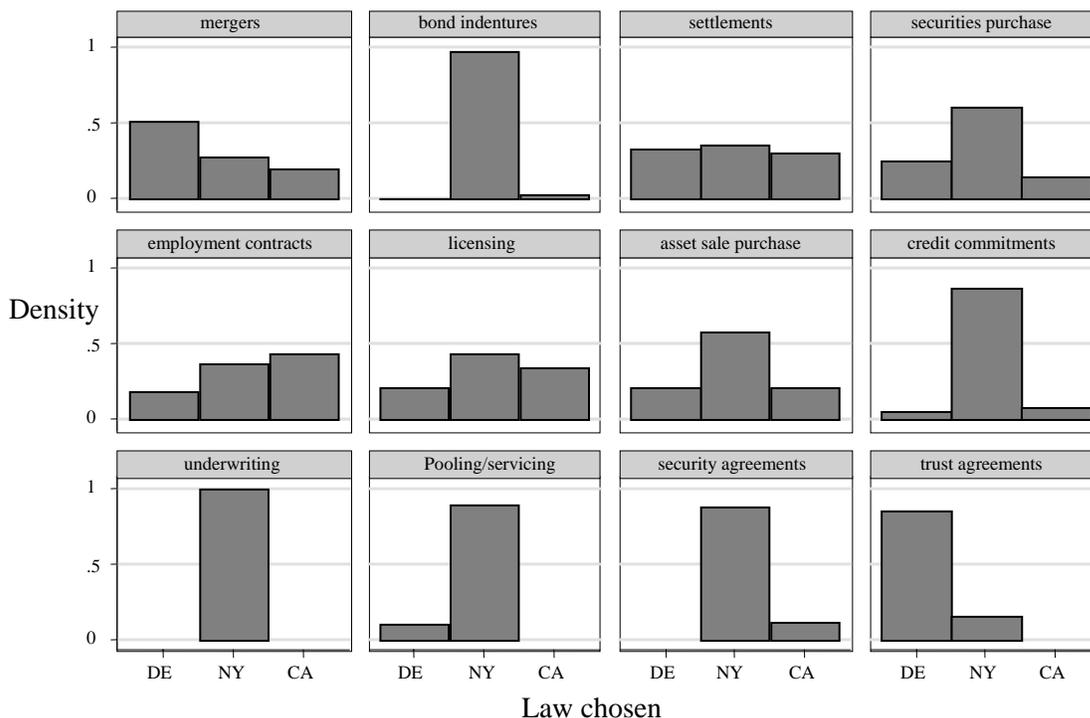
Sources: Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly Held Companies' Contracts* (forthcoming); Lucian Ayre Bebchuk and Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 *Journal of Law and Economics* 383, 391 Table 2 (2002). $r = .828$.

New York and Delaware are outliers, however: New York is the dominant firm in the contracts data, while Delaware is the dominant firm for incorporations. It appears worthwhile to further investigate this difference.

Some information for the observed patterns might be found by disaggregating the types of incorporations or contracts. Bebchuk and Cohen looked at the distribution for all publicly traded firms, Fortune 500 firms, and firms going public from 1996-2000.⁴² Delaware remained the dominant firm in each sample, although there were some differences among the other leading states. In the case of contracts, as might be expected, Eisenberg and Miller find much greater variation of choice-of-law when the contracts are disaggregated by type:

⁴² Lucian Ayre Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, 46 *Journal of Law and Economics* 383, 391 Table 2 (2002).

Figure 4. Distribution of Choice of Law by Contract Type



Source: Theodore Eisenberg and Geoffrey Miller: *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in Publicly-Held Companies' Contracts*, __ De Paul Law Review __ (2007).

Delaware retains a significant advantage in only two categories: mergers and trust agreements (the latter is due to the popularity of the Delaware Business Trust, a business form that allows the parties nearly unlimited autonomy in designing their governance structures).⁴³ New York is the dominant state in all but one of the other categories of contracts. In some types of contracts, e.g., underwriting agreements, New York is virtually the exclusive provider of governing law.

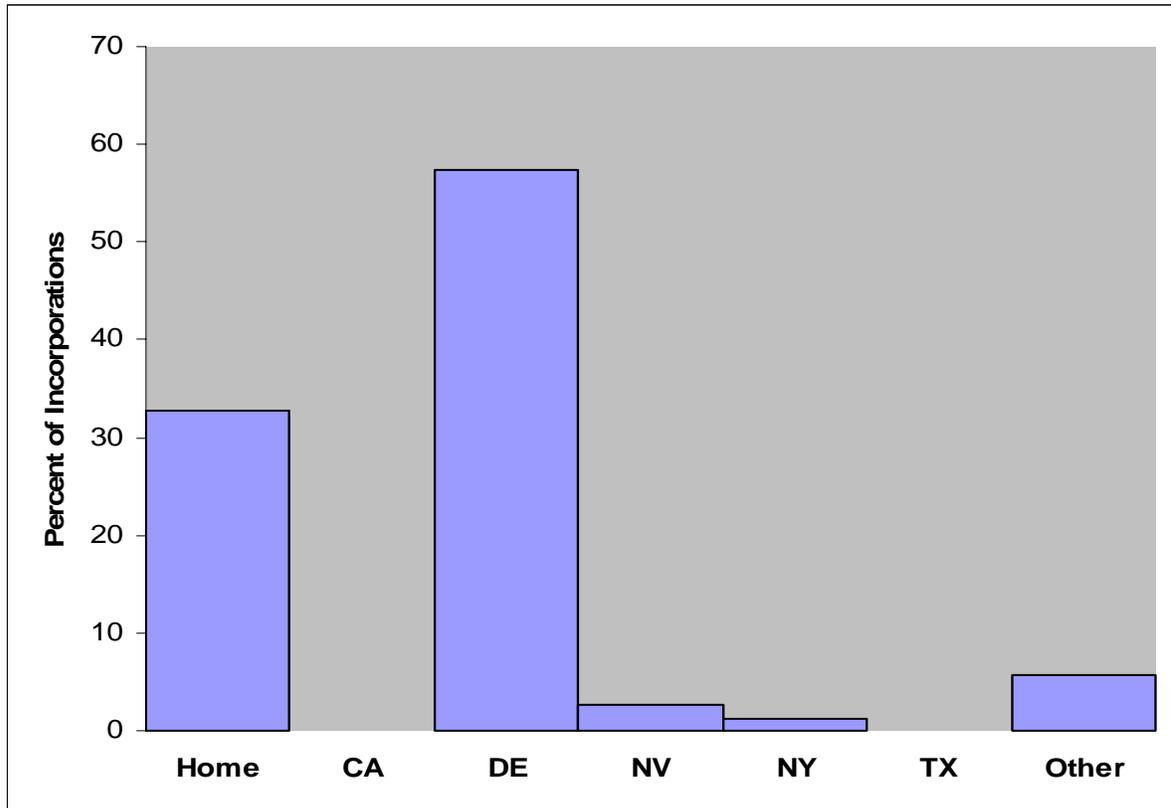
Research originating with Robert Daines has demonstrated that firms overwhelmingly obtain their charters either from Delaware or else from their home

⁴³ See Robert H. Sitkoff, *The Rise of the Statutory Business Trust* (forthcoming) (outlining advantages of the Delaware Business Trust form).

jurisdictions.⁴⁴ Confirming this observation, Bebchuk and Cohen found that 57.3% of the firms in their sample were incorporated in Delaware even though not located there and 32.7% of the firms were incorporated in their home states. Other than Delaware, only Nevada had a significant number of foreign incorporations (2.6% of all firms). It is evident, therefore, that there are only two significant competitors in the market for incorporation: Delaware and the firm's place of business. A summary of Bebchuk and Cohen's results is displayed in Figure 5:

⁴⁴ See Robert Daines, *The Incorporation Choices of IPO Firms*, 77 *New York University Law Review* 1559 (2002); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 *Journal of Financial Economics* 525 (2001); Lucian Ayre Bebchuk and Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 *Journal of Law and Economics* 383 (2003).

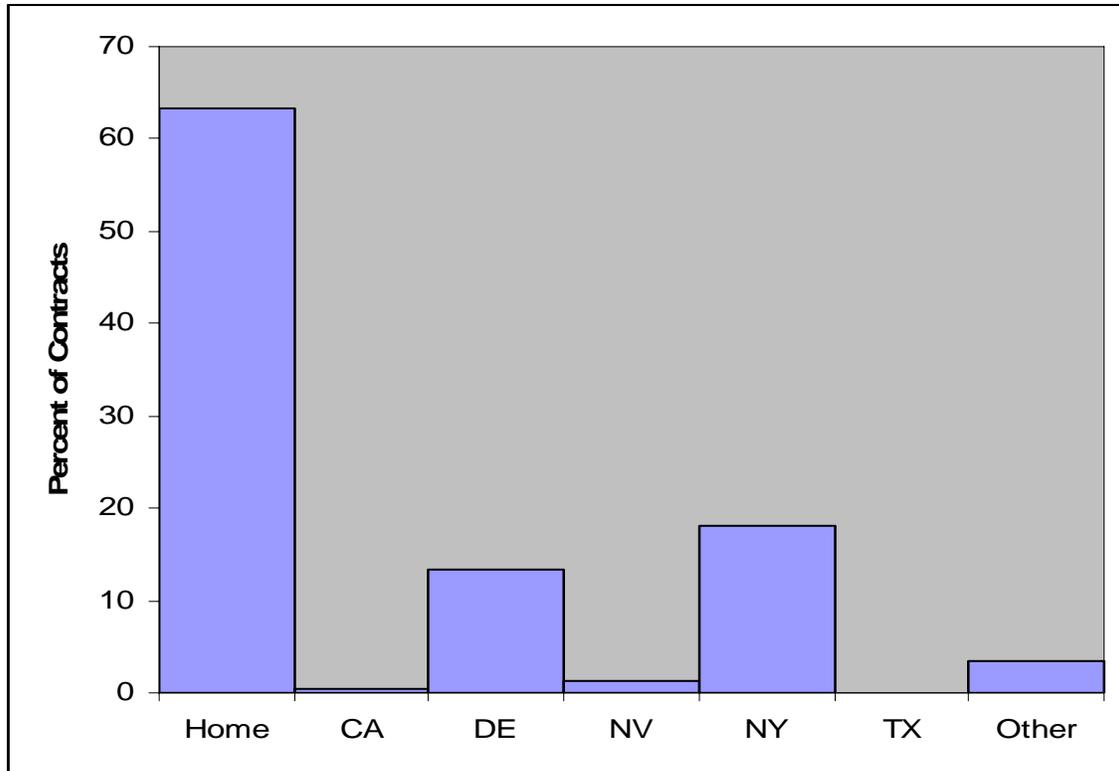
Figure 5: Incorporations: Home or Foreign States



Source: Derived from Bebchuk and Cohen, *Firms' Decisions Where to Incorporate*, p. 395, Table 5.

Do similar home state effects show up for corporate contracts? Unlike the incorporation decision, which involves only one party, a commercial contract involves two (or more) firms which may be located in different states. Thus to evaluate home state effects it is necessary to consider the locations of both contracting parties. Home state effects are, in fact, significant in the contracts data. Figure 6 shows the percentages of contracts that selected the law of at least one of the parties' home states and compares this with the percentages of contracts in states where neither of the contracting parties was located:

Figure 6: Choice of Law in Major Commercial Contracts: Home and Foreign States



Source, Source: Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (forthcoming). N = 2268.

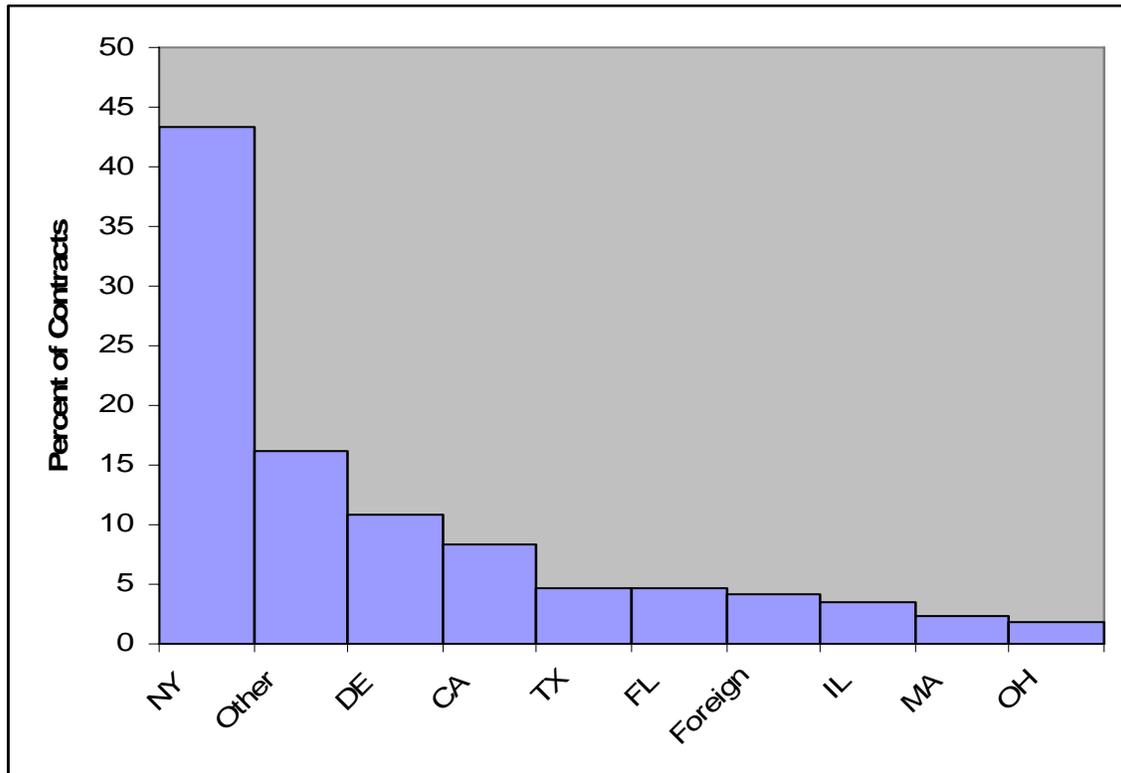
When home state effects are taken into account, it is apparent that there are three significant competitors for choices of law: New York, Delaware, and the location of a party. New York outperforms Delaware as an attractor for contracts between out-of-state parties, however. Moreover, New York's attractive power, relative to Delaware, is understated by this figure because New York, unlike Delaware, is home to a significant number of major firms. We are unable to assess how many New York firms would have selected New York law even if they had been located in some other state.

The home state preference shown in the contracts data (63.4% of contracts) is significantly greater than the home state preference for incorporations (32.7% of incorporations). We can interpret this fact as reflecting several factors. First, because two parties are involved, it is more likely that contracting parties would select the law of one of their home states even if choice-of-law were random. Second, the home state preference for choice-of-law may reflect lingering concerns about enforceability: as noted above,⁴⁵ most states still require a nexus with the transaction before they will enforce a choice-of-law clause. Selecting one's home state ensures that the designated law will not be rejected as having an insufficient relationship with the transaction. It may also be the case that parties, through their attorneys, sometimes do not consider the possibility of selecting a law other than the law of their home states, perhaps because the attorneys are unfamiliar with other options.

We are interested in the pattern of forum selection in commercial contracts. While forum selection clauses generally track choice-of-law clauses, there is no hard-and-fast rule requiring this: a contract could select New York law but designate Delaware as the forum, or vice versa. Moreover, contracting parties frequently omit forum selection clauses even when they include a choice-of-law clause; nonrandom omissions may result in a different pattern for forum selection clauses. The results for forum selection are shown in Figure 7:

⁴⁵ See notes ___ and accompanying text, *supra*.

Figure 7: Forum Selection Clauses in Major Commercial Contracts



Theodore Eisenberg and Geoffrey Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (forthcoming). N = 1017.

Again, New York dominates over all other states, with nearly four times as many forum selection clauses as its nearest competitor, Delaware. Both New York and Delaware show a drop-off when we move from choice-of-law to forum selection, while the “other” category significantly improves. We can interpret this as indicating that the contracting parties prefer to litigate disputes close to home even if they borrow the law of another state. But Delaware’s loss is much larger in percentage terms: while New York dropped 6.4%, Delaware dropped 27.3%. It is evident that some parties to commercial contracts do not find Delaware courts as attractive as Delaware law.

III. The Appeal of New York Law

At least two major conclusions can be drawn from the empirical evidence presented in the previous section. First, even controlling for home state effects, a significant percentage of major commercial contracts (36.6%) select the law of a state other than the location of the parties. This in itself is powerful evidence of a market for contracts. Second, while (aside from home states) Delaware is the only significant choice for incorporations, New York is the dominant state when it comes to contractual choices of law and forum. What explains New York's prominence in commercial contracts?

In considering the market for contracts, it is useful to separate the demand and supply sides. Even if states did not try to attract contracts, differences in legal systems could induce the contracting parties to select into the environment which they believe maximizes their joint welfare. This is the demand side of the market. States may also undertake affirmative measures with an eye towards attracting (or not losing) contracts – the supply side. Both demand side and supply side effects have been proposed to explain Delaware's role in corporate chartering.⁴⁶ This section presents evidence on several features of New York law that appear consistent with either supply or demand side explanations (or both).

A. Arbitration Statutes

Evidence of New York involvement in a market for contracts can be found early in the twentieth century in the campaign to establish arbitration as an effective alternative for the resolution of commercial disputes.

⁴⁶ See Lucian Ayre Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, 46 Journal of Law and Economics 383 (2003). The poster child for supply side explanations is Delaware's adoption of § 102(b)(7) of its corporation code, authorizing charter provisions exculpating directors of personal liability for breaches of the duty of care in the wake of the Delaware Supreme Court's decision in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), a case which appeared to impose a worrisome risk of such liability.

Commercial arbitration was known and practiced in the American business community during the late nineteenth and early twentieth centuries.⁴⁷ The reasons given for arbitration's popularity were similar to those commonly heard today: although it did not guarantee an impartial tribunal or accurate application of the law,⁴⁸ arbitration avoided congested court dockets,⁴⁹ eliminated expensive hearings and appeals,⁵⁰ and supplied expert decision-makers⁵¹ who were "more intelligent"⁵² than juries and better than judges whose decisions might not serve industry needs.⁵³ New York was the nation's leading venue for commercial arbitration,⁵⁴ with services offered both by trade associations⁵⁵ and by the New York Chamber of Commerce, an umbrella association of merchants which had offered arbitration services since 1768.⁵⁶

⁴⁷ See generally I. R. Macneil, *American Arbitration Law* (1992).

⁴⁸ Richard C. Curtis, *A Comparison of the Recent Arbitration Statutes*, 13 *A.B.A. Journal* 567, 568 (1927).

⁴⁹ See Richard C. Curtis, *A Comparison of the Recent Arbitration Statutes*, 13 *A.B.A. Journal* 567, 568 (1927); Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 269 (1926); Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 108 (1925).

⁵⁰ Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 269 (1926).

⁵¹ See Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 110 (1925).

⁵² See Richard C. Curtis, *A Comparison of the Recent Arbitration Statutes*, 13 *A.B.A. Journal* 567, 568 (1927); Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 269 (1926); Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 108 (1925).

⁵³ Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 269 (1926).

⁵⁴ I. R. Macneil, *American Arbitration Law* 25-31 (1992); Julius Henry Cohen, *Commercial Arbitration and the Law* 10 (1918).

⁵⁵ By the first decades of the twentieth century arbitration tribunals were well established in the rubber, silk, produce, dried fruit, lumber, building trades, printing, and clothing industries, among others. See Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 6-8 (1948) (building trades, printing, and clothing); Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 280 (1926) (rubber, silk, produce, dried fruit, and lumber).

⁵⁶ Frances Kellor, *Arbitration and the Legal Profession: a Report Prepared for the Survey of the Legal Profession* 7 (n.d.); Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 482 (1995).

In 1911 the Chamber appointed a committee on arbitration under the leadership of Charles L. Bernheimer, a successful cotton trader, with the apparent objective of modernizing and improving the Chamber's arbitration services. Aply assisted by the Chamber's General Counsel Julius Henry Cohen,⁵⁷ Bernheimer revamped procedures and upgrading the arbitrator list.⁵⁸ These efforts no doubt improved the attractiveness of the Chamber's arbitration services. But they were not successful at establishing the Chamber as a fully effective tribunal for the resolution of business disputes.

The problem was the rule of revocability: the legal doctrine that arbitration agreements were revocable at will and not specifically enforceable in court. When a dispute arose one party was likely to perceive advantages in going to court, either because he could benefit from delay or because he believed that general law offered a greater chance of success than principles of commercial usage.⁵⁹ The rule of revocability allowed a party to avoid arbitration by refusing to participate (if a defendant) or filing a lawsuit (if a plaintiff).⁶⁰

⁵⁷ Ian Macneil, *American Arbitration Law: Reformation, Nationalization, Internationalization* 28 (1992). Cohen served as general counsel of the New York State Chamber of Commerce and later the New York Port Authority. See Jameson W. Doig, *Empire on the Hudson* 31, 39, 66, 17-18, 190-93 (2001). Cohen had been an attorney for clothing manufacturers during the New York garment workers strike of 1910, and had in that capacity advocated arbitration as a method for the communal resolution of the dispute. See Yankl Stillman, *Edward Filene: Pioneer of Social Responsibility*, *Jewish Currents* (September 2004); Julius Cohen, *77, Lawyer for 53 Years*, *New York Times*, Oct. 7, 1950, p.12.

⁵⁸ See *Conference of Bar Association Delegates*, 5 *American Bar Association Journal* 45-46 (1919); Julius Henry Cohen, *Commercial Arbitration and the Law* viii (1918); Julius Henry Cohen, *They Buildd Better Than they Knew* 152 (1948).

⁵⁹ Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 270 (1926).

⁶⁰ See *Arbitration of Interstate Commercial Disputes: Joint Hearings On S. 1005 And H.R. 646 Before The Subcommittees of The Committees of The Judiciary*, 68th Cong., 1st Sess. 14 (1924) (hereinafter "Joint Hearings") (testimony of Julius Cohen) ("the difficulty is that men do enter into such agreements and then afterwards repudiate the agreement").

This problem plagued the Chamber's efforts to upgrade its arbitration services. Unlike trade associations,⁶¹ the Chamber could not rely on social norms to enforce promises to arbitrate.⁶² Denied either specific performance or an effective extra-legal sanction, the disappointed party would be remitted, at best, to the inadequate remedy of damages for breach of the agreement to arbitrate.⁶³ These difficulties placed the Chamber at a distinct disadvantage in competition with specialized tribunals for the provision of arbitration services.⁶⁴

Developments elsewhere heightened the Chamber's reasons for seeking repeal of the rule of revocability. England had made pre-dispute arbitration agreements enforceable by statute in 1886,⁶⁵ resulting in an increase in the caseload of the London Court of Arbitration⁶⁶ -- no doubt at the Chamber's expense.⁶⁷ The Chamber also faced

⁶¹ See Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 266 (1926) (“[s]ystems of arbitration depending for their effectiveness wholly upon the moral suasion of the business community have grown up in the past decades in many lines of American business. Usually the most successful are to be found in the ranks of thoroughly organized trade associations which can exercise an effective discipline.”)

⁶² Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 270 (1926) (“business has become so used to the doctrine of revocability of arbitration agreements that these clauses are not regarded in the same light as other contractual obligations.”)

⁶³ See, e.g., *Hamilton v. Home Ins. Co.*, 137 U.S. 370, 385 (1890); *Union Ins. Co. v. Central Trust Co.* 52 N.E. 671, 674 (N.Y. 1899); *Miller v. Junction Canal Co.*, 41 N.Y. 98, 100 (1869); *Hazzard v. Morgan*, 5 N.Y. 422, 426 (1851). The remedy was inadequate because, given the unenforceability of agreements to arbitrate, courts would not award damages based on the expected arbitral award.

⁶⁴ Bruce L. Benson provides evidence that the Chamber of Commerce was losing increasing business to these specialized arbitration tribunals during the course of the nineteenth century. Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 488-87 (1995).

⁶⁵ See English Arbitration Act of 1889 (chapter 49, 52-53 Victoria); *Manchester Ship Canal Co. v. Pierson & Son*, 2 Q.B. 606 (1900); *Austrian Lloyd Co. v. Gresham*, 1 K.B. 249 (1903). See also *Conference of Bar Association Delegates*, 5 *American Bar Association Journal* 48 (1919) (remarks of Charles L. Bernheimer) (noting New York's competitive disadvantage compared with England).

⁶⁶ Contracts between English and American parties frequently included agreements to arbitrate disputes in England. *U.S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006 (D.C.N.Y. 1915) (describing such a clause as “very ordinary”); A.W. Brian Simpson, *Contracts for Cotton to Arrive: The Case of the Two Ships Peerless*, 11 *Cardozo L. Rev.* 287, 293-314, 321 (1989) (describing arbitration of cotton contracts in England); Julius Henry Cohen, *Commercial Arbitration and the Law* 20-21 (1918) (noting that by the early Twentieth Century England had developed a well-established system of commercial arbitration in many industries.) While specifying arbitration in England increased the probability that the parties would arbitrate their dispute, it did not guarantee that result because the

domestic competition. The Pennsylvania Supreme Court ruled in 1913 that arbitration clauses were enforceable notwithstanding a statute which purported to nullify them.⁶⁸ The result was that parties might opt for a Pennsylvania arbitrator in order to enhance prospects that arbitration agreements would be effective.⁶⁹ While this was only a minor threat – depending as it did on the contract being subject to Pennsylvania law – if other states followed Pennsylvania’s lead the Chamber’s pre-eminence in domestic arbitration would be jeopardized.⁷⁰

The Chamber had reason to hope that the courts might repudiate the rule of revocability, a doctrine both long in the tooth and inconsistent with freedom of contract. But expectations were disappointed in 1914 when the New York Court of Appeals decided *Meacham v. Jamestown*.⁷¹ This was a lawsuit brought in New York by a Pennsylvania contractor against a Pennsylvania railroad for work done in Pennsylvania.

aggrieved party could bring preemptive litigation in a jurisdiction such as New York that refused on public policy grounds to enforce pre-dispute arbitration agreements. See *U.S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006 (D.C.N.Y. 1915).

⁶⁷ The two tribunals clearly competed for business. In 1919 the London Court of Arbitration asked the New York Chamber of Commerce to promulgate a model arbitration clause which would submit all disputes under the contract to arbitration in London. The Chamber declined the invitation and instead recommended a model clause submitting the dispute to arbitration before the Committee on Arbitration of the New York Chamber of Commerce. See Conference of Bar Association Delegates, 5 *American Bar Association Journal* 48 (1919) (remarks of Charles L. Bernheimer).

⁶⁸ *Adinolfi v. Hazlett*, 242 Pa. 25, 88 A. 869, 870 (1913). The decision, overturning a statute enacted in 1907, restored the authority of a line of Pennsylvania cases that had recognized the enforceability of arbitration clauses. See *Snodgrass v. Gravit*, 28 Pa. 221 (1857). Virginia had also recognized the enforceability of pre-dispute arbitration clauses. *Condon v. Southside R.r. Company*, 14 Gratt. 320, Virginia (1858). See generally Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 486 (1995).

⁶⁹ This would not guarantee arbitration, but would significantly increase the chance that the clause would be enforced. Arbitration was not assured because the aggrieved party might sue in a jurisdiction that refused to enforce such agreements – as happened the following year. *Meacham v. Jamestown, F. & C.R. Co.*, 105 N.E. 653 (N.Y. 1914).

⁷⁰ The possibility of loss of business if Pennsylvania’s innovation were followed elsewhere was not lost on New York judges: Judge Cardozo commented that if New York courts were to enforce arbitration agreements valid under Pennsylvania law, “jurisdiction over controversies arising under such contracts may be withdrawn from our courts and the litigation remitted to arbitrators in distant states.” *Meacham v. Jamestown, F. & C.R. Co.*, 105 N.E. 653, 656 (N.Y. 1914) (Cardozo, J., concurring).

⁷¹ *Meacham v. Jamestown, F. & C.R. Co.*, 105 N.E. 653 (N.Y. 1914).

The contract required the parties to submit disputes to the chief engineer before bringing suit. The trial court, in a decision affirmed by the Appellate Division, dismissed the case on the ground that under Pennsylvania law submission to the arbitrator was a mandatory precondition to suit. But the Court of Appeals rejected the clause on public policy grounds, thus allowing the litigation to go forward in New York. Judge Cardozo's concurring opinion made it clear that even if New York courts might defer to forum selection clauses that called for adjudication, the same was not true for arbitration: "[i]f any exceptions to the general rule are to be admitted, we ought not to extend them to a contract where the exclusive jurisdiction has been bestowed, not on the regular courts of another sovereignty, but on private arbitrators."⁷²

The possibility remained that federal courts would reach a different result. But those prospects were crushed in *U.S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*⁷³ A South Dakota corporation had chartered vessels from a British owner and used them for transporting goods between the United States and Trinidad. The chartering agreement provided that disputes would be resolved by arbitration in London. It was undisputed that the agreement to arbitrate was valid under English law. When war broke out in 1914 the British owner reclaimed the ships, resulting in the American company filing a lawsuit for damages in New York federal court. The owner moved to dismiss for failure to comply with the arbitration agreement. The trial court criticized the rule of revocability, finding it to be based on unsound reasoning, but reluctantly declared the

⁷² Id. at 655.

⁷³ 222 F. 1006 (S.D.N.Y. 1915).

matter settled: “[i]nferior courts may fail to find convincing reasons for it; but the rule must be obeyed.”⁷⁴

The *Meacham* and *Trinidad Lake* cases were not wholly catastrophic. By refusing to enforce clauses specifying arbitration under the laws of New York’s principal competitors, these cases undermined the competitive advantage England and Pennsylvania would otherwise have enjoyed.⁷⁵ But overall the cases were a setback. They made it clear that the New York courts were not going to enforce arbitration clauses no matter where the proceedings were to be conducted. New York arbitrations would fail along with the rest. If recourse was to be had against the “deadly rule”⁷⁶ of revocability, it had to be through legislation.⁷⁷

Two groups joined to lobby for repeal.⁷⁸ The New York business community, represented by the Chamber, supported arbitration as a low-cost alternative to litigation as a means for resolving disputes.⁷⁹ Arbitration also received support from attorneys, although their attitude was more ambivalent.⁸⁰ Here the leading figure was Julius Henry

⁷⁴ Id. at 1012.

⁷⁵ London merchants were alarmed enough at the result of the *Trinidad Lake* case that they remonstrated with the New York Chamber of Commerce. See Julius Henry Cohen, *The Law of Commercial Arbitration and the New York Statute*, 31 *Yale Law Journal* 147 (1921).

⁷⁶ Julius Henry Cohen, *They Builded Better than they Knew* 153 (1948).

⁷⁷ The defendant did not take an appeal in the *Trinidad Lake* case.

⁷⁸ See Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 10 n. 4 (1948).

⁷⁹ Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 265 (1926) (describing arbitration as a “movement which commands an unusually widespread support in the business world.”). The United States Chamber of Commerce reported in 1925 that “the substantial element of the American business public is overwhelmingly in favor of arbitration in the settlement of commercial disputes in both domestic and foreign trade.” Id. at 285. Hundreds of trade associations and businessmen supported the work of the American Arbitration Association. Id. at 280; Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 186-198 (1948) (listing more than 500 individual businessmen in various industries who had committed to promoting arbitration), 199-203 (listing hundreds of trade associations and their local subdivisions which agreed to promote arbitration).

⁸⁰ For an account noting the role of attorneys in lobbying for arbitration reform, see Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 491-92 (1995); .

Cohen, whose work with Bernheimer had convinced him that commercial arbitrations were a natural extension of a lawyer's business.⁸¹ England's repeal of the rule of revocability had resulted in a new and lucrative practice for attorneys there;⁸² Cohen believed that similar benefits could be captured by New York lawyers. He and other arbitration boosters argued that lawyers would be called to represent clients in arbitration just as much as in litigation.⁸³ Lawyers' business would even increase because clients would be induced to enforce their rights if given access to speedy and inexpensive procedures.⁸⁴ Satisfied clients would pay as much for arbitration as for litigation, no questions asked.⁸⁵ Even if the attorney's fee were slightly lower this would not matter because he also had lower expenses.⁸⁶ Overall the attorney would earn a better return.⁸⁷ Not all attorneys shared Cohen's enthusiasm for arbitration, however.⁸⁸ A previous effort to set up a government-sponsored arbitration tribunal in New York under the Chamber's

⁸¹ Arbitrations before the Chamber of Commerce were adversarial proceedings intended for the benefit of the broader business community. Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 9 (n.d.). Lawyers could often play a role in these proceedings as representatives of the parties or as paid arbitrators. In contrast, arbitrations before trade organizations rarely included attorneys and thus offered few benefits to lawyers and some costs, if disputes that would otherwise be tried in court were routed to an industry tribunal. Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 8 (n.d.). Some trade organizations even prohibited attorney participation. *Id.*

⁸² Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 20 (n.d.).

⁸³ Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 109 (1925) ("lawyers are no more dispensable in a Tribunal of Arbitration than they are in a court of law.")

⁸⁴ Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 116 (1925).

⁸⁵ Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 116 (1925) ("the lawyer's fees are in no wise diminished by having his clients resort to Arbitration."); Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 283 (1926) (arbitration produced satisfied clients).

⁸⁶ Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 116 (1925)

⁸⁷ Julius Henry Cohen and Kenneth Dayton, *The New Federal Arbitration Law*, 4 *Virginia Law Review* 265, 283 (1926).

⁸⁸ In fact, attorneys were responsible for the demise of a formal arbitration court authorized by the New York legislature in 1874 and abandoned in 1878. Julius Henry Cohen, *They Built Better than They* K new 152-53 (1948).

auspices had failed during the 1870s as a result of opposition from attorneys.⁸⁹ Many lawyers continued to worry that arbitration agreements might result in cases that would otherwise be litigated going to tribunals where lawyers played no role.⁹⁰

Between 1915 and 1920 Cohen and others worked on three fronts, attempting to persuade business interests to accept attorneys as party representatives and arbitrators, to persuade lawyers to support arbitration as an alternative to litigation and to persuade the New York legislature to repeal the rule of revocability.⁹¹ Their efforts eventually paid off: the New York legislature enacted a statute in 1920,⁹² heralding a “new era in American arbitration.”⁹³

The New York statute survived the inevitable constitutional challenge.⁹⁴ But it did not provide complete protection for arbitration clauses. When the disputants were of diverse citizenship either could prevent enforcement, notwithstanding the New York

⁸⁹ Julius Henry Cohen, *They Built Better than They Knew* 152-53 (1948).

⁹⁰ See Bruce L. Benson provides evidence that the Chamber of Commerce was losing increasing business to these specialized arbitration tribunals during the course of the nineteenth century. Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 *Journal of Law, Economics and Organization* 479, 491-92 (1995); Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 19 (n.d.) (resistance among lawyers to arbitration attributed to fear of “adverse effect upon the livelihood of bench and bar.”)

⁹¹ In 1916 Cohen persuaded the New York State Bar Association formed a Committee on Prevention of Unnecessary Litigation, headed by Cohen, which was charged with enhancing attorney involvement in arbitration. Julius Henry Cohen, *They Built Better than They Knew* 155 (1948). A principal task of this committee was to seek common ground with the New York Chamber of Commerce for the coordinated provision of arbitration services. Common ground was not hard to find, given that Cohen was also General Counsel of the Chamber and a close associate of Bernheimer’s. See *Conference of Bar Association Delegates*, 5 *American Bar Association Journal* 45 (1919) (remarks of Charles L. Bernheimer, Chairman of the Committee of Arbitration of the New York Chamber of Commerce). Eventually the Chamber and the bar committee agreed on uniform rules for arbitration. Julius Henry Cohen, *Commercial Arbitration and the Law* 11 (1918). The groups also worked for repeal of the revocability rule. Recognizing that any such law would face a constitutional challenge, they sought to obtain a constitutional amendment authorizing the legislature to act in the area, but were informed that no such amendment was needed. Julius Henry Cohen, *Commercial Arbitration and the Law* ix (1918). In 1918, at the behest of the New York Chamber of Commerce, Cohen published a monograph which promoted the case for judicial enforcement of arbitration clauses. Julius Henry Cohen, *Commercial Arbitration and the Law* vii-xii (1918) (introduction Charles L. Bernheimer).

⁹² 1920 N.Y. Laws, Ch. 275.

⁹³ Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 9 (1948).

⁹⁴ *Berkovitz v. Arbib & Houlberg, Inc.*, 130 N.E. 288 (N.Y. 1921).

statute, simply by taking the dispute to federal court, which continued to adhere to the rule of revocability. Given the *Trinidad Lake* case it was evident that protection from this risk could only come from Congress. The arbitration reform interests in New York therefore sought enactment of a federal law.⁹⁵ The campaign culminated in the Federal Arbitration Act of 1925,⁹⁶ which, among other things, made pre-dispute arbitration agreements enforceable in federal court.

Another problem with the New York statute was that it did nothing to affect the laws of other states. Thus if a contract called for arbitration in New York City, the aggrieved party might avoid arbitration by suing the defendant in the courts of some state that did not enforce arbitration clauses. This problem was mitigated by the federal statute, since if the parties were of diverse citizenship either could ensure the clause was enforced by bringing the action into federal court. But even after 1925 the problem remained, albeit in reduced form, where the parties were not diverse and the plaintiff could obtain jurisdiction over the defendant in a state that preserved the doctrine of revocability. New York arbitration advocates thus sought to “spread the benefits of [the New York statute] to all States, all trades and all industries compassed within our

⁹⁵ Cohen worked to persuade the American Bar Association of the benefits of repealing the revocability rule, even bringing Bernheimer to address the Conference of Bar Association Delegates on the subject. Bernheimer’s remarks failed to generate a very positive reception, however, after he admitted that, in his experience, arbitration cases handled without the assistance of attorneys are disposed of “more quickly and in the long run more satisfactorily.” Conference of Bar Association Delegates, 5 American Bar Association Journal 15, 56 (1919). On Cohen’s prompting the American Bar Association prepared a draft of federal legislation modeled on the New York law (also written by Cohen). Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 38 (n.d.); *Arbitration of Interstate Commercial Disputes, Joint Hearings before the Subcommittees of the Committees on the Judiciary*, 68th Cong, 1st Sess. 10 (testimony W.H.H. Piatt). Cohen and Bernheimer testified in favor of the legislation before a joint hearing of the House and Senate judiciary committees. *Arbitration of Interstate Commercial Disputes, Joint Hearings before the Subcommittees of the Committees on the Judiciary*, 68th Cong, 1st Sess. 5-9 (testimony Charles L. Bernheimer), 13-19 (statement of Julius Henry Cohen) (1924). The New York-based Arbitration Society of America also lobbied for federal legislation. *Arbitration of Interstate Commercial Disputes, Joint Hearings before the Subcommittees of the Committees on the Judiciary*, 68th Cong, 1st Sess. 25-28 (1924) (testimony Alexander Rose).

⁹⁶ Codified at 9 U.S.C. §§ 1-16.

national life.”⁹⁷ Repeal of the revocability rule in other states threatened New York interests to some extent because it meant that parties could specify other states as forums for arbitration; but the potential loss of business was more than offset by the increased custom expected to flow from assurance that contracts specifying New York as the forum for arbitration would be enforced elsewhere.

Lobbying by arbitration advocates achieved a few early results: New Jersey enacted a statute in 1923⁹⁸ and Massachusetts and Oregon followed in 1925.⁹⁹ California, Pennsylvania and Wyoming fell into line in 1927.¹⁰⁰ In general, however, state legislatures proved resistant to enforcing pre-dispute arbitration clauses. The American Bar Association backed off its support¹⁰¹ and the Conference of Commissioners of Uniform State Laws declined to propose a law advocated by Cohen,¹⁰² endorsing instead a provision that did not include enforcement of agreements to arbitrate.¹⁰³ Only 15 states had modern arbitration clauses on the books in 1945.¹⁰⁴ This resistance to arbitration reflected concerns of attorneys outside New York that nationwide

⁹⁷ See Harris Jay Griston, *The Substitution of Arbitration for Litigation*, 2 *New York University Law Review* 107, 107 (1925).

⁹⁸ N.J. Laws 1923, chapter 134.

⁹⁹ See Sabra A. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 *Minnesota Law Review* 240, 250-51 (1927); Richard C. Curtis, *A Comparison of Recent Arbitration Statutes*, 13 *American Bar Association Journal* 567-570 (1927); Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 172 (1948).

¹⁰⁰ See Sabra A. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 *Minnesota Law Review* 240, 250-51 (1927); Richard C. Curtis, *A Comparison of Recent Arbitration Statutes*, 13 *American Bar Association Journal* 567-570 (1927).

¹⁰¹ Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 19 (n.d.).

¹⁰² See *Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings of the Thirty Fifth Annual Meeting*, 62 (1925) (referring to the proposal as Cohen’s “pet child.”).

¹⁰³ Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 19 (n.d.) (opposition from commission on uniform laws had been “instrumental in retarding further progressive statutory legislation in this direction”).

¹⁰⁴ Frances Kellor, *Arbitration and the Legal Profession: A Report Prepared for the Survey of the Legal Profession* 20 (n.d.).

enforcement of arbitration clauses would benefit New York lawyers at their expense.¹⁰⁵ In the words of one opponent, “Now, in Alabama, Illinois, West Virginia, or California, do you want to take a written contract in which there is a little clause sneaked in the middle there that any disputes in this contract shall be submitted to arbitration, and another little clause, ‘All arbitration shall take place in New York and New Jersey’? [T]hat’s what the net result of [other states’ adopting the New York approach] will be.”¹⁰⁶

The foregoing history shows that the campaign for modern arbitration laws was heavily concentrated in New York City.¹⁰⁷ The New York Chamber of Commerce lobbied for reform in order both to expand its status as the leading provider of general arbitration services and also to respond to competitive threats from London and other American states. Assisting or even leading this lobbying effort were New York attorneys who perceived a potentially valuable source of future business if arbitration agreements became enforceable in the state. The New York arbitration law of 1920 served the purpose of attracting arbitrations to New York (and avoiding losses of business to

¹⁰⁵ In retrospect, it appears that arbitration did in fact serve as a valuable source of business for New York lawyers in the wake of the statutory reforms. Lawyers, especially New York lawyers, continued to play a leading role in the activities of the American Arbitration Association, formed in New York in 1926 in a merger between the Arbitration Society of America and the Arbitration Foundation, an affiliate of the New York State Chamber of Commerce. Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 18 (1948) (describing active role played by lawyers in New York arbitration organizations). The American Arbitration Association, although officially a body of nationwide scope, was dominated in the early years by New York interests. See Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 18 (1948). The early participants in the activities of the American Arbitration Association confirm the overwhelming dominance of New York City in the Association’s activities and management. The Association appointed a board of industry leaders whose task was to promote arbitration across the country; 497 of the 520 members came from New York City itself, with several of the others from nearby towns. See Frances Kellor, *American Arbitration: Its History, Functions and Achievements* 186-198 (1948).

¹⁰⁶ Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings of the Thirty Fifth Annual Meeting, 77 (1925) (remarks of Mr. Miller).

¹⁰⁷ See Ian R. Macneil, *American Arbitration Law: Reformation, Nationalization, Internationalization* (1992) (arbitration reform movement had its “first flowering” in New York); Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings of the Thirty-fifth Annual Meeting 62 (remarks of Mr. O’Connell) (characterizing advocacy of irrevocable arbitration agreements as being characteristic of “the school coming out of New York City.”); id at 75 (remarks of Mr. Miller) (“the new cult down in New York”)

competitor jurisdictions). The subsequent campaign to project the New York statute to the federal government and other states, which was also spearheaded by New York interests, also can be understood as part of a competition for contracts. These laws were needed to assure contracting parties that their choice of a New York arbitral forum would be respected even if a party wishing to avoid arbitration was able to direct litigation into some other forum. New York legal and commercial interests worked together to maintain and enhance the attractiveness of New York as a forum for arbitration chosen by parties to commercial contracts.

B. Assurance of Law and Forum

Contract law provides significant protections for the ability of parties to specify the law and forum. But not all states protect choice of law and forum to the same extent. The hypothesis of a market for contracts suggests that states that attract contracts would also provide unusually strong assurances that party choice of law and forum will be respected. Evidence for this hypothesis is found in New York's approach to choice-of-law and forum selection clauses, especially for financial contracts involving sophisticated parties.

New York courts presume that the law selected by the parties will be applied.¹⁰⁸ If otherwise enforceable under contract law principles, choice-of-law clauses will be respected unless they lack a reasonable relationship to the state or violate a fundamental public policy.¹⁰⁹ These exceptions are rarely (if ever) dispositive in New York commercial litigation. The “reasonable relationship” standard is satisfied if there are

¹⁰⁸ See, e.g., *Hartford Fire Ins. Co. v. Orient Overseas Containers Lines*, 230 F.3d 549, 556 (2d Cir. 2000).

¹⁰⁹ *Finucane v. Interior Constr. Corp.*, 264 A.D.2d 618, 620, 695 N.Y.S.2d 322, 324-25 (1st Dep't 1999); *Radioactive, J.V. v. Manson*, 153 F.Supp.2d 462, 469-70 (S.D.N.Y. 2001).

some contacts between the contract and the state, even if the contacts with another jurisdiction are greater.¹¹⁰ Indeed, the parties' decision to select New York law in itself may constitute the requisite contact.¹¹¹ New York courts in commercial cases also strictly construe the principle that the parties' choice of law may be ignored if it violates a fundamental public policy. In applying this exception New York courts appear to consider the public policy of New York only.¹¹² Thus contracts selecting New York law appear to be immune from public policy challenge in New York. As to other state's laws, New York will refuse enforcement only when the chosen law would infringe some "fundamental principle of justice."¹¹³ It is difficult to imagine that a New York court would often conclude that a decision by sophisticated commercial parties to subject themselves to the law of another state would fail this test. Indeed, because respecting the parties' choice of law is itself a policy of New York,¹¹⁴ it may be doubted that such a choice would ever be considered against public policy.¹¹⁵ Overall, therefore, it appears that choices of law in commercial cases will receive nearly absolute respect in New York courts.¹¹⁶

¹¹⁰ See *Cap Gemini Ernst & Young U.S. LLC v. Nackel*, 2004 U.S. Dist. LEXIS 4492 (S.D.N.Y. 2004); *Radioactive, J.V. v. Manson*, 2001, 153 F.Supp.2d 462 (S.D.N.Y. 2001).

¹¹¹ Cf. *Mechanic v. Princeton Ski Shop, Inc.*, 1992 U.S. Dist. LEXIS 19979, 1992 WL 397576, at *3 (S.D.N.Y. 1992) (the parties' decision to select a particular law to govern their contract is given "heavy weight" in determining the jurisdiction with the most significant contacts with a transaction).

¹¹² *Home Ins. Co. v. Appleton Papers, Inc.*, 2002 WL 22024 (S.D.N.Y. 2002). Courts applying New York conflicts of law rules are not completely in accord on this issue however. See, e.g., *DCMR v. Trident Precision Mfg.*, 317 F.Supp.2d 220 (W.D.N.Y. 2004) (fundamental policy of a jurisdiction other than New York may provide a basis for New York courts refusing to enforce a choice-of-law clause).

¹¹³ *Cooney v. Osgood Mach. Inc.*, 81 N.Y.2d 66, 78, 595 N.Y.S.2d 919, 612 N.E.2d 277 (1993).

¹¹⁴ *Babcock & Wilcox Co. v. Control Components*, 161 Misc. 2d 636, 641, 614 N.Y.S.2d 678 (N.Y. 1993) ("public policy favors New York courts retaining lawsuits where New York is the designated forum.").

¹¹⁵ The public policy limitation on enforceability of choice-of-law clauses appears to be principally, if not exclusively, relevant to cases involving consumer contracts or other contexts where the parties are deemed to possess significant inequality of bargaining power. See, e.g., *Cap Gemini Ernst & Young, U.S., L.L.C. v. Nackel*, 346 F.3d 360 (2d Cir. 2003) (employment agreement).

¹¹⁶ See *Hackett v. Milbank, Tweed, Hadley & McCloy*, 86 N.Y.2d 146, 154, 654 N.E.2d 95, 100, 630 N.Y.S.2d 274, 279 (1995).

Most states follow New York in generally enforcing choice-of-law clauses.¹¹⁷ Where differences exist, however, they tend to be in the direction of giving less effect to these clauses. The public policy exception to enforcement of choice-of-law clauses, for example, is interpreted in many jurisdictions to include the fundamental policy of states other than the forum.¹¹⁸ This increases the likelihood that a court will reject the parties' choice on public policy grounds. States other than New York may also apply a more demanding concept of their own public policy: Texas¹¹⁹ and California¹²⁰ are examples. Some courts interpret choice-of-law clauses more narrowly than other contract terms,¹²¹ reject them for particular classes of contracts,¹²² disapprove them as not reflecting the real intent of the parties,¹²³ or refuse to recognize them if another state is found to have a materially greater interest in the matter.¹²⁴

New York also favors party autonomy in forum selection. Arbitration agreements are vigorously enforced in New York, even when they foreclose class actions¹²⁵ or add

¹¹⁷ See Symeon C. Symeonides, Choice of Law in the American Courts in 1997, 46 American Journal of Comparative Law 233, 273 (1998).

¹¹⁸ See Restatement (Second) of Conflict of Laws § 187.

¹¹⁹ See, e.g., *Access Telecom v. MCI Telecommunications Corp.*, 197 F.3d 694, 695, 705 (5th Cir. 1999) (refusing to enforce parties' choice of Mexican law on the ground of the "fundamental policy" of Texas to "make valid export contracts in Texas for the sale of U.S. services.")

¹²⁰ See *Govett American Endeavor Fund Ltd. v. Trueger*, 112 F.3d 1017, 1023 (9th Cir. 1997) (refusing to apply parties' choice of law to preclude enforcement of civil RICO statute); *ABF Capital Corp. v. Grove Properties Co.*, 126 Cal. App. 4th 204, 220 (Cal. App. 2005) (refusing to respect New York choice of law on grounds it would violate fundamental state policy of requiring reciprocal treatment of contracting parties with respect to attorneys fees).

¹²¹ See *Thompson and Wallace of Memphis, Inc. v. Falconwood Corp.*, 100 F.3d 429 (5th Cir. 1996) (applying Texas law).

¹²² See Louisiana Revised Statute 23:921(A)(2) (declaring choice-of-law clauses in certain employment agreements unenforceable).

¹²³ See, e.g., *Fairfield Leasing Corp. v. Technigraphics, Inc.*, 256 N.J. Super. 538 (1992) (refusing to accept an explicit and unambiguous choice-of-law provision in a consumer contract on the ground that it did not reflect the "real intent" of the parties).

¹²⁴ See *Rosenmiller v. Bordes*, 607 A.2d 465, 468 (Del. Ch. 1991).

¹²⁵ See, e.g., *Ranieri v. Bell Atlantic Mobile*, 304 A.D.2d 353, 354, 759 N.Y.S.2d 448, 449 (2003).

nonstandard procedures.¹²⁶ New York is also receptive to judicial forum selection clauses. New York courts routinely enforce such clauses absent a “strong showing”¹²⁷ that they result from fraud or overreaching, are unreasonable or unfair, or contravene some strong public policy.¹²⁸ Such clauses are enforceable in New York even if they operate unilaterally to bind only one of the parties.¹²⁹ They are defeated by claims of fraud in the inducement only if the fraud alleged relates to the forum selection clause itself rather than to the contract generally.¹³⁰ Conclusory allegations of fraud or duress are insufficient; the complaining party must allege facts setting forth a strong showing that the complaining party was induced to agree to the forum selection clause by fraud.¹³¹

Most other states enforce forum selection clauses. But many do not provide the same level of assurance to the parties. Some courts retain jurisdiction over cases in which the parties have selected another state’s forum if they conclude that their own tribunals would be more convenient.¹³² Some are more willing to reject forum selection

¹²⁶ See Michael H. LeRoy and Peter Feuille, *The Revolving Door Of Justice: Arbitration Agreements that Expand Court Review of an Award*, 19 Ohio State Journal on Dispute Resolution 861 (2004).

¹²⁷ *DiRuocco v. Flamingo Beach Hotel & Casino, Inc.*, 163 A.D.2d 270, 557 N.Y.S.2d 140 (App. Div. 1990). A test of New York’s commitment to enforcing forum selection clauses may be presented in the controversy surrounding “portable” choice of forum clauses contained in various agreements entered into by Norvergence Inc., a commercial leasing firm. See *Sterling National Bank, as assignee of Norvergence Inc., v. Kings Manor Estates LLC*, 9 Misc3d 1116A, n.7 (1st Dept. 2005) (collecting cases); *IFC Credit Corp. v. Aliano Brothers General Contractors*, 2006 WL 230179 (7th Cir. 2006) (enforcing clause).

¹²⁸ *DiRuocco v. Flamingo Beach Hotel & Casino, Inc.*, 163 A.D.2d 270, 557 N.Y.S.2d 140 (App. Div. 1990).

¹²⁹ See *Karl Koch Erecting Co. v. New York Convention Ctr. Dev. Corp.*, 838 F.2d 656, 660 (2d Cir. 1988) (holding that a forum selection clause binding only one party is enforceable).

¹³⁰ *Stamm v. Barclays Bank of New York*, 960 F. Supp. 724, 729 (S.D.N.Y. 1997).

¹³¹ *National School Reporting Services, Inc. v. National Schools of California, Ltd.*, 924 F. Supp. 21, 24 (S.D.N.Y. 1996). This is also the federal rule. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12 (1972).

¹³² See Michigan Stat. § 600.745(d)(3) (permitting Michigan courts to retain jurisdiction, despite forum selection clause, if the state chosen by the parties would be a “substantially less convenient place” for trial.)

clauses on grounds that they contravene public policy,¹³³ are unreasonable,¹³⁴ fail to establish personal jurisdiction in the forum,¹³⁵ or fail to accomplish “substantial justice.”¹³⁶ Some approve forum selection clauses only grudgingly,¹³⁷ reject them in particular types of cases,¹³⁸ exercise discretion over whether to enforce them,¹³⁹ or refuse to enforce them at all.¹⁴⁰

New York’s receptive attitude towards choice-of-law and forum selection clauses helps assure parties to commercial contracts that their choice of New York law and forum will be respected. However, because they are not legislative in nature, and because they technically admit the possibility of exceptions, New York case law does not provide absolute assurance to attorneys drafting major commercial contracts.

In the early 1980s the New York Bar Association became active in attempting to rectify these problems. A report of the New York Bar Association’s Committee on Foreign and Comparative Law recognized several advantages that flowed from New

¹³³ Compare *Kubis & Perszyk Associates Inc. v. Sun Microsystems Computer Corp.*, 146 N.J. 176 (1996) (declaring forum selection clauses for agreements subject to the state’s franchise protection law to be “presumptively invalid”) with *Hellex Car Rental Systems, Inc. v. Dollar Systems, Inc. d/b/a Dollar Rent A Car*, 2005 WL 3021963 (E.D.N.Y. 2005) (holding that New York franchise law does not preclude forum-selection clause). California has been particularly active in rejecting forum selection clauses on public policy grounds. See, e.g., *America Online v. Superior Court*, 90 Cal. App. 4th 1 (Cal. App. 2001) (enforcement of the contractual forum selection and choice-of-law clauses in defendant’s service agreements held to be unenforceable because they were the functional equivalent of a contractual waiver of the consumer protections under the California Legal Remedies Act); *Hall v. Superior Court*, 150 Cal. App. 3d 411 (Cal. App. 1983) (California Blue Sky law); *GMAC Commer. Fin. LLC v. Superior Court*, 2003 Cal. App. Unpub. LEXIS 5917 (2003) (California Finance Lenders Law).

¹³⁴ *Churchill Corp. v. Third Century, Inc.*, 578 A.2d 532, 536 (Pa. Super. Ct. 1990).

¹³⁵ *Johns v. Taramita*, 132 F. Supp. 2d 1021, 1029 (S.D. Fla. 2001); *Ex parte Kenco Signs & Awning Div., Inc.*, 732 So. 2d 1019, 1024 (Ala. Ct. App. 1999).

¹³⁶ *GMAC Commer. Fin. LLC v. Superior Court*, 2003 Cal. App. Unpub. LEXIS 5917 (2003)

¹³⁷ For example the Texas Supreme Court has upheld such a clause, but only by a 5-4 decision that left considerable uncertainty as to the applicable law See *In re AIU Insurance Company*, 47 Tex. Sup. Ct. J. 1093 (2004).

¹³⁸ See Louisiana Revised Statute 23:921(A)(2) (employment contracts).

¹³⁹ See *Smith, Valentino & Smith, Inc. v. Superior Court of Los Angeles County*, 17 Cal. 3d 491, 496 (Cal. 1976) (forum selection clauses may be given effect “in the court’s discretion”).

¹⁴⁰ See, e.g., Idaho Code § 29-110 (1997); *McCarty v. Herrick*, 41 Idaho 529 (1925); Mont. Code Ann. § 28-2-708 (1997); *State ex rel. Polaris Indus. v. Dist. Ct.*, 695 P.2d 471 (Mont. 1985); *Davenport Mach. & Foundry Co. v. Adolph Coors Co.*, 314 N.W.2d 432 (Iowa 1982); *Bartlett v. Union Mut. Fire Ins. Co.*, 46 Me. 500 (1859).

York's proven ability to attract contracts from other jurisdictions. Parties "not otherwise having substantial connections with New York" may be induced to conduct business in the state if they could be assured of a New York law and forum.¹⁴¹ New York's "legal and business communities" would benefit "if significant agreements are governed by New York law and if significant commercial litigation is conducted in the state."¹⁴² "New York's stature as a preeminent financial and commercial center" would be "preserved and ultimately enhanced."¹⁴³ The committee warned, however, that questions about the enforceability of New York choice-of-law and forum selection clauses could deter parties from selecting New York law or forum.¹⁴⁴ The problem had become critical because "other international business centers" had taken "affirmative measures to attract foreign business by providing ready access to a competent forum for dispute resolution."¹⁴⁵ The committee recommended, therefore, that "parties to significant commercial contracts should be encouraged to submit to the jurisdiction of the New York courts and to choose New York law as their governing law."¹⁴⁶

The New York legislature adopted the committee's recommendations in 1984. Section 5-1401 of the General Obligations Law, added in that year, provides that the parties to any contract for more than two hundred fifty thousand dollars may "agree that the law of [New York] shall govern their rights and duties in whole or in part, whether or not such contract . . . bears a reasonable relation to this state." Section 5-1402 provides that any person may sue a foreign party in New York courts where the lawsuit relates to

¹⁴¹ Committee on Foreign and Comparative Law, Proposal for Mandatory Enforcement of Governing-Law Clauses and Related Clauses in Significant Commercial Agreements, 38 Record of the Association of the Bar of the City of New York 537, 537 (1983).

¹⁴² Id.

¹⁴³ Id.

¹⁴⁴ Id. at 538.

¹⁴⁵ Id. at 548-49.

¹⁴⁶ Id. at 549.

any contract for more than a million dollars for which a choice of New York law has been made under section 5-1401 and which contains a provision submitting to New York jurisdiction. A provision of the Civil Practice Law and Rules, also added in 1984, prohibits New York courts from dismissing actions on *forum non conveniens* grounds where the action arises out of a contract, agreement or undertaking to which section 5-1402 applies and the have selected New York law.¹⁴⁷

The upshot of these intertwining provisions is that parties to major commercial contracts received a guarantee that New York courts will respect clauses selecting New York as the law or forum, regardless of whether the parties have any other connections with New York State. New York's innovation has been emulated by other states, including California (1986);¹⁴⁸ Florida (1989),¹⁴⁹ Delaware (1993),¹⁵⁰ Ohio (1991)¹⁵¹ and Texas (1993).¹⁵²

C. Superior Adjudicative Services

A prominent theory of Delaware's success in the market for corporate charters is that the Delaware courts, and especially the Delaware Chancery Court, offer expert, prompt, and reliable judicial services for the adjudication of corporate disputes.¹⁵³ Does a similar phenomenon exist in the case of the market for contracts? This section will illustrate how New York and other states compete for litigation (and forum selection clauses) by offering upgraded judicial services to major commercial parties.

¹⁴⁷ N.Y.C.P.L.R. Rule 327(b) (McKinney 2003).

¹⁴⁸ Cal. Civ. Code § 1646.5 (West 2002).

¹⁴⁹ Fla. Stat. Ann. § 685.101 (West 2001).

¹⁵⁰ 6 Del.C. § 2708

¹⁵¹ Ohio Rev. Code Ann. § 2307.39 (West 2001).

¹⁵² Tex. Bus. & Com. Code Ann. § 35.51 (Vernon 2001).

¹⁵³ See, e.g., Roberta Romano, *The Genius of American Corporate Law* 39-40 (1993); Marcel Kahan and Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 *Stanford Law Review* 679, 708 (2002).

Because of their location in the nation's most important commercial city, state and federal courts in Manhattan enjoy a natural advantage over other courts as preferred forums for the adjudication of business disputes. Even so New York has labored under certain deficits as compared with Delaware as regards the project of establishing its courts as national leaders in their respective fields. Delaware Chancery Court judges are appointed for lengthy terms (twelve years) from a list submitted by a judicial advisory council.¹⁵⁴ They tend to be persons with experience in business law matters and good reputations among other lawyers and judges in the small world of the Delaware bar. New York trial court judges, on the other hand, have been selected in back room deals by politicians whose interests are not necessarily consonant with identifying persons with extensive business law experience or sensitivity to the needs of international finance.¹⁵⁵ And while most New York state court judges are public servants of sterling character and outstanding reputations, this is not true for all.¹⁵⁶

The problem faced by New York in supplying credible judicial services to contracting parties was not limited to unpredictable judges. Docketing practices employed in New York Supreme Court moved matters from judge to judge as the case progressed.¹⁵⁷ Backlogs were an issue. Businesses had to wait in line with all other civil litigants. Moreover, unlike the Delaware Chancery Court, which operates without a jury, an action for breach of contract for money damages would ordinarily be tried to a jury in

¹⁵⁴ Roberta Romano, *The Genius of American Corporate Law* 40 (1993).

¹⁵⁵ See Geoffrey P. Miller, *Bad Judges*, 83 *Texas Law Review* 431 (2004) (Brooklyn Democratic Party leadership reportedly sold judgeships for \$50,000, with the bribes being distributed up and down the party food chain).

¹⁵⁶ See Geoffrey P. Miller, *Bad Judges*, 83 *Texas Law Review* 431 (2004) (describing alleged pattern of systematic criminality, favoritism and malfeasance in the Brooklyn, New York court system).

¹⁵⁷ See Tamara Loomis, *High-Profile Case Casts Spotlight on Well-Regarded Court*, *New York Law Journal*, 6/20/2002.

New York.¹⁵⁸ Commercial interests frequently express dismay at the prospect of having their cases tried to a jury, on the theory that people drawn at random from a jury pool are unpredictable, unlikely to understand the complexities of a commercial case, and prone to deciding cases on the basis of extraneous factors.¹⁵⁹ Other things equal, the prospect of submitting a case to a New York jury might be considered a detriment to selecting New York as a forum. These and other problems resulted in substantial dissatisfaction among the business community with the level of judicial services provided in the New York state court system.¹⁶⁰ Given a choice, business litigators were likely to prefer to go to New York federal courts,¹⁶¹ to the courts of another state such as Delaware, or to arbitration.¹⁶² The bad repute of the New York state court system posed an obvious threat to New York's ability to compete for contracts.¹⁶³

¹⁵⁸ *Motor Vehicle Mfrs. Assn. v. State of New York*, 75 N.Y.2d 175, 181, 551 N.Y.S.2d 470, 550 N.E.2d 919 (1990) (cause of action seeking money damages for breach of contract is quintessentially an action at law).

¹⁵⁹ See, e.g., John Lande, *Failing Faith in Litigation? A Survey of Business Lawyers' and Executives' Opinions*, 3 *Harvard Negotiation Law Review* 1, 51-52 (1998). Contracting parties in New York can opt out of jury trials simply by including a well-drafted waiver in their agreements, See *Sherry Associates v. Sherry-Netherland, Inc.*, 273 A.D.2d 14, 708 N.Y.S.2d 105 (1st Dept. 2000), but, somewhat surprisingly, sophisticated parties frequently omit such clauses from their agreements. See Theodore Eisenberg and Geoffrey Miller, *Flight to the Jury: An Empirical Study of Jury Trial Waivers in Large Corporate Contracts* (forthcoming).

¹⁶⁰ See Mitchell L. Bach & Lee Applebaum, *A History of the Creation and Jurisdiction of Business Courts in the Last Decade*, 60 *Business Lawyer* 147, 152 (2004) (commercial courts created at a "time of failing confidence in the state trial courts' ability to address business litigation").

¹⁶¹ See *Bar Council Supports Commercial Divisions*, *New York Law Journal*, November 20, 1995, at 5 (committee of attorneys practicing in federal court predicted that the commercial divisions would help end the state courts' status as the "less-favored forums for commercial and other complex litigation, resulting in the increasingly frequent resort by commercial litigators to federal courts whenever a choice of forum is available.")

¹⁶² Mitchell L. Bach & Lee Applebaum, *A History of the Creation and Jurisdiction of Business Courts in the Last Decade*, 60 *Business Lawyer* 147, 152 (2004) (quoting Legal Opinion Letter from Robert L. Haig, Esquire, to Washington Legal Foundation (Jan. 9, 1998)).

¹⁶³ See Michael Bobelian, *Rewriting the Rules: A group of judges and lawyers seeks to bring more consistency to commercial courts*, *New York Law Journal*, July 8, 2004 (describing fear of losing litigation business).

New York addressed these problems in the 1990s under the leadership of Chief Judge Judith Kaye¹⁶⁴ and Robert L. Haig, a prominent New York attorney.¹⁶⁵ In 1993 the state instituted a pilot commercial court program in the New York County (Manhattan) Supreme Court.¹⁶⁶ The pilot program designated a single judge for assignment to all aspects of a case, thus eliminating the revolving-door approach to judicial assignments that had characterized the New York system. Judging the pilot a success, the state established a permanent Commercial Division of the Supreme Court in 1995.¹⁶⁷ In addition to continuing the policy of assigning one judge to a case, the commercial division initiative enlisted judges and court personnel who were experienced in business law, implemented new case management techniques, and offered enhanced opportunities for court-annexed alternative dispute resolution.¹⁶⁸ The judges assigned to the commercial division serve fourteen year terms. They are selected by the Chief Judge, and thus can be picked for their business law experience.¹⁶⁹ They develop a reputation for expertise that enhances their stature and also may improve their prospects for

¹⁶⁴ Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 152 n.20 (2004) (Judge Kaye described as the “Chief Judge Kaye as the only truly indispensable person in creating the Commercial Division.”)

¹⁶⁵ Mr. Haig’s role in promoting commercial courts in New York and across the country is documented in Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147 (2004).

¹⁶⁶ Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 152 (2004).

¹⁶⁷ See Daniel Wise, Supreme Court Commercial Division Set Up: Crane, Rochester’s Stander Added to Handle Disputes, New York Law Journal (October 11, 1995). For a comprehensive account of the creation of this and other business courts, see Mitchell E. Bach and Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147 (2004).

¹⁶⁸ See Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 159 (2004).

¹⁶⁹ Gary Craig, Three vie for two state judicial seats: Supreme Court race features rivals with a range of experience, Rochester Democrat and Chronicle (October 9, 2004) (citing the “extensive tax and business law experience” of Commercial Division judge).

reelection.¹⁷⁰ Chief Judge Judith Kaye explained that the purpose of the commercial division is to give the New York business community a level of judicial service “commensurate with its status as the world financial capital.”¹⁷¹

The commercial division has been deemed a success, at least by its promoters. The average time to resolve a contract action has reportedly been reduced from 648 days to 396 days.¹⁷² Jury pools are said to be improved as a result of more intensive supervision by the commercial division judges.¹⁷³ Chief Judge Kaye reported that judges of the commercial division are contributing to a “growing body of commercial law once again being generated by the New York State courts.”¹⁷⁴ The court has “helped to stem the flight of commercial litigants from New York’s courts, and to maintain New York’s status as the premier state for the conduct of business.”¹⁷⁵

Other states have followed New York’s lead in creating specialized business courts,¹⁷⁶ including Pennsylvania,¹⁷⁷ Massachusetts,¹⁷⁸ Maryland,¹⁷⁹ Colorado,¹⁸⁰ Florida,

¹⁷⁰ See Rochester Democrat and Chronicle, Our recommendations, Rochester Democrat and Chronicle, October 20, 2004 (endorsing judge of the Commercial Division for reelection on the ground that the judge had become an “expert jurist on contractual matters”).

¹⁷¹ See Daniel Wise, Supreme Court Commercial Division Set Up: Crane, Rochester’s Stander Added to Handle Disputes, New York Law Journal (October 11, 1995) (internal quotation omitted).

¹⁷² Comprehensive Civil Justice Program 2005: Study and Recommendations p. 19.

¹⁷³ Tommy Fernandez, Lawyers mine differences in boroughs' courtrooms Jury pools prove anything but equal; official attempts at reform fall short, Crain's New York Business, October 25, 2004; Focus on the Judiciary, Interview: The Honorable E. Leo Milonas Urges Support of Court Reform Metropolitan Corporate Counsel (August 1999).

¹⁷⁴ Judith S. Kaye New York's Commercial Division Celebrates Four Years Of Solid Progress Metropolitan Corporate Counsel (November 1999).

¹⁷⁵ The Council on Judicial Administration, Report on the Chief Judge's Court Restructuring Plan, 52 Record 929, 948 (1997).

¹⁷⁶ See Marcel Kahan and Ehud Kamar, The Myth of State Competition in Corporate Law, 55 Stanford Law Review 679, 708-715 (2002) (contrasting business courts with Delaware Chancery Court).

¹⁷⁷ See Partnering With Outside Counsel for a Philadelphia Business Court, Metropolitan Corporate Counsel, March 2000 (describing how Philadelphia’s business court initiative was explicitly modeled on the New York approach); Melissa Nann Burke, Abramson Joining Commerce Court, The Legal Intelligencer (January 14, 2005) (Commerce Court judges must be “willing to work hard” and have “business sense.”); Asher Hawkins, Bevilacqua Reflects On Time In Charge Of Phila. Bar Association, The Legal Intelligencer (January 10, 2005) (commerce court now a permanent separate division).

North Carolina,¹⁸¹ Nevada,¹⁸² and Oklahoma.¹⁸³ An ad hoc committee of the American Bar Association has also endorsed the idea.¹⁸⁴ Even staid Delaware has entered the competition as a result of the expansion of Chancery Court jurisdiction to include technology disputes.¹⁸⁵

D. Substantive Law

Delaware's success in the market for corporate charters is often attributed to its responsiveness to the concerns of corporate managers.¹⁸⁶ Does a similar phenomenon occur in the case of commercial contracts? A detailed analysis of substantive law is beyond the scope of this paper. We can, however, examine several rules applicable to one industry – finance – which is a particular prominent consumer of New York choice-of-law and forum selection clauses.

¹⁷⁸ See Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 159 (2004)

¹⁷⁹ Maryland Business and Technology Court, Maryland Business and Technology Court Task Force Report, Appendix B at 24-25, available at <http://www.courts.state.md.us/finalb&treport.pdf>.

¹⁸⁰ Governor's Task Force on Civil Justice Reform, Committee on Business Courts, Final Report of Governor's Task Force on Civil Justice Reform 14-15 (Sept. 6, 2000), available at <http://www.state.co.us/cjr/f/report/download/reportl.doc>

¹⁸¹ Carrie A. O'Brien, The North Carolina Business Court: North Carolina's Special Superior Court for Complex Business Cases, 6 N.C. Banking Inst. 367, 375 n.63 (2002); North Carolina Business Court, available at <http://www.ncbusinesscourt.net>.

¹⁸² Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 184 (2004)

¹⁸³ Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 184 (2004)

¹⁸⁴ ABA Ad Hoc Committee on Business Courts, Business Courts: Towards A More Efficient Judiciary, 52 Business Lawyer 947 (1997).

¹⁸⁵ See Mitchell L. Bach & Lee Applebaum, A History of the Creation and Jurisdiction of Business Courts in the Last Decade, 60 Business Lawyer 147, 151-52 (2004)

¹⁸⁶ See, e.g., Lucian Arye Bebchuk & Assaf Hamdani, Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters, 112 Yale L.J. 553 (2002); Jonathan R. Macey and Geoffrey P. Miller, An Interest-Group Theory of Delaware Corporate Law, 65 Texas Law Review 469 (1987) (Delaware likely to favor the interests of corporate managers over those of the public on questions going to management entrenchment).

New York courts and lawmakers do not disguise their concern to serve the interests of global finance.¹⁸⁷ One way to serve the needs of global finance is to articulate rules of law that facilitate international financial transactions. New York law has, in fact, been accommodating to the interests of financial firms.¹⁸⁸ For example, New York has an unusual procedure in its Civil Practice Law and Rules that permits plaintiffs, in actions “based upon an instrument for the payment of money only,” to jump the litigation queue by filing a motion for summary judgment against the defendant in lieu of complaint.¹⁸⁹ Although this statute has been used by a variety of plaintiffs, among its principal beneficiaries are financial institutions seeking to enforce defaulted loans. Similarly, when the introduction of the Euro raised uncertainty about the enforceability of contracts calling for settlement in outmoded currencies, New York was in the vanguard of states acting to correct the problem, enacting a statute in July 1997 declaring the Euro a commercially reasonable substitute for the currency designated in the contract.¹⁹⁰

New York has also been generous to financial institutions in the area of lender liability. Actual rather than constructive knowledge is the standard in New York for proof of aiding and abetting a breach of fiduciary duty.¹⁹¹ Similarly, New York law is

¹⁸⁷ See *Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 94 N.Y.2d 726, 739, 709 N.Y.S.2d 865, 873, 731 N.E.2d 581 (2000) (describing New York as the “financial capital of the world”); *Credit Francais v. Sociedad Financiera*, 490 N.Y.S.2d 670, 676 (N.Y. Sup. Ct. 1985) (New York law is to global commerce what the dollar is to international finance: the internationally accepted legal standard).

¹⁸⁸ New York’s receptive attitude towards commercial interests extends back at least to the 1920s. See William E. Nelson, *The Legalist Reformation: Law, Politics, and Ideology in New York 1920-1980* 80-92 (2001) (judges of the Court of Appeals – a majority of them from the New York City area – crafted a set of rules tailored to suit the needs of mercantile and commercial interests of New York City during the 1920s and 1930).

¹⁸⁹ New York Civil Practice Law and Rules § 3213.

¹⁹⁰ New York Gen. Obl. L. 5-1603. Illinois acted almost simultaneously with New York, 815 Ill. Comp. Stat. Ann. 617, and several other states soon followed suit. See James H. Fries, Jr., *Continuity of Contracts after the Introduction of the Euro: The United States Response to European Economic and Monetary Union*, 53 *Business Lawyer* 701 (1998).

¹⁹¹ *Lesavoy v. Lane*, 304 F.Supp.2d 520, 524 (S.D.N.Y. 2004). Thus even if a secured lender knew of the fraud and received the proceeds of corporate looting in satisfaction of their claims, this in itself is not

unfriendly to the tort of deepening insolvency, under which a lender can be held responsible for actions that permit an insolvent firm to continue in operation while losses mount.¹⁹² Under New York law, lenders can generally avoid liability for extending credit to a firm in the zone of insolvency even if the loans are ill-considered and contribute to creditor losses.¹⁹³

The state's approach to traded financial contracts provides another example of efforts to meet the needs of the finance industry in situations where failure to act would threaten New York's ability to compete with other financial centers for choice of law or forum.¹⁹⁴ New York's Statute of Frauds had long required that certain widely used financial contracts had to be signed by the party to be bound in order to represent enforceable obligations.¹⁹⁵ This presented a problem because such contracts were typically made orally. Although commercial usage was to treat them as legally binding at the time of the agreement, the law technically allowed either party to avoid the transaction. Even though it appears that social norms among traders prevented people from relying on this avenue to escape their obligations, there was always the possibility of breakdown in the event of market disruptions. In response to this problem, New York revised its Statute of Frauds in 1994 to provide alternative means for establishing the enforceability of agreements for the purchase and sale of currencies, commodities,

sufficient to establish liability on an aiding and abetting theory. *In re Sharp International Corporation*, 403 F.3d 43, 54 (2d Cir. 2005).

¹⁹² See Paul Rubin, *New Liability Under 'Deepening Insolvency' - The Search for Deep Pockets*, 23 *Am. Bankr. Inst. J.* 50 (April 2004); Jonathan Landers, *Deepening Insolvency Comes of Age*, *New York Law Journal*, Oct. 5, 2006.

¹⁹³ *In re Global Service Group LLC*, 36 B.R. 451 (S.D.N.Y. 2004).

¹⁹⁴ We thank Roberta Romano for bringing this to our attention.

¹⁹⁵ See Denis M. Forster, *Comment: Standard Swaps Agreements Don't Insulate Users from Risk*, 159 *American Banker* 20 (June 13, 1994).

foreign exchange, deposits and options, indexes and similar instruments.¹⁹⁶ The New York Legislature expanded the provision in 2002 to include institutional sales of commercial loans by means of telephone or oral communications.¹⁹⁷

IV. Other Explanations

The previous section suggested that New York's success in attracting choice-of-law and forum selection clauses has been due, in substantial part, to the state's provision of rules, procedures, and adjudicative services deemed attractive by major commercial parties. This explanation parallels the well-known theory that Delaware's success in the incorporation market is largely due to the superior quality of legal services it provides to its corporate clients. But other explanations have been advanced to explain Delaware's behavior in the corporate chartering market. This section briefly considers several of these alternative theories.

One such theory highlights the influence of Delaware attorneys; the basic concept is that attorneys influence Delaware corporate law in a fashion that serves their self-interest in obtaining lucrative legal business.¹⁹⁸ We may infer that lawyers also play a role in the market for contracts. Indeed, their hand is explicit in several of the events discussed above – the adoption of the New York arbitration law in 1920, the 1984 revisions that provided assurance to commercial parties of their choices of New York law and forum, and the Commercial Division initiative of the 1990s. Attorney self-interest

¹⁹⁶ New York General Obligations Law § 5-701.

¹⁹⁷ See letter from New York Bankers Association to Honorable James M. McGuire, Counsel to the Governor, July 3, 2002, in New York Bill Jacket, 2002 Senate Bill 5669 225th Legislature, 2002 Regular Session.

¹⁹⁸ See, e.g., John Coates IV, Explaining Variation in Takeover Defenses: Blame the Lawyers, 89 California Law Review 1301 (2001) (finding that the identity of the law firm chosen for work on initial public offerings substantially affects what anti-takeover provisions will be included in the firms' charters); Jonathan R. Macey and Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Texas Law Review 469 (1987) (suggesting that Delaware bar influences the state's legal rules in order to increase business and income).

may also play a role in the selection of law and forum in particular contracts.

Commercial lawyers are most likely to be familiar with the laws of their own state, New York and Delaware. Their interest is to apply a familiar law. They may also consider the fact that if the contract does generate a dispute, selection of a law and forum in which they are qualified to practice increases the likelihood that they will be selected as litigating counsel.¹⁹⁹ Thus, regardless of the interests of their clients, attorneys may prefer the observed outcomes – that the law or forum chosen be that of a home state, New York, or Delaware. They may also conclude, with justification, that this is also in their clients’ best interests since selecting a different law or forum would impose unnecessary costs and risks.

Network effects have also been proposed as a solution to the corporate chartering puzzle.²⁰⁰ Such effects undoubtedly exist in the case of contracts. Because New York has long been the nation’s leading commercial center, New York courts adjudicate significant numbers of commercial disputes. These adjudications generate precedents that lend predictability and certainty to the law, and also educate New York judges and attorneys in commercial law matters. Given these advantages, New York tends to be preferred more often in choice-of-law and forum selection clauses, thus further enriching the supply of precedents and expertise. Each contract that specifies a New York law or forum increases the value of other contracts that do the same. The certainty and transparency of New York law, to the degree it exists, may also facilitate efficient

¹⁹⁹ Eisenberg and Miller found, however, that although New York lawyers are significantly more likely to use forum selection clauses than lawyers from other cities, they displayed no particular preference for New York as the forum. See Theodore Eisenberg and Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, __ *Vanderbilt Law Review* __ (2007).

²⁰⁰ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 *Va. L. Rev.* 757 (1995).

contracting by establishing well-understood standards that can reduce transactions costs.²⁰¹

Some commentators argue that Delaware law is attractive to chartering companies because of a bonding effect: because Delaware relies on revenues from corporate franchise taxes, it cannot afford to lose incorporations, and thus will adjust its legal rules to satisfy the demands of its corporate clients.²⁰² The same bonding effect could not be said to occur in New York: the state earns no direct fiscal benefits when contracting parties specify New York law or forum; indeed, because the court system is subsidized, the selection of a New York forum imposes the equivalent of a tax on New York residents. Yet New York, arguably, does offer contracting parties a sort of bonding. As home to many of the nation's biggest financial firms and markets, New York is unlikely to adopt laws that run counter to the interests of these powerful constituencies.

Conclusion

New York is the Delaware of commercial contracts. Its law is frequently selected by sophisticated parties to govern important agreements. Its courts, too, are designated far more frequently than any other state's as forums for resolving disputes. Several of the explanations that have been proposed for Delaware's dominance in corporate chartering can be carried over to explain New York's impressive influence in commercial contracting. This paper has examined the evidence of a market for contracting with particular focus on the role of New York as the leading provider of law and forum.

²⁰¹ See Edward A. Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer's View of The Law & Economics Literature*, 74 *Or. L. Rev.* 189 (1995). For this reason, loan agreements in multi-lender transactions (where lenders may come from different jurisdictions) typically select either New York or England as the source of law. See Francis D. Logan & Peter D. Rowntree, *Term Loan Agreements*, in 1 *International Financial Law* § 2.5, at 7 (2d ed. 1985).

²⁰² See Roberta Romano, *The Genius of American Corporate Law* 38 (1993).