ECONOMICS OF LAW AS CHOICE OF LAW

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> If it is true that the more developed state of economics, as compared to the other social sciences, has been due to the happy chance (for economics) that the important factors determining economic behaviour can be measured in money, it suggests that the problems faced by practitioners in these other fields are not likely to be dissipated simply by an infusion of economists, since in moving into these fields, they will commonly have to leave their strength behind them. The analysis developed in economics is not likely to be successfully applied in other subjects without major modifications.
>
> R.H. Coase [1]

I

INTRODUCTION: ECONOMICS DISCOVERS CHOICE OF LAW

Economics is about choice.[2] It is about private choice and public choice, and it is about choice made by individuals and choice made by the state. This means economics *of law* should be about choice *of law*. It should be about choice of the applicable private and public law, and it should be about private and public choice of law—choice of law by individuals or by the state.

In a broad sense, this is the case. Normative law and economics tells us what kinds of legal regimes to choose from the various models we can think of: negligence or strict liability for tort law, specific performance or damages for contract law, restrictions of market entry or monopoly positions as triggers of antitrust law, and so forth. Normative law and economics also tells us whether the relevant choices should be made by individuals—especially through contract—or whether the respective rules should be provided by the state.

Choice of law as a field is also about choices like the one between negligence and strict liability. But this choice is not made in general: it is made

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1. R.H. Coase, *Economics and Contiguous Disciplines*, 7 J. LEGAL STUD. 201, 209 (1978).

2. See, e.g., the title of one widely used textbook, JAMES D. GWARTNEY ET AL., ECONOMICS: PRIVATE & PUBLIC CHOICE 3 (11th ed. 2005) ("Economics is about how people choose."); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 3 (7th ed. 2007) ("Economics, the science of human choice").

in a specific constellation, for example between the negligence regime governing in the state where a defective machine was sold and the strict-liability regime governing in the state where that machine was produced. Choice of law is about private and public choice *of law*, the tension between objective determination of the applicable law and party autonomy. But the law thus chosen is always, at least so far, the law of a state.[3]

In view of this similarity in sensitivities between choice of law and law and economics, it may seem surprising that economists all but ignored choice of law for many years. Although conflict of laws had been the first field that legal realism attacked and although it remains the field in which realist and post-realist conceptions have had the most impact,[4] law and economics, as a (sometime) self-declared heir of realism, has stayed away from the field for a long time. This is no longer so. Things have changed, and economics of choice of law has become prominent. The economics of choice of law is the theme of two books[5] and one lecture at the Hague Academy of International Law,[6] and it boasts contributions to two encyclopedias[7] and by now a considerable number of law-review articles,[8] many of which have recently been compiled in a two-

3. Ralf Michaels, *The Re-State-ment of Non-State Law. The State, Choice of Law, and the Challenge from Global Legal Pluralism*, 51 WAYNE L. REV. 1209 (2005).

4. For the best analysis of the role of legal realism in this oft-told history, see Annelise Riles, *A New Agenda for the Cultural Study of Law: Taking on the Technicalities*, 53 BUFF. L. REV. 973 (2005).

5. The first is MICHAEL J. WHINCOP & MARY KEYES, POLICY AND PRAGMATISM IN THE CONFLICT OF LAWS (2001). For reviews, see Richard Garnett, 26 MELB. U. L. REV. 236 (2002); Peter Mankowski, 69 RABELSZ 175 (2005); Megan Richardson, *Policy Versus Pragmatism? Some Economics of Conflict of Laws*, 31 COMMON L. WORLD REV. 189 (2002); Michael J. Solimine, *The Law and Economics of Conflict of Law*, 4 AM. L. & ECON. REV. 208 (2002); Roberta Wertman, 35 N.Y.U. J. INT'L L. & POL. 1160 (2003). A second book is JÜRGEN BASEDOW & TOSHIYUKI KONO, AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW (2006). For a review, see Paul Lagarde, 103 REVUE CRITIQUE DE DROIT INTERNATIONAL PRIVÉ 665 (2007). Giesela Rühl (Hamburg Max Planck Institute for Comparative and International Private Law and European University Institute, Florence) is working on a comprehensive monograph on the topic.

6. Horatia Muir Watt, *Aspects Economiques du Droit International Privé*, *in* ACADEMIE DE DROIT INTERNATIONAL DE LA HAYE, 307 RECUEIL DES COURS 25 (2004).

7. Erin A. O'Hara & Francesco Parisi, *Conflict of Laws*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 387 (Peter Newman ed., vol. 1, 1998); Erin O'Hara & Larry E. Ribstein, *Conflict of Laws and Choice of Law*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS 631–60 (Bouckaert & De Geest eds., vol. 5, 2000), *available at* http://encyclo.findlaw.com/ 9600book.pdf; Francesco Parisi & Larry E. Ribstein, *Choice of Law*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 236 (Peter Newman ed., vol. 1, 1998). See also the brief survey in Alan O. Sykes, *International Law*, *in* HANDBOOK OF LAW AND ECONOMICS 757, 816–18 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

8. More recent foundational articles in the United States include the following: LEA BRILMAYER, CONFLICT OF LAWS 169–218 (2d ed. 1995); Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L. J. 883 (2002); Larry D. Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277 (1990); Erin O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151 (2000); Giesela Rühl, *Methods and Approaches in Choice of Law: An Economic Perspective*, 24 BERKELEY J. INT'L L. 801 (2006); Michael J. Solimine, *An Economic and Empirical Analysis of Choice of Law*, 24 GA. L. REV. 49 (1989); Joel P. Trachtman, *Conflict of Laws and Accuracy in the Allocation of Government Responsibility*, 26 VAND. J. TRANSNAT'L L. 975 (1994); Joel P. Trachtman, *Economic Analysis of Prescriptive Jurisdiction*, 42 VA. J. INT'L L. 1 (2001), adapted as chapter 2 in JOEL P. TRACHTMAN, THE ECONOMIC STRUCTURE OF INTERNATIONAL LAW 26–71 (forthcoming 2008). Two

volume issue.[9] Almost all of these studies are normative[10] and oriented toward either efficiency or maximization of welfare: they set out to yield criteria for better, more efficient, conflict-of-laws norms. The powerful arguments, almost thirty years old, why efficiency and welfare are both problematic criteria to determine better rules[11] are largely ignored, as they are in other areas of the law.

This interest of economists in conflict of laws holds promises for economists and lawyers alike. The benefits to economists are not the topic of this article (though they exist without doubt).[12] The law can certainly benefit from interdisciplinary analysis. Famously and repeatedly referred to as a "dismal swamp,"[13] choice of law as a discipline indeed yearns for intellectual nurture. The clean laboratories of economic modeling promise to provide answers to the perpetual problems that choice of law faces as a discipline. Where choice of law is viewed as too conceptual and abstract,[14] economics promises much-needed pragmatism.[15] Where choice-of-law doctrine is chided for its oblivion to the practical impact of its rules,[16] law and economics promises to provide empirical foundations.[17] Where choice of law is viewed as devoid of theory,[18] economics

general articles on the economic analysis from a non-U.S. perspective are Kurt Siehr, *Ökonomische Analyse des Internationalen Privatrechts*, in FESTSCHRIFT FÜR KARL FIRSCHING ZUM GEBURTSTAG 269 (Dieter Henrich & Bernd von Hoffmann eds., 1985); Horatia Muir Watt, *Law and Economics: Quel apport pour le droit international privé?*, *in* LE CONTRAT AU DEBUT DU XXIEME SIECLE—ETUDES OFFERTES A JACQUES GHESTIN 685 (Gilles Goubeaux et al. eds., 2001).

9. THE ECONOMICS OF CONFLICT OF LAWS (Erin O'Hara ed., 2007).

10. For a positive analysis, see Solimine, *supra* note 8.

11. *E.g.*, Ronald Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191 (1980); Duncan Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387 (1981); Mario Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641 (1980). On the ineffectiveness of this critique, see Anita Bernstein, *Whatever Happened to Law and Economics?*, 64 MD. L. REV. 101, 109–12 (2005). For criticism of efficiency as a criterion for optimal choice-of-law rules (and a promising alternative approach), see Christian Kirchner, *An Economic Analysis of Choice-of-Law and Choice-of-Forum Clauses*, in BASEDOW & KONO, *supra* note 5, at 34.

12. *See, e.g.*, Joseph Stiglitz, *Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights With Responsibilities*, 23 AM. U. INT'L L. REV. 451 (2008).

13. The quote was first introduced by torts scholar William L. Prosser in *Interstate Publication*, 51 MICH. L. REV. 959, 971 (1953).

14. For a particularly stark recent statement, see Earl M. Maltz, *Do Modern Theories of Conflict of Laws Work? The New Jersey Experience*, 36 RUTGERS L.J. 527, 547–48 (2005).

15. WHINCOP & KEYES, *supra* note 5, at 6–7.

16. Hillel Y. Levin, *What Do We Really Know About the American Choice-of-Law Revolution?*, 60 STAN. L. REV. 247, 249, 256–60 (2007).

17. *See generally* Patrick J. Borchers, *The Choice-of-Law Revolution: An Empirical Study,* 49 WASH. & LEE L. REV. 357 (1992); Solimine, *supra* note 8; Stewart E. Sterk, *The Marginal Relevance of Choice of Law Theory*, 142 U. PA. L. REV. 949 (1994). *See also* Christopher A. Whytock, Domestic Courts and Global Governance (Aug.11, 2006), *available at* http://ssrn.com/abstract=923907.

18. Riles, *supra* note 4, at 974.

promises to be that theory.[19] Where choice of law is viewed as hopelessly complex,[20] economics promises to provide clear guidelines.[21]

This article does not aim at evaluating the contribution of law and economics at large. Instead, the interest lies in a very particular question, namely, how far economic models can function *as doctrine*. This may look like a deliberate misreading of their purpose. If one views law and economics as antidoctrinal and antiformalist, it seems inappropriate to read it as doctrine. Yet most doctrine today is, or claims to be, antiformalist. And most economic models make very concrete proposals as to how choice-of-law rules should be shaped. In this sense, economic analysis is like any other analysis of law.[22] And to the extent it aims to inform the resolution of cases, it can, and should, be measured against the same standards.

This article makes it clear that economics does not and probably cannot fulfil this function. However, this failure makes a very important contribution to choice of law. It is the heroic failure of economic analysis, not its claimed success, that presents a real, and immensely valuable, contribution. Economic models achieve clarity, but the unrealistic abstractions necessary to achieve it only highlight the inescapable messiness of the problems with choice of law. The isolation of certain values in the economic analysis, especially those of private and public ordering, respectively, shows that it is the combination of, and the conflict between, these values that defines the field. The failure of attempts to develop new solutions on the basis of abstract economic reasoning, regardless of existing doctrine, makes us see clearly the high degree of disciplinary knowledge that is present, though often unacknowledged, within our doctrinal concepts and rules, imperfect as they are.

The remainder of this article is structured as follows: Part II compares existing doctrine and economic models on a macro level. This comparison shows greater proximity than is usually acknowledged. The economic models are largely based on existing doctrinal models, while those models in turn can be read as resting on certain economic ideas. The part focuses especially on three types of models—a private law model, an international law model, and a combined model—and addresses the role of the best law in each of these models. Part III moves to a micro-comparison and analyzes how the different economic models fare in responding to existing problems in choice of law. It uses three different questions as example. One question concerns the rules for a specific problem, the law applicable to transboundary torts. The second question concerns a traditional, general problem of choice of law, namely the

19. Michael J. Whincop & Mary Keyes, *Towards an Economic Theory of Private International Law*, 25 AUSTRALASIAN J. LEGAL PHILOSOPHY 1 (2000).

20. This criticism is shared (or adopted) by economists. *See* RICHARD POSNER, THE PROBLEMS OF JURISPRUDENCE 430 (1990).

21. WHINCOP & KEYES, *supra* note 5, at 7; *but see* Trachtman, *Economic Analysis*, *supra* note 8, at 10–11.

22. *See* STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 4 (2004).

issue of characterization. The third question is one of design of rules, namely that of whether rules or standards are preferable. In all three questions, it turns out that economic models replicate both the responses given to doctrinal questions and the disputes over these results existing in doctrine. In this sense, instead of resolving these disputes, existing economic models reinforce the impression that these disputes are not resoluble. Part IV finally goes to the core of the three models by analyzing an issue central to all of them: the relation between party autonomy and binding state law. This analysis reveals that two of the economic models ultimately collapse into substantive-law models (of private law and of international law respectively), whereas the third one, the combined model, makes a meaningful and potentially renewing contribution to the field of choice of law. The conclusion assesses the contribution made by economics to choice of law and notes that this contribution is very important, though not in the anticipated way.

II

ECONOMIC MODELS AS DOCTRINAL MODELS

Economists have claimed that "[t]he theories [of choice of law] that have so far held centre stage owe virtually nothing to economic theory."[23] Consequently, most economic analyses start out by dismissing existing doctrines of choice of law[24] before presenting their own economic model as something entirely new. But the hope to resolve, once and for all, existing questions, seems improbable in view of the "foregone conclusion," expressed in this very journal forty-five years ago, "that everything worthy of trying has been tried before, under the same or other labels."[25] And, alas, the claim that an economic approach brings something entirely new turns out to be exaggerated too.

On the one hand, doctrine never developed oblivious to economics and economic theory. As early as the 1890s, German choice-of-law scholar Ludwig von Bar, in a presentation for economists, based choice of law on two simple economic arguments: a reciprocity argument (each country is better off if it treats foreigners equally to citizens) and a rough market-related argument (trade will prosper more if foreigners can take some rules of their own legal

23. O'Hara & Ribstein, *supra* note 8, at 1152; *cf.* Guzman, *supra* note 8, at 885–86 ("[E]fficiency analysis in general, and law and economics in particular, has, to date, had only a minor impact on choice of law.").

24. Guzman, *supra* note 8, at 890–94; O'Hara & Ribstein, *supra* note 8, at 1165–84; WHINCOP & KEYES, *supra* note 5, at 8–26. For a more benevolent analysis, see Trachtman, *Conflict of Laws*, *supra* note 8, at 998–1022. *See also* Kazuaki Kagami, *The Systematic Choice of Legal Rules for Private International Law: An Economic Approach*, *in* BASEDOW & KONO, *supra* note 5, at 15, 24–28.

25. Kurt H. Nadelmann, *Marginal Remarks on the New Trends in American Conflicts Law*, 28 LAW & CONTEMP. PROBS. 860, 860 (Autumn 1963), *cited in* FRIEDRICH K. JUENGER, CHOICE OF LAW AND MULTISTATE JUSTICE 6 (1993).

systems with them).[26] One of the "new foundations" formulated by Andrew Guzman more than 110 years later reformulates this finding quite exactly.[27] This part will show how some doctrinal arguments can be read as economics (albeit unformalized and often crude)—typically, the economics of the time. Even the most formalistic doctrines can be shown to rest on economic ideas.

On the other hand, most economic models owe more than they admit to traditional models in choice of law. In choice-of-law doctrine, no agreement exists on what questions should be asked. Is choice of law about conflicts between states and their desires to regulate (as the governmental-interest analysis dictates it)? Or is it about conflicts between private rights acquired in one state and public regulation in another (as in a vested-rights theory)? Or is it not about conflicts at all, but merely about the technical designation of the applicable law? Economic models would be extremely helpful if they could point us to the right question, but few of them try to do so. Instead, most of them choose one of these questions as the relevant one without spending much time justifying this choice, and then give economically substantiated answers to their chosen question.

With some generalization, it is possible to distinguish three economic models: a private-law model, an international-law model, and a combined model. If this article assigns the work of individual scholars to one of these models, this is done neither to claim they fit fully in one of the categories, nor to claim that all they contribute is the establishment of these models. However, the fact that they pose different questions makes it possible to group them and discuss the ensuing groups instead of the individual models. The first two of these models share close affinity with two doctrinal models: the vested-rights theory (in its old version and in its new version as country-of-origin principle) and governmental-interest analysis. The third model, in turn, has spurred new approaches to choice of law as a regulatory instrument.

A. Private-Law Models

A first economic approach, represented in particular by Whincop and Keyes, and to some extent by O'Hara and Ribstein, can be called a "private-law model." An economic private-law model will apply considerations from the economics of private law to the design of private-international-law rules;[28] it

26. LUDWIG VON BAR, DAS FREMDENRECHT UND SEINE VOLKSWIRTSCHAFTLICHE BEDEUTUNG 26 (1893). Von Bar was the author of several books on conflict of laws, two of which have been translated into English. The reciprocity argument, though usually phrased in less economic terms, is even older. See the references in JOSEPH STORY, COMMENTARIES ON THE CONFLICT OF LAWS § 35, 45–46 (3d ed. 1846).

27. Guzman, *supra* note 8, at 927–30.

28. WHINCOP & KEYES, *supra* note 5, at 3 ("[T]he policies that underlie what we think of as 'substantive' private law areas should, where suitable, inform the private international law rules that apply in these areas.").

focuses on individuals and individual interest.[29] The goal is either efficiency or the maximization of global social welfare, understood as the sum of the utilities of all individuals worldwide.[30] The main way to achieve these goals is private, contractual choice of law.[31] When parties choose the applicable law, this choice should usually be enforced. When private choice is either impossible or not executed, the contracts paradigm does not cease to govern: choice-of-law rules should enable the law applied to fit as smoothly into a contractual scheme as possible. Substantively, choice-of-law rules should mimic the result of a hypothetical choice-of-law agreement between the parties.[32] Formally, they should provide clear and predictable rules enabling the parties to contract, or settle, against a firm baseline.[33] One solution that some authors accept, if somewhat reluctantly, is to resort to the subsidiary use of an approach of "regulatory advantage."[34] According to this approach, developed by Judge Posner, courts should determine the applicable law by reference to the government that has the greatest ability to regulate the relevant conduct, which usually coincides with territoriality.[35] For torts outside market relations, this is usually *lex loci delicti*.[36] This should ensure, ideally, that parties will be governed by the best (and thus the most efficient) substantive law.

When all focus is on the interests of individuals, other policy considerations— especially those promulgated by states as mandatory laws— are suspect. Once the necessity of mandatory rules has been defined away (because private transactions are presumed efficient), such laws are opposed because they are unlikely to represent the interests of all individuals represented[37] and are (therefore) often inefficient.[38] Invocations of sovereignty

29. *Id*. at 34; O'Hara & Ribstein, *supra* note 8, at 1152–53, 1185.

30. Guzman, *supra* note 8, at 898; Siehr, *supra* note 8, at 274.

31. O'Hara & Ribstein, *supra* note 8, at 1186–87; Rühl, *supra* note 8, at 802; WHINCOP & KEYES, *supra* note 5, at 29.

32. Michael Whincop & Mary Keyes, *Putting the 'Private' Back into Private International Law: Default Rules and the Proper Law of the Contract*, 21 MELB. U. L. REV. 515, 536 (1997); *but cf.* WHINCOP & KEYES, *supra* note 5, at 22. *See also* Hans-Bernd Schäfer & Katrin Lantermann, *Choice of Law in Economic Perspective*, *in* AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW, *supra* note 5, at 87, 97–98. For discussion, see Jürgen Basedow, *Lex Mercatoria and the Private International Law of Contracts in Economic Perspective*, *in* AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW, *supra* note 5, at 57, 69–71.

33. O'Hara & Ribstein, *supra* note 8, at 1188–92; WHINCOP & KEYES, *supra* note 5, at 44–45 (for contracts).

34. O'Hara & Ribstein, *supra* note 8, at 1190–92.

35. The concept is developed by RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 602–03 (2003). For examples of the concept's application, see *Kaczmarek v. Allied Chem. Corp*., 836 F.2d 1055, 1058 (7th Cir. 1987), and *Spinozzi v. Itt Sheraton Corp.*, 174 F.3d 842, 845 (7th Cir. 1999). For critical discussion, see Jack L. Goldsmith & Alan O. Sykes*, Lex Loci Delictus and Global Economic Welfare:* Spinozzi v. ITT Sheraton Corp., 120 HARV. L. REV. 1137, 1139–43 (2007); O'Hara & Ribstein, *supra* note 8, at 1179–80; Solimine, *supra* note 8, at 59–68; Trachtman, *Choice of Law*, *supra* note 8, at 1022–26; WHINCOP & KEYES*, supra* note 5, at 20.

36. *Spinozzi*, 174 F.3d at 844–45; WHINCOP & KEYES, *supra* note 5, at 97–104; O'Hara & Ribstein, *supra* note 8, at 1216–18.

37. Paul A. Stephan, *The Political Economy of Choice of Law*, 90 GEO. L.J. 957, 958–59 (2002).

to justify their application are denounced as communitarian[39] and as smokescreens for what are really political tastes.[40] Policies and justice are dismissed because they display no pragmatic values.[41] Consequently, the desire of parties to avoid such inefficient rules is to be encouraged and supported. This, in fact, is one main purpose of party autonomy. By and large, the only policies worth pursuing in private international law are those of private law,[42] and that means, apparently, the protection of private-property rights and transactions. The tendency expressed in the title of one leading article—"from politics to efficiency"[43]—suggests how politics is viewed as standing in contrast to desirable efficiency.[44]

Distrust in politics and a focus on the interests of individuals over those of governments are not, of course, inventions of the private-law model. Such considerations underlie an old doctrinal approach to choice of law: the theory of vested rights, under which courts are bound to enforce rights vested under a foreign law typically determined by some territorial connection.[45] That approach is now universally condemned, and economists within the private-law model largely chime in on the condemnation,[46] even though they share many of the convictions underlying the vested-rights theory[47]—the focus on individual interests and on territoriality, a disdain for public policy, mandatory substantive laws and governmental interests, and an emphasis on formal interests like predictability over substantive considerations of policy.

Closer scrutiny suggests grounds for the affinity. The vested-rights theory is not grounded merely in formalism or metaphysics, as is regularly suggested. Its main propagator, Joseph Beale, used instrumental and even purely economic justifications for applying a single pertinent law to activity: "society requires the final distribution of all costs, including those of accidents, so that they will come into the cost of production or of use and be shared among the ultimate

38. O'Hara & Ribstein, *supra* note 8, at 1156–60.

39. Stephan, *supra* note 37, at 957–58.

40. *Id*. at 958.

41. For the strongest statement in this regard, see WHINCOP & KEYES, *supra* note 5, at 32–34.

42. WHINCOP & KEYES, *supra* note 5, at 3.

43. O'Hara & Ribstein, *supra* note 8; *see also* Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law,* 37 GA. L. REV. 363 (2003) (criticizing such a development toward politics).

44. But see, for clarification of this point, Erin O'Hara & Larry E. Ribstein, *Rules and Institutions in Developing a Law Market: Views from the US and Europe*, TUL. L. REV. Part I.D.4 (forthcoming 2008) ("[T]he relevant choice is not between efficiency and other values, but between political and contractual mechanisms for achieving efficiency.").

45. For overview, see Ralf Michaels, *EU Law as Choice of Law? Reconceptualising the Country-of-Origin Principle as Vested-Rights Theory*, 2 J. PRIV. INT'L L. 195 (2006).

46. *See* Guzman, *supra* note 8, at 891; O'Hara & Ribstein, *supra* note 8, 1166–68. *But see id.* at 1165 ("[F]or all its arbitrariness, the vested rights theory comes closer to satisfying an efficiency criterion . . . ."). *See also* WHINCOP & KEYES, *supra* note 5, at 14–15. *But see* Stephan, *supra* note 37, at 957 n.2.

47. See, for example, Judge Posner's reasoning in *Kaczmarek v. Allied Chem. Corp.*, 836 F.2d at 1057, and WHINCOP & KEYES, *supra* note 5, at 17–19.

consumers,"[48] which requires "keeping the expense of new social protection at its lowest point consistent with efficiency."[49]

The underlying idea that insurance costs must be internalized as costs of production and as such must be held low underlies Pigovian economics (which were popular in Beale's time), as well as current economic thought. If Pigou is now nonetheless widely rejected,[50] it is so not because of the idea of internalization. Rather, today's economists usually follow Coase's finding contrary to Pigou that, as long as rights are clearly defined and transaction costs are sufficiently low, the market will be better than the state at optimally allocating rights. In choice of law, the parallel is to let parties themselves determine the applicable law. Consequently, what economists mainly criticize is that the vested-rights theory allows no space for party determination of the applicable law. But this is not an intrinsically necessary element of a theory focused on vested rights. This shortcoming has been remedied by the renaissance of the vested-rights theory as a country-of-origin approach,[51] whereby the law applicable to a product or a company is determined by its origin, and that origin can be selected more or less freely. That idea, as a choice-of-law principle, rests on explicitly economic considerations not dissimilar to those for the vested-rights theory, especially the desire to lower costs arising from having to deal with multiple legal systems.[52]

In view of this close proximity, it is not surprising how many of the proposals made from the private-law model repeat solutions of the First Restatement:[53] predictable rules,[54] application of *lex loci* for tort liability without

48. Joseph Beale, *Social Justice and Business Costs*, 49 HARV. L. REV. 593, 608 (1936). For discussion, see *id*. at 604–08.

49. *Id*. at 609. Beale's affinity to economics and social thought is occasionally recognized. For conflict of laws, see Riles, *supra* note 4, at 977–82. More generally, see Herbert Hovenkamp, *The Political Economy of Substantive Due Process*, 40 STAN. L. REV. 379, 401 (citing to the request for courts to use more economics, *in* J. BEALE & B. WYMAN, THE LAW OF RAILROAD RATE REGULATION 24–40 (1906)). This early book makes it unlikely that Beale endorsed economic considerations only after publication of the Restatement, as suggested by Ibrahim J. Wani, *Borrowing Statutes, Statutes of Limitation and Modern Law*, 57 UMKC L. REV. 681, 696 n.84 (1989).

50. For a defense of Pigou by a legal historian, see Brian A.W. Simpson, *Coase v. Pigou Reexamined*, 25 J. LEGAL STUD. 53 (1996). Coase's harsh response is preceded by a quote from Stigler: "it takes an economist to read an economist." R.H. Coase, *Law and Economics and A.W. Brian Simpson*, 25 J. LEGAL STUD. 103, 103 (1996).

51. For similarities, see Michaels, *supra* note 45.

52. *See, e.g.*, COPENHAGEN ECONOMICS, THE ECONOMIC IMPORTANCE OF THE COUNTRY OF ORIGIN PRINCIPLE IN THE PROPOSED SERVICES DIRECTIVE—FINAL REPORT 10 (2005), http://www.berr.gov.uk/files/file22901.pdf. An additional justification—impact on regulatory competition—belongs to the combination model and will be discussed *infra* II.C.

53. *See generally* William M. Richman, *The First Restatement of Conflict of Laws on the Twenty-Fifth Anniversary of its Successor: Contemporary Practice in Traditional Courts*, 56 MD. L. REV. 1196, 1197–1200 (1997).

54. O'Hara & Ribstein, *supra* note 8, at 1188; Rühl, *supra* note 8, at 840; Schäfer & Lantermann, *supra* note 32, at 90–92; WHINCOP & KEYES, *supra* note 5, at 44.

distinction between loss-allocation and conduct-regulation,[55] opposition to general questions like characterization,[56] *renvoi*,[57] and a public-policy exception.[58] Indeed, sometimes the First Restatement itself is proposed as an economically superior solution to choice-of-law problems.[59] And this proposal is quite implausible. Whatever the advantages of the First Restatement may be in the abstract, it did not stand the test of time. Yet, although economics prides itself as an empirical science, the private-law model has not developed a response to the factual failure of the First Restatement.

B. International-Law Models

Almost diametrically opposed to this private-law model is a second model. Supported in particular by Joel Trachtman, it can be called an "international-law model" because it extends the economics of international law into choice of law. Methodologically, this model is in many ways similar to the private-law model. Like the private-law model, the international-law model assumes that actors are rational in the sense that they maximize their own utilities; its normative goal is efficiency; and the instrument to achieve efficiency consists in rules that set optimal incentives for the actors or that mimic contractual agreements between them, ensuring that they engage in efficient (and refrain from inefficient) conduct. The decisive difference between this model and that of private law is that the actors in question are not individuals; they are states.[60] In this model, choice-of-law rules must be shaped so as to enable states, not individuals, to maximize the sum of their interests. States maximize the effectiveness of their own policies as embodied, especially, in their legislation.[61] Analogizing jurisdiction to property, Trachtman asks us to allocate prescriptive jurisdiction with the state that cares most about a particular problem. The consequence of such an allocation is that the role of party autonomy is very limited.

Unlike the private-law model, the international-law model draws more explicitly on a doctrinal model: governmental-interest analysis, as established by

55. O'Hara & Ribstein, *supra* note 8, at 1217; WHINCOP & KEYES, *supra* note 5, at 96–97 (without discussion).

56. *Infra* III.B.

57. O'Hara & Ribstein, *supra* note 8, at 1197.

58. *Id.* at 1194–95.

59. Erin O'Hara & Larry E. Ribstein, *Interest Groups, Contracts and Interest Analysis*, 48 MERCER L. REV. 765, 768–69 (1997); William H. Allen & Erin A. O'Hara, *Second Generation Law and Economics of Conflict of Laws: Baxter's Comparative Impairment and Beyond*, 51 STAN. L. REV. 1011, 1043–47 (1999).

60. BRILMAYER, *supra* note 8, at 7; Sykes, *supra* note 7, at 762; Joel P. Trachtman, *The Methodology of Law and Economics in International Law*, 6 INTERNATIONAL LAW FORUM DU DROIT INT'L 67 (2004). For discussion of whether this is compatible with methodological individualism, see Ralf Michaels, *Two Economists Three Opinions? Economic Models for Private International Law–Cross-Border Torts as Example*, *in* BASEDOW & KONO, *supra* note 5, 143, at 163–65; Trachtman, *Economic Analysis*, *supra* note 8, at 21–23.

61. See Trachtman, *Economic Analysis*, *supra* note 8, at 15–23.

Brainerd Currie.[62] Governmental-interest analysis assumes that conflicts of law are conflicts among sovereigns over which of them gets to regulate a specific conduct. Although interest analysis has been influential, Currie's own position that forum law should usually be applied[63] has not found many followers. Most courts and scholars suggest some degree of balancing between laws, at least when they are in true conflict.

This debate is not usually presented as an economic one, but it easily can be. Translated, Currie's much-maligned preference for application of forum law becomes an application of Pareto efficiency. If, as is the case for Currie, the application of forum law provides the initial assignment of jurisdiction,[64] then the move to another state of affairs—application of foreign law—is justified, according to the Pareto definition of efficiency, only under two conditions: First, the move makes no state worse off, and, second, the move makes at least one state better off. The first condition excludes the move in all cases in which the forum has an interest in the application of its law. It follows that forum law applies in false conflicts when only the forum is interested and in true conflicts when both states are interested. The second condition excludes the application of foreign law in "unprovided-for" cases—cases in which neither the forum nor the other state is interested in their laws' being applied. In such a case, application of the foreign law would make no state worse off, but it would also make no state better off. Foreign law applies only in false conflicts when the forum is disinterested and the other state is interested, the only case in which the move to foreign law is Pareto efficient. This is Currie's result, too.

Such (simple) economic reasoning underlies not only Currie's variant of interest analysis. The resistance to Currie's preference for applying forum law can be translated as resistance to Pareto efficiency, in accordance with dissatisfaction among many law-and-economic scholars with this criterion. Globally, Currie's forum preference leads to the mutually suboptimal result that most states usually apply their own law, a situation that can be (and often is) presented as a prisoners' dilemma.[65] Among the many proposals to overcome this dilemma, one has a decidedly economic flair: Baxter's comparative-impairment theory.[66] Baxter proposed to resolve true conflicts not by simple

62. Trachtman, *Economic Analysis*, *supra* note 8, at 16.

63. For the clearest exposition of this theory, see Brainerd Currie*, Notes in Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171, *reprinted in* BRAINERD CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 177–87 (1963).

64. CURRIE, SELECTED ESSAYS, *supra* note 64, at 46–48, 183.

65. BRILMAYER, *supra* note 8, at 181; William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT'L L. J. 161, 219–26 (2001); Kramer, *supra* note 8, at 280; O'Hara & Ribstein, *supra* note 8, at 1182; Joel P. Trachtman, *Externalities and Extraterritoriality: The Law and Economics of Prescriptive Jurisdiction*, *in* ECONOMIC DIMENSIONS IN INTERNATIONAL LAW: COMPARATIVE AND EMPIRICAL PERSPECTIVES 642, 662–63 (Jagdeep S. Bhandari & Alan O. Sykes, eds. 1997).

66. William F. Baxter, *Choice of Law and the Federal System*, 16 STAN. L. REV. 1 (1963). For economic reformulation (and critique), see Allen & O'Hara, *supra* note 59; Trachtman, *Conflict of*

preference of the forum law (as Currie had suggested), but rather with a view toward which state's policy would be more seriously impaired if it were not enforced. To reach this result, he effectively used three common economic instruments that show his differences from Currie. Baxter's first economic instrument was the hypothetical Coasean bargain:[67] if the states could negotiate over who gets to regulate, jurisdiction would always end up in the state with the greater interest. In the presence of high transaction costs, however, such transactions do not take place, so we must give jurisdiction to that state from the start. One justification for the preference of one state's interests over those of another is found in Baxter's second move, which was, effectively, to replace Currie's focus on Pareto efficiency with Kaldor–Hicks efficiency. In comparative impairment, one state can be made worse off (through nonapplication of its laws) if the loss to that state is more than outweighed by the gain to another state by enforcement of that latter state's laws.[68] Another justification lies in Baxter's third move, which was to slightly change the conditions of Currie's game-theoretical model. Currie had focused essentially on a one-shot game, in which it is rational for each state not to cooperate. However, in repeat games a certain degree of cooperation is mutually beneficial.[69] Applied to choice of law, this suggests that if each state is willing to give up jurisdiction to other states, in the long run all states will profit.[70]

The point here is not that traditional doctrine actually qualifies as sophisticated economic analysis. The traditional doctrine does not go much beyond this in terms of economics and resolves specific conflicts with case-specific doctrine. The economic model, by contrast, expands greatly on the doctrine and introduces additional economic ideas in order to better understand the bargaining process: information asymmetries (where one party has information that the other lacks), the theory of muddy entitlements (according to which property rights are not fully defined ex ante), and the theory of the

Laws, *supra* note 8, at 1017–22. Antoine Pillet had developed a similar idea in France forty years earlier. *See* ANTOINE PILLET, TRAITÉ PRATIQUE DE DROIT INT'L PRIVÉ 106 (1923):

> The way to resolve conflicts is to give preference to the law of the state which has the greatest interest that the goal pursued by the law in question be attained . . . , that its law regulate the litigation. If a sacrifice must be made, it should be as small as possible (translation by author).

The similarity between Pillet and Baxter is occasionally recognized in North America. *See, e.g.*, FRIEDRICH K. JUENGER, CHOICE OF LAW AND MULTISTATE JUSTICE 141 (special ed. 2005); William Tetley, *A Canadian Looks at American Conflict of Law Theory and Practice, Especially in the Light of the American Legal and Social Systems*, 38 COLUM. J. TRANSNAT'L L. 299, 314 n.47 (2000); Trachtman, *Economic Analysis*, *supra* note 8, at 26 n.91.

67. Baxter, *supra* note 66, at 7–11; *cf.* Allen & O'Hara, *supra* note 59, at 1021.

68. *Cf.* Baxter, *supra* note 66, at 17–18 ("The principle is to subordinate, in the particular case, the external objective of the state whose internal objective will be least impaired in general scope and impact by subordination in cases like the one at hand.").

69. The most famous formulation of this insight can be found in ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984). For an earlier formulation, see MICHAEL TAYLOR, ANARCHY AND COOPERATION (1976).

70. Baxter, *supra* note 66, at 10–11. For doubts as to the workability of this approach, see BRILMAYER, *supra* note 8, at 193–96; Kramer, *supra* note 8, at 299–300.

nature of the firm. The point is that, despite its greater economic sophistication, the economic model is largely an extension of the doctrine, not an independent analysis. For this reason, the economic model shares the weaknesses of the doctrinal model, in particular the most urgent problem with governmental-interest analysis: the difficulty of determining what actually constitutes governmental interests, and the manipulability of the concept. This problem has plagued scholars of governmental interests since the theory's inception; it provides perhaps the strongest point of criticism in the doctrine. Yet the problem is ignored, or assumed away, in economic models.

C. Combined Models

A third set of economic models can be called "combined models" because they combine the private- and the international-law models. For combined models, suggested most explicitly by Andrew Guzman, the interests to be maximized are those of individuals: choice of law should maximize global welfare as calculated between individuals. However, the focus on the incentives of choice-of-law rules is not only on individuals, but also on states as creators of substantive laws. Rational states are assumed to care, in their lawmaking, only for the effects these laws have on their own citizens; effects on other states' citizens are externalities. This means that states will allow globally inefficient transactions if they are locally beneficial, and they will prohibit transactions that would be globally efficient if they would be locally detrimental.[71] Strict extraterritoriality is inefficient because it enables states to externalize costs from their laws; strict territoriality is inefficient because it prevents states from regulating conduct taking place outside their borders even if that conduct harms them.

A combination of private and international aspects is of course common in choice-of-law doctrine. Most choice-of-law methods are not purely private or public; they combine public and private considerations and differ in the weight they give to each of these. The Second Restatement[72] is a prime example of a mixed approach. Its central provision, Section 6, combines public-law-model factors[73] and private-law-model factors[74] with factors arising from the specific cross-border situations.[75] The European choice-of-law regulations provide comparable combinations: most of their rules are based on a private-law model, but they contain exceptions, in accordance with governmental-interest

71. Guzman, *supra* note 8, at 899–900.

72. RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1969).

73. These factors are (a) the needs of the interstate and international system, (b) the relevant policies of the forum, and (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue.

74. These factors are (d) the protection of justified expectations and (f) certainty, predictability, and uniformity of result.

75. These factors are (e) the basic policies underlying the particular field of law and (g) ease in determination and application of the law to be applied.

analysis.[76] In this sense, nearly all existing doctrines would fall under the combined model. However, their translation into economics would present problems precisely because they are so mixed and eclectic.[77] Because the relationship between the underlying policies is unclear, so are its economics. This may explain why economic analyses have all but ignored the Second Restatement,[78] although it represents the most widely used approach to choice of law in the United States. (By contrast, Savignyan choice-of-law ideas, central to continental European thinking, are being translated into an economic model by Giesela Rühl, who emphasizes deliberate neutrality toward the substance of potentially applicable law.[79])

Recently, however, writings on choice of law have gone beyond presenting a mishmash or eclectic mix and have explicitly addressed this clash of public and private policies in a more systematic manner. Robert Wai has presented a subtle interpretation of choice of law as an instrument that simultaneously enables and enhances private freedom and the effectuation of state policies and that creates both a private sphere outside of states and a "touchdown" relationship with states.[80] For him, "the function of transnational private law is not simply facilitation of transactions, but also compensation for harms and social regulation of transnational conduct."[81] The private law in private international law is not only about contracts, but also about compensation and interests of third parties; when private parties do not bring about the right degree of compensation, the state must intervene.[82] Although not based in economics (nor disinterested in the political relevance of the subject), Wai's

76. *See* Erik Jayme, *The American Conflicts Revolution and its Impact on European Private International Law*, *in* FORTY YEARS ON: THE EVOLUTION OF POSTWAR PRIVATE INTERNATIONAL LAW IN EUROPE 15 (1990); Frank Vischer, *New Tendencies in European Conflict of Laws and the Influence of the U.S. Doctrine – A Short Survey*, *in* LAW AND JUSTICE IN A MULTISTATE WORLD: ESSAYS IN HONOR OF ARTHUR T. VON MEHREN 459 (James A. Nafziger & Symeon C. Symeonides eds., 2002). For a more general discussion, see Ralf Michaels, *The European Conflict of Laws Revolution*, 82 TUL. L. REV. 1607 (forthcoming 2008).

77. William A. Reppy, *Eclecticism in Choice of Law: Hybrid Method or Mishmash?*, 34 MERCER L. REV. 645 (1983).

78. O'Hara & Ribstein, *supra* note 8, at 1183–84 (claiming the Restatement "ends up sanctioning whatever the courts want to do"); Trachtman, *Choice of Law*, *supra* note 8, at 1012, 1016 (mentioning the Restatement as a balancing test).

79. Rühl, *supra* note 8; *see also* Giesela Rühl, *Die Kosten der Rechtswahlfreiheit: Zur Anwendung ausländischen Rechts durch deutsche Gerichte*, 71 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 559 (2007); Giesela Rühl, *Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency*, *in Conflict of Laws in a Globalized World*, *in* ESSAYS IN MEMORY OF ARTHUR T. VON MEHREN 153 (Gottschalk et al. eds., 2007).

80. Robert Wai, *Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization*, 40 COLUM. J. TRANSNAT'L L. 223 (2002); Robert Wai, *Transnational Private Law and Private Ordering in a Contested Global Society*, 46 HARV. INT'L L. J. 471 (2005); Robert Wai, *The Interlegality of Private International Law*, 71 LAW& CONTEMP. PROBS. 105 (Summer 2008).

81. Wai, *Transnational Private Law*, *supra* note 80, at 471.

82. *Id*. at 474–75.

approach rests on certain economic considerations not dissimilar to those suggested by Guzman. Like Guzman, Wai considers the competitive superiority of local over global regulatory institutions,[83] the need of law to address externalities,[84] and especially the function of private international law to coordinate various regulations in order to avoid both over- and underregulation,[85] as well as regulatory competition that would enable opportunistic behavior by private actors.[86] These ideas are present as economic considerations in the recent work by Muir Watt, who endorses many of Wai's points and enriches them with inspirations from the economic literature.[87]

What distinguishes proponents of combined models, in economics and in doctrine alike, is their respective views on the desirability of regulatory competition and party autonomy. For Guzman, choice-of-law rules should guarantee that the applicable law is the law of a state that is least likely to externalize the costs of its legislation, for that law is likely to be closest to a globally optimal law. This makes it necessary to determine the applicable law objectively on the basis of effects; domicile plays only a limited role, and the place of conduct plays no role at all. Party autonomy is desirable only when transaction costs have no third-party effects.[88] By contrast, proponents of regulatory competition find an argument for party autonomy even when third-party externalities may exist. Party autonomy is advocated as an instrument to force states to abolish inefficient laws. The idea, in a nutshell, is that states will compete in a market for laws for parties to choose their laws.[89] In order to prevail in this market, the theory goes, states must provide efficient laws—laws that benefit greatly and cost little. Analysts of jurisdictional or regulatory competition have long all but ignored choice-of-law rules; lately, regulatory competition has been used more explicitly as a principle for choice-of-law rules.[90]

D. The Best Law

All three models face the question presented at the outset: What is special about choice of law as opposed to regular economic analysis? Why is the result of a choice-of-law question not simply the choice of the more efficient law, as

83. Wai, *Transnational Liftoff*, *supra* note 80, at 239, 243–44.

84. *Id*. at 251.

85. *Id*. at 253–54 ("The basic role of private international law in addressing transnational regulatory gaps is to coordinate the process of regulation by national authorities and national laws.").

86. *Id*. at 254–55.

87. Muir Watt, *supra* note 6.

88. Guzman, *supra* note 8, at 913–14.

89. Larry E. Ribstein & Erin O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661 (2008).

90. *E.g.*, Horatia Muir Watt, *Concurrence d'ordres juridiques et conflits de lois de droit privé*, *in* LE DROIT INT'L PRIVE: ESPRIT ET METHODES: MELANGES EN L'HONNEUR DE PAUL LAGARDE 615, 625–33 (2005); Francisco J. Garcimartín Alférez, *Regulatory Competition: A Private International Law Approach*, 8 EUR. J.L. & ECON. 251 (1999).

economic analysis of domestic law would suggest? Such an approach is indeed known in choice-of-law doctrine as "better law theory"—the idea that the judge should apply the better of the two laws. "Better" is defined at least in part in economic terms, as "superiority of one rule of law over another in terms of socio-economic jurisprudential standards."[91] In other words, the judges should apply the law that is the best from an economic perspective—if efficiency is the criterion, then they should choose the most efficient law. Under this approach, economic analysis of substantive law would immediately offer itself as a choice-of-law doctrine.

The better-law approach is the direct translation of normative economics into choice of law. Courts have occasionally used it as such, and have based the preference of one state's rules on comparative negligence over the other state's rules on contributory negligence explicitly on the (alleged) economic superiority of a comparative-negligence regime.[92] So it is not surprising that nearly all economic analyses address the theory. What is surprising, at first, is that proponents of all three models reject the approach. Indeed, this is so although every one of these models has a very specific idea of the role of the "best law" in choice of law. Simply substituting determination of the best law for the choice-of-law analysis would mean that choice of law would be no different from substantive law. At the same time, the goal of efficiency or welfare maximization makes it necessary to formulate the best law as the goal of the analysis. The struggle from choice-of-law doctrine between substantive justice and conflicts justice is not resolved; it is merely transposed into a struggle between substantive efficiency and conflicts efficiency.

Why "better law" is not a solution for the international-law model is obvious: if law is the effectuation of government policies, then this determination cannot be undermined by invocation of some otherwise-determined best law.[93] The best law must be determined by the (democratically legitimated) legislator, not by the judge or the economist (or by private parties). Respect for autonomy of states (which would translate within doctrine into respect for sovereignty) makes judgments about the best substantive laws

91. Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. REV. 267, 296 (1966). *See also* Heath v. Zellmer**,** 151 N.W.2d 664, 673–76 (Wis. 1967); Diesel Service Co. v. AMBAC Intern. Corp., 961 F.2d 635, 643 (7th Cir. 1992), *overruled on other grounds by* Generac Corp. v. Caterpillar Inc., 172 F.3d 971 (7th Cir. 1999).

92. *See* McDaniel v. Ritter, 556 S.2d 303, 316–17 (Miss. 1989) (applying Tennessee rule of comparative negligence over the common-law rule of contributory negligence of another state with the most significant relationship, because the Tennessee rule is "demonstrably superior . . . [b]oth from the point of view of civil justice and economic efficiency . . . ."); Threlkeld v. Worsham, 30 Ark. App. 251, 255–56 (Ark. Ct. App. 1990) (applying the same reasoning as the Court in *McDaniel*). Ironically, the main proponent of the better-law approach himself had some sympathy for contributory over comparative negligence. *See* Robert A. Leflar, *Comments on* Maki v. Frelk—*Comparative v. Contributory Negligence: Should the Court or Legislature Decide?*, 21 VAND. L. REV. 918 (1968). The economic debate is less clear than the decisions suggest. For a recent perspective, see Oren Bar-Gill & Omri Ben-Shahar, *The Uneasy Case for Comparative Negligence*, 5 AM. L. & ECON. REV. 439 (2003).

93. Trachtman, *Economic Analysis*, *supra* note 8, at 42.

undesirable. Trachtman invokes Kegel's preference of "conflicts justice over substantive justice"[94] and thus assumes (though without real argument) one position within the hotly fought doctrinal debate between conflicts justice and substantive justice.

By contrast, rejection from the private-law model is prima facie surprising.[95] When such rejection is not due to a misunderstanding of the better-law theory as focusing on justice instead of efficiency,[96] the main arguments against a better-law approach are that judges would not be up to the task of assessing efficiency[97] or that "[r]esolving a choice of law problem by applying the efficient law will only have the desired effects on accident precaution if parties expect the law to apply."[98] These arguments prove more than they want to. If judges cannot assess efficiency, and if parties cannot expect an efficiency standard to apply, then judges should not engage in efficiency analysis within substantive law either—for example by applying the Learned Hand formula to determine negligence. And, of course, they should not use efficiency as a criterion to develop choice-of-law rules either. Moreover, if judges are unable to assess the best law, it is not clear why either the parties themselves or the maker of choice-of-law rules should be better equipped. Ultimately, rejection of the better-law approach is based more on a question-begging definition of the problem than on fully fledged efficiency analysis: "the situation *we* are studying is not the formulation of tort rules, but the selection between them in order to resolve a conflict of laws."[99]

The most interesting rejection is that made by the combined model. Guzman rejects the better-law approach with a combination of the arguments brought forward under the other two models: judges are ill-equipped to determine the better law (a private-law-model argument), and the competing policies so determined may be incommensurable (an international-law argument).[100] But then it turns out that his rejection is based on a misunderstanding of the better-law theory as either focusing on justice and reasonability[101] or as necessarily leading to a forum bias.[102] And Guzman himself

94. *Id.* at 42 n.110; *cf.* Trachtman, *Conflict of Laws*, *supra* note 8, at 889 n. 45, 995–96.

95. *See, e.g.*, Peter Mankowski, *Europäisches Internationales Privat- und Prozessrecht im Lichte der ökonomischen Analyse*, *in* VEREINHEITLICHUNG UND DIVERSITÄT DES ZIVILRECHTS IN TRANSNATIONALEN WIRTSCHAFTSRÄUMEN 118, 127 (Ott & Schäfer eds., 2002); O'Hara & Ribstein, *supra* note 8, at 1178–80; WHINCOP & KEYES, *supra* note 5, at 25; WHINCOP & KEYES, *supra* note 5, at 21–22 (generally), 90 (with regard to tort law). *But see* Kramer, *supra* note 8, at 339; Solimine, *supra* note 5, at 215 (arguing that the emphasis on efficiency in economic analyses of choice of law suggests a better law approach).

96. WHINCOP & KEYES, *supra* note 5, at 21; Guzman, *supra* note 8, at 893.

97. Allen & O'Hara, *supra* note 59, at 1030–31; Guzman, *supra* note 8, at 893; O'Hara & Ribstein, *supra* note 8, at 1178–80.

98. WHINCOP & KEYES, *supra* note 5, at 90.

99. *Id.*

100. Guzman, *supra* note 8, at 893–94, 896.

101. *Id.* at 893. For a similar misunderstanding, see WHINCOP & KEYES, *supra* note 5, at 21.

requires an idea of the better law when he establishes "the globally efficient substantive law" as the goal.[103] Judges are unable to find it, but economic analysis outside the courtroom can nonetheless set it as an ideal.

III

ECONOMIC SOLUTIONS AS DOCTRINAL SOLUTIONS

The economic models are more similar to existing doctrine than is usually admitted. If this is so, it must be possible to evaluate the answers they give to specific doctrinal problems. Most doctrines can be translated into economic models but become quite unconvincing as economics. Translated into economics, stripped of all its peculiarities, doctrine turns into very bland, straightforward, and unsatisfactory models. The economic models are undoubtedly superior in their economics, but does this mean they can also claim to give more sophisticated answers to traditional problems of choice of law? Some such claims are somewhat implausible, for example, the idea that a return to the First Restatement and its rules would create an advantage.[104] Others are less novel than their proponents present them, for example, the insight that *Hartford Fire* involved an actual conflict.[105] But the models do provide responses to specific questions, and this is where they should be tested. As the analysis shows, the results are of limited use for doctrine. Specific subject matters prove to be too complex for meaningful economic guidance. General problems like characterization do not become dispensable. Debates on the optimal design of choice-of-law rules replicate similar debates in doctrine. Translated into doctrine, the economic analysis looks very bland.

A. Specific Subject Matters: Transboundary Tort Liability

One good example of a specific subject matter is the problem of transboundary torts.[106] The main problem here is whether the law of the place of conduct or the law of the place of injury should govern. Some economists in a

102. *Id*. at 896–97. Although the relation to forum bias is an empirical reality, it is not a necessary element of the theory.

103. *Id*. at 898.

104. *See* reference*s supra* note 59.

105. Guzman, *supra* note 8, at 886, 918–19, referring to Hartford Fire Ins. Co. v. California, 509 U.S. 764, 797–99 (1993). The criterion for "true conflicts" used by the Supreme Court in *Hartford Fire* was inconsistent with interest analysis, which has long admitted that, contrary to what the Supreme Court assumed, states may also have an interest in permitting certain conduct. The decision in *Hartford Fire* rested on a misunderstanding of the Restatement for International Law. *See* Andreas Lowenfeld, *Conflict, Balance of Interests, and the Exercise of Jurisdiction to Prescribe: Reflections on the Insurance Antitrust Case*, 89 AM. J. INT'L L. 42, 50 (1995). *See also* Ralf Michaels, *Two Paradigms of Jurisdiction*, 27 MICH. J. INT'L L. 1003, 1059–60 (2006).

106. See more extensively, Michaels, *supra* note 60 (with further references); Antonio Nicita & Matteo M. Winkler, The Cost of Transnational Accidents: Evolving Rules on Torts (2007), available at http://www.cbs.dk/content/download/67236/929984/file/The%20cost%20of%20transnational%20accidents%20(Nicita-Winkler%202007).pdf.

private-law model prefer, at least prima facie, the place of conduct because it is thought to have a regulatory advantage.[107] The country-of-origin principle likewise favors the place of conduct because this enables defendants to rely on just one law. Economists from an international-law model, by contrast, focus on the place of injury that feels the effects of the conduct. Among proponents of the combined model, finally, views are mixed: Guzman strongly disfavors relying on the law of the place of conduct because doing so would encourage externalization.[108] Others provide a more complex analysis: If defendants must comply with the strict rules of their home states, they may face a competitive disadvantage in foreign markets; this consideration could favor preference for a place-of-injury rule.[109] However, if defendants must comply with the strict rules of the place of injury, they may be unable to compete in that market because they face a disadvantage vis-à-vis local companies that are better equipped to deal with the local law. Closer analysis shows that even this discrepancy in views presents too simple a picture because the focus is only on the tortfeasor and his conduct, not on that of the victim. Taking Coase seriously requires focusing on both tortfeasor and victim and their respective conduct, or on place of conduct and place of injury and their respective laws and policies.[110]

All of this makes the design of optimal choice-of-law rules such a complex and fact-specific analysis that workable rules are unachievable through a rigorous economic analysis. At some point, each analysis strikes a decision on the basis of intuition. The general choice of the law of either the place of conduct or the place of injury is made on the basis of the need for simplicity rather than that of economic efficiency. This brings clarity, but this clarity comes for the sake of grossly simplifying the cases to be solved; once specifics are included, their solutions are indistinguishable from those of traditional doctrine.

B. General Devices: Characterization

If economic models cannot resolve difficult specific problems, can they help dispense with general institutions that the doctrine still carries with it? One example is characterization. Traditional methods rely strongly on characterization—whether an issue belongs to the law of contract or tort, or whether it is substantive or procedural, is a relevant question to determine the adequate choice-of-law rule. More modern approaches have tried to reduce or eliminate the need to characterize, but although the methods and concepts have

107. O'Hara & Ribstein, *supra* note 8, at 1217 (but ultimately preferring place of injury in order to minimize characterization issues). It is not obvious why, as regards choice of law (versus enforcement), the place of conduct should have a regulatory advantage over the place of injury.

108. Guzman, *supra* note 8, at 921–24; Schäfer & Lantermann, *supra* note 32, at 117–18.

109. Goldsmith & Sykes, *supra* note 35, at 1144–46.

110. *See* Michaels, *supra* note 60, at 158–60, 175–76.

changed, the need to characterize has remained: loss-allocating rules must be distinguished from conduct-regulating ones.

Economists readily adopt the frequent critique of characterization and ask that economic analysis should dispel the need to characterize, for it increases uncertainty (and thus transaction costs).[111] However, instead of avoiding characterization, economic models replicate it. Some writers merely avoid the problem, as did the First Restatement. O'Hara and Ribstein largely put characterization in the background and develop rules for contracts, corporations, and marriage, without worrying much about explaining how to distinguish these concepts.[112] Whincop and Keyes deal with characterization on the level of definition.[113] A similar solution is to argue at such a high level of abstraction that application on the ground becomes detached—when the distinction is between transactions with third-party externalities and transactions without such externalities,[114] or when the focus is entirely on private law and we are asked to believe the claim that "most private law situations have few third party effects."[115]

If characterization is not assumed away, attempts are made at its simplification, but such attempts face the same problems as similar suggestions in doctrine. Some writers shift the boundaries between concepts—by rejecting the distinction between loss-allocating and conduct-regulating rules,[116] or by treating "market torts" like contracts.[117] This move does not abolish the need to distinguish categories; it merely changes the categories: now market torts must be distinguished from nonmarket torts. One may of course deny that this kind of distinction between market and nonmarket torts is a matter of characterization: "courts should focus on whether the parties have bargained with each other instead of asking whether a case involves a 'contract' or a 'tort.'"[118] But not only is this still characterization, as is admitted elsewhere;[119] it also leaves unaddressed the prior question, central to traditional doctrine, of why we should view market torts like contracts rather than like torts.

Indeed, not only the need for characterization remains; we can even recognize traditional modes of characterization replicated as economic approaches. The old debate whether the objects of characterization are facts or rules of law, now usually considered moot, is revived when O'Hara and Ribstein argue that "to maximize ex ante predictability, characterization should

111. WHINCOP & KEYES, *supra* note 5, at 6–7; O'Hara & Ribstein, *supra* note 8, at 1168, 1189–90.
112. O'Hara & Ribstein, *supra* note 8, at 1197–1221.
113. WHINCOP & KEYES, *supra* note 5, at 89.
114. Guzman, *supra* note 8, at 894.
115. WHINCOP & KEYES, *supra* note 5, at 4.
116. O'Hara & Ribstein, *supra* note 8, at 1179–80.
117. *Id*. at 1211; WHINCOP & KEYES, *supra* note 5, at 107–23.
118. O'Hara & Ribstein, *supra* note 8, at 1190.
119. *Id*. at 1221.

be based on facts rather than legal theory."[120] The same is true for the question of how to characterize. If Guzman assumes that the existence *vel non* of third-party externalities can be determined objectively,[121] this is equivalent to autonomous characterization according to objective criteria. If, for Trachtman, "the mandatory nature of a law is an indicator, and is perhaps the best evidence, that the law addressed externalities in the private sector,"[122] this is in essence a characterization *lege causae*—the applicable law determines its own categorization.[123]

Economists can, for some time at least, avoid the difficulty and messiness of characterization because of their affinity for models: something can be *assumed* to be a contract, a relationship with third-party effects, et cetera. But the clarity is a mirage. Once these models are applied to the real world, they provide no more guidance than do the doctrinal approaches they aim at replacing. As models, the proposals are pure and attractive; as doctrine they are no better, often strikingly similar, but far less differentiated than existing doctrinal approaches. Doctrine is replicated as economics, but its problems are not resolved by the translation.

C. Design: Rules or Standards?

A third question to ask is whether choice-of-law solutions should be formulated as specific, predictable rules (as in the First Restatement), or as open-ended standards or approaches (as in the Second Restatement). Since the general economic literature has not (yet) found common ground,[124] it is not surprising to find discrepancies among different analyses of choice of law. What is surprising is that these different positions on the rules-versus-standards question largely align with different models, although the arguments for or against rules or standards should normally apply similarly to transactions between individuals and transactions between states. Proponents of the private-law model by and large favor clear and rigid rules as a baseline for negotiations and as a means to decrease uncertainty as to litigation outcomes.[125] By contrast, Trachtman, as a proponent of the international-law model, points out the

120. O'Hara & Ribstein, *supra* note 8, at 1221; *see also id.* at 1190 ("[T]he applicable choice-of-law rule should turn on facts, which are harder for courts to manipulate than legal categories.").

121. *See* Guzman, *supra* note 8, at 894–95.

122. Trachtman, *Economic Analysis*, *supra* note 8, at 6.

123. For critical analysis, see Ernest G. Lorenzen, *The Qualification, Classification, or Characterization Problem in the Conflict of Laws*, 50 YALE L.J. 743 (1941).

124. *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE. L.J. 557 (1992). *But see* Jason Scott Johnston, *Bargaining Under Rules Versus Standards*, 11 J.L. ECON. & ORG. 256 (1995). For an overview, see Louis Kaplow, *General Standard of Rules*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS 631–60 (Bouckaert & De Geest eds., vol. 5, 2000), *available at* http://encyclo.findlaw.com/9000book.pdf.

125. O'Hara & Ribstein, *supra* note 8, at 1199, 1201 (contracts), 1217 (nonmarket torts), 1220–21; Schäfer & Lantermann, *supra* note 32, at 90–92; WHINCOP & KEYES, *supra* note 5, at 25, 36–37 (contracts). For extensive debate, see Rühl, *supra* note 8, at 831–40.

advantages of "muddy entitlements,"[126] that allow ad hoc adaptation in the individual case and may provide incentives to states to bargain more effectively over the exact allocation of jurisdiction.

This alignment is in accordance with traditional doctrine, in which private-law models like the First Restatement emphasize the need for predictable rules, whereas governmental-interest analyses prefer open standards. Unfortunately, the economic models make little use of experience with these approaches. The First Restatement was unsuccessful in large part because its rules turned out to be far less predictable than intended and because the costs from inflexibility turned out to be too great. Furthermore, if both models view the First Restatement as the only possible example for rules, they ignore both the far more-favorable experience with rules in Europe and the U.S. experience with, and proposals for, new, but better, rules.[127] In contrast, experience with governmental-interest analysis suggests issues that should be relevant for economic analysis, too: high transaction costs for negotiations among states leave muddy entitlements intact, which in turn lead to frequent forum preference and thus globally suboptimal outcomes. In short, existing economic analyses replicate the doctrinal debate, but with not much attention spent on experiences from that debate.[128]

IV

PRIVATE ORDERING AND PUBLIC LAW

This analysis so far has revealed that economic models, viewed as doctrine, lose much of their novel character. Furthermore, as doctrine, the economic models propose solutions that often appear strangely to disregard the complexities of the problems they set out to answer. However, one thing the economic analyses do make clear is that the choice of one or the other model has implications for results—not only in doctrine, but also in economic reasoning. Since the central difference between a private-law model and an international-law model is the role of private-versus-public determination of the applicable law, it seems worthwhile to focus on this in detail.

A. Private Choice and Mandatory Rules

Emphasis on party autonomy is sometimes promoted as a decisive contribution from economic analysis. This is a little exaggerated: party

126. Trachtman, *Economic Analysis*, *supra* note 8, at 45–46.

127. SYMEON SYMEONIDES, THE AMERICAN CHOICE-OF-LAW REVOLUTION: PAST, PRESENT AND FUTURE 425–37 (2006); William M. Richman, *Review Essay: A New Breed of Smart Empirically-Derived Conflicts Rules: Better Law Than "Better Law" in the Post-Tort-Reform Era*, 82 TUL. L. REV. 2181 (forthcoming 2008).

128. An exception is Rühl, *supra* note 8.

autonomy has long been accepted as a basis for choice of law in contracts.[129] One eminent conflicts scholar has voiced her surprise as to why law and economics even bothers to prove the efficiency of party autonomy.[130] And, indeed, the two limits to party autonomy that economists name—negative third-party externalities and information asymmetries—are mirrored in the traditional constraints to party autonomy regarding so-called internationally mandatory rules[131] and regarding specific kinds of contracts with structurally weaker parties: consumer contracts, employment contracts, and insurance contracts.[132] Differences are only those between rule and exception. For the private-law model, party determination of the applicable law should be a cornerstone of choice of law;[133] where neither third-party externalities nor information asymmetries exist between the parties, the parties should be permitted to choose the law that governs their relationship.[134] For the international-law model, objective determination of the applicable law is the rule, but "[i]f the governmental interest is reduced substantially enough, then a rule of party autonomy may be followed."[135]

Whether party autonomy should be the rule or the exception is not entirely unimportant. For example, the private-law model successfully suggests that we should enforce contractual choice more often. It does so by shifting our attention to the relatively unproblematic, bilateral relationship between two

129. *See* REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS (Rome I) art. 3, *available at* http://register.consilium.europa.eu/pdf/en/07/st03/st03691.en07.pdf; UCC § 1-105 (2001); RESTATEMENT (SECOND) OF CONFLICT OF LAW § 187 (1971); PETER NYGH, AUTONOMY IN INTERNATIONAL CONTRACTS 8–14 (1999); Mathias Reimann, *Savigny's Triumph*, 39 VA. J. INT'L L. 571 (1999); Rühl, *Party Autonomy*, *supra* note 79, at 155–58. For party autonomy in other areas of the law than contract, see Dorothee Einsele, *Rechtswahlfreiheit im Internationalen Privatrecht*, 60 RABELSZ 417 (1996); Jan von Hein, *Rechtswahlfreiheit im Internationalen Deliktsrecht*, 64 RABELSZ 595, 603–06 (2000); *see also* Peter Nygh, *The Reasonable Expectations of the Parties as a Guide to the Choice of Law in Contract and in Tort*, 251 RECUEIL DES COURS 269 (1995).

130. Muir Watt, *supra* note 8, at 688.

131. REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS (Rome I) art. 9, *available at* http://register.consilium.europa.eu/pdf/en/07/st03/st03691.en07.pdf. The term "mandatory rules" is unfamiliar in U.S. law, but the reasoning is essentially the same. Patrick J. Borchers, *Categorical Exceptions to Party Autonomy in Private International Law*, 82 TUL. L. REV. (forthcoming 2008).

132. Borchers, *supra* note 131.

133. WHINCOP & KEYES, *supra* note 5, at 5–6 and passim; O'Hara & Ribstein, *supra* note 8, at 1185. *See also* Kirchner, *supra* note 11; Schäfer & Lantermann, *supra* note 32, at 92. For a positive analysis of the rise of party autonomy, see Ribstein, *supra* note 43.

134. Erin A. O'Hara, *Economics, Public Choice, and the Perennial Conflict of Laws*, 90 GEO. L.J. 941, 943 (2002).

135. Trachtman, *Economic Analysis*, *supra* note 8, at 64; *see id.* at 20 ("Given this focus on governmental preferences, where such preferences are not implicated substantially, either as evidenced by the fact that the law at issue is merely facultative, or because the international setting so attenuates the governmental preferences, . . . it would seem appropriate to allow private parties to determine the governing law.").

rational actors,[136] and away from the messy problems of what is euphemistically called "third-party externalities," and which comprises everything that is problematic for choice of law for contracts. The international-law model in contrast, by focusing on policy conflicts between states, suggests that third-party externalities are usually implicated, so party autonomy retains a relatively small space.

However, these are not substantive differences. Such substantive differences emerge once more controversial issues are addressed. The challenging question is not whether parties can choose the applicable law in general, but whether they can, by so doing, avoid application of rules that would normally be mandatory. Traditional doctrine has developed relatively subtle (and somewhat unpredictable) criteria to distinguish norms that are *internally* mandatory (and that can be evaded through choice of another law) from norms that are *internationally* mandatory (and that apply even if the parties choose another law). Economists have fewer scruples about suggesting broad solutions. Here, the models differ significantly.

Proponents of a private-law model propose that such choice should be widely possible, except where a legislature explicitly provides for an internationally mandatory character.[137] Sometimes this is explained as a direct consequence of viewing party autonomy as a mere extension of freedom of contract.[138] Yet this would not explain why party autonomy, as a mere extension of freedom of contract, should supervene such rules that could not be avoided through mere freedom of contract.[139] The stronger argument is that such mandatory laws are to be avoided precisely *because* they are binding domestically: "If tort rules are mandatory on a domestic basis, choices of foreign law are the only way to contract on other, preferred terms."[140] From this perspective, there is no reason to confine party autonomy to contract law. Indeed, it has been proposed for other areas of private law like tort law,

136. For the complexity of even this relationship, see Fleur Johns, *Performing Party Autonomy*, 71 LAW & CONTEMP. PROBS. 243 (Summer 2008).

137. For this exception, see O'Hara & Ribstein, *supra* note 8, at 1184, 1199–1200; WHINCOP & KEYES, *supra* note 5, at 61.

138. *E.g.*, Richard A. Posner, *Foreword*, *in* WHINCOP & KEYES, *supra* note 5, at xiv, xv:

> [T]he choice of law to be applied to contract disputes should be regarded a s simply an extension of the parties' decision regarding what terms to include in their contract. Choice of law is just another term. If they specify a choice of law, it should be honored even if . . . the choice is to circumvent the mandatory rule of a jurisdiction the law of which would otherwise apply.

This is an extension of contract law only if contract law is about freedom of contract, not about its limits.

139. *See, e.g.*, Kramer, *supra* note 8, at 329 ("[P]roposing that parties should always be free to choose the law that governs their contract . . . would be tantamount to repealing the law of contract by enabling parties to opt out of any limitation not imposed by every state or nation in the world.").

140. WHINCOP & KEYES, *supra* note 5, at 78. *Cf.* O'Hara & Ribstein, *supra* note 8, at 1152, 1154–55.

regulatory law like securities law[141] or antitrust law,[142] and even noneconomic law like marriage, including same-sex marriage.[143] More importantly, perhaps, the argument is not necessarily confined to international transactions. The traditional distinction between different types of mandatory rules applies only to international cases; in purely domestic contracts, application of domestic law has nothing arbitrary, and consequently party autonomy is excluded.[144] But if, indeed, mandatory rules are presumably inefficient and party autonomy leads to efficient contracts and efficient laws, then there is no reason to reserve it to transnational actors. Individuals may suffer from inefficient laws in purely local transactions, too. This suggests that the freedom to choose the applicable law over mandatory domestic norms should be granted even in purely domestic contracts.[145] At this point, there is no difference between choice of law and general freedom of contract. What starts as choice of law ends up as a radical transformation and privatization of domestic law.

In contrast, proponents of an international model are quite opposed to parties' freedom to evade any mandatory rules through private choice of law. In such models, party autonomy is usually not even considered. Insofar as private international law is conceived of only as conflicts between states over the right to regulate a certain conduct, parties do not even enter the picture as relevant actors. (This matches the opposition to party autonomy in governmental analysis.)[146] In Joel Trachtman's words, "[T]he mandatory nature of a law is an indicator, and is perhaps the best evidence, that the law addressed externalities in the private sector."[147] As a consequence, domestically mandatory rules should be treated, prima facie, as internationally mandatory rules: "In fact, in circumstances of mandatory law, where we assume externalities domestically, it is appropriate to assume the existence of interstate externalities." Here, the

141. Stephen J. Choi & Andrew T. Guzman, *Portable Recognition: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES IN L. 387 (2001). For criticism, see Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999); Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?*, 95 MICH. L. REV. 2498 (1998); Merrit B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQUIRIES IN LAW 563 (2001); Horatia Muir Watt, *Choice of Law in Integrated and Interconnected Markets: A Matter of Political Economy*, 9 COLUM. J. EUR. L. 383 (2003).

142. Choi & Guzman, *supra* note 141; Guzman, *supra* note 8.

143. O'Hara & Ribstein, *supra* note 8, at 1209 (with an exception for noncontractual aspects like marriage subsidies and parenting rights, borrowed from F.H. Buckley & Larry Ribstein, *Calling a Truce in the Marriage Wars*, 2001 U. ILL. L. REV. 561, 598–99 (2001)).

144. REGULATION OF THE EUROPEAN PARLIAMENT AND THE COUNCIL ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS 15 (Dec. 15, 2005); RESTATEMENT (SECOND) OF CONFLICT OF LAW § 187 cmt. d (1971); Rühl, *Party Autonomy*, *supra* note 79, at 159–60.

145. Gerhard Wagner, *The Virtues of Diversity in European Private Law*, *in* THE NEED FOR A EUROPEAN CONTRACT LAW 3, 14–15 (Jan Smits ed., 2005); Rühl, *Party Autonomy*, *supra* note 79, at 179.

146. *See* CURRIE, SELECTED ESSAYS, *supra* note 63, at 732–33.

147. Trachtman, *Economic Analysis*, *supra* note 8, at 6.

opposite happens from what occurred in the private-law model: wherever domestically mandatory rules are in play, party autonomy no longer has a role. Party autonomy does not go beyond ordinary contractual freedom.

B. The Collapse Into Domestic Law

There is an extreme difference between giving the parties the ability to avoid all mandatory rules of domestic law and letting mandatory rules always trump. Given the importance of these strong normative claims, we should expect proponents of one or the other model to give considerable attention to the question of which model to choose. Yet what we find are largely ad hoc appeals to common sense.

Whincop and Keyes, for example, argue that "as befits a theory of *private* international law, we emphasise parties and party interests."[148] But why would private *international* law not equally suggest an international-law model? And what model would befit a discipline called *conflict of laws*? More importantly, why would private law be only about individual interests?[149] Why would its main function not be the restriction of private autonomy?

Joel Trachtman offers the opposite argument for the international-law model simply by using a different definition of private law. For him, "if choice of law and prescriptive jurisdiction is not about governmental preferences, then it is not about law, as law is the expression of governmental preferences."[150] Although, for the private-law model, all good law is private, for the international-law model, all law is public. The distinction between private law and public law is moot[151] and "must be replaced by a more subtle metric,"[152] which turns out to be between the state and the market; and because law is provided by the state as a public good,[153] all law is public law.[154] But even if all law is public law, why must it necessarily trump individual autonomy, especially in international transactions?

Not only are these questions unanswered; the exchange suggests that what lies at the heart of the differences between these models is nothing less than a debate about the role of law. That debate, important as it is, has little to do with private international law; it is a debate about substantive law. The tension between mandatory state norms and private ordering, well known as a central theme from private law, usually takes on a decisively different character once it is addressed as a problem of choice of law, as the difficult distinction between

148. WHINCOP & KEYES, *supra* note 5, at 4 (emphasis in original).

149. For different uses of private law, see Ralf Michaels & Nils Jansen, *Private Law Beyond the State? Europeanization, Globalization, Privatization*, 54 AM. J. COMP. L. 843, 846–53 (2006). For the idea that private law is about private interests, see id. at 847–48.

150. Trachtman, *Economic Analysis*, *supra* note 8, at 21, 77.

151. Trachtman, *Conflict of Laws*, *supra* note 8, at 1035.

152. Trachtman, *Economic Analysis*, *supra* note 8, at 5.

153. Trachtman, *Conflict of Laws*, *supra* note 8, at 1045.

154. Trachtman, *Economic Analysis*, *supra* note 8, at 21.

different kinds of mandatory rules shows. For most economic models, such difficult distinctions hardly exist. Instead, each of these two models simply extrapolates one side of the tension—the private side or the state side—and builds its entire choice-of-law approach on that side. For proponents of the private-law model, mandatory rules are generally bad: "The primary justification for mandatory rules may come from interest group effects or violations of standard economic assumptions."[155] The international-law model, in sharp contrast, simply assumes, "heroically," that mandatory rules represent common interests.[156] Public-choice problems with the creation of substantive law either are ignored (because it would be "immodest for prescriptive jurisdiction and choice of law rules to take this concern into account"[157]) or cannot be helped by choice of law.[158]

These assessments are, remarkably, as general as they are radical. The differentiated (if ultimately unsatisfactory) way in which the doctrine of choice of law distinguishes rules that are mandatory in the international sense from those that are mandatory in a purely domestic sense is lost. Even more amazingly, these assessments on the quality of mandatory rules are based almost entirely on assumptions.

These assumptions are crucial elements for each model. If a state legislator makes a norm mandatory, it may do so for various reasons. The legislator may consider the norm necessary to prevent third-party externalities it may consider the norm efficient between the parties, or it may aim at goals other than efficiency—paternalism, for example. If states are the players, as they are in the international-law model, then this determination is by definition rational. By contrast, if individuals are the players, as is the case in the private-law model, such norms are presumably inefficient because they cannot account for different individuals' heterogeneous preferences and because they are frequently the inefficient result of special-interest-group lobbying. In other words, for models to be internally coherent and consistent, it is important to externalize difficult questions from the research.

At the same time, these questions are relevant not specifically for choice of law but for domestic law. Whether mandatory rules are good or bad depends crucially on whether they represent considerations of general welfare or whether they merely represent the interests of special groups. This is a problem of public choice on the one hand and democratic legitimacy on the other. As such, it is obviously central to the legitimacy of law and extremely hard to answer in the abstract. But the argument, from the private-law model and the international-law model alike, that these questions cannot be answered from a

155. WHINCOP & KEYES, *supra* note 5, at 54.

156. Trachtman, *Economic Analysis*, *supra* note 8, at 16.

157. *Id.*

158. *Id.* ("[I]t would leave bad law in place when there are no cross-border connections, and eviscerate good law when there are cross-border connections.").

choice-of-law perspective, seems disingenuous if the entire models rely on them. The opposite seems true: the respective models are responses, albeit quite radical and crude ones, to precisely this question.

It does not seem to be too much of a stretch to say that the private-law model of choice of law is not only an extension of substantive private law,[159] but that it also represents a position within debates on substantive law. Choice of law and, especially, party autonomy are used primarily not just to determine the most appropriate law but as a way to circumvent undue restrictions on freedom of contract stemming from mandatory law.[160] Traditionally, the limits to the creation of mandatory law have been the domain not of choice of law but of the political process. Now party autonomy is established as an equivalent substitute for democratic determination of the applicable law—not as a theoretical and rhetorical trope but as a concrete reality.[161] Yet party determination of the applicable law in purely domestic contracts is hardly an issue of choice of law; it is an issue of the relationship between the state and the private. Governance becomes entirely private governance; states are no more than inconvenient obstacles to be circumvented.

The opposite move can be seen in the international-law model. Tellingly, this model views choice of law as a mere subset of international law, and questions of the conflict between laws are not essentially different from conflicts between different policies more generally. For Trachtman, "the problems of choice of law and prescriptive jurisdiction . . . address the problem of the horizontal scope of state power."[162] The vertical scope of state power over individuals is ignored. In an international-law model in which states are viewed as unitary actors, the problem of inefficient domestic rules cannot exist because those disadvantaged by such norms, private parties, are simply absent from the analysis, or rather, their interests are subsumed into those of states. As a consequence, wherever policies exist, actors are by definition prevented from opting out of them. The political idea behind this, even if not spelled out explicitly, is one of global governance as exclusively public governance, a cartel of states that allocate jurisdiction among themselves, but collectively protect themselves against manipulation by individuals.

159. *See* text accompanying note 138.

160. For their own mistrust in mandatory rules, see WHINCOP & KEYES, *supra* note 5, at 52–68. Elsewhere, WHINCOP & KEYES argue that "[p]arty autonomy is not desirable simply for liberal reasons, but because it provides an opportunity to limit the consequences of rules that are sometimes wrong." It is hard to see how the reason they name—the preference of private ordering over public regulation—is not "simply liberal." *Id.* at 187. *See also id.* at 9 ("[T]o permit parties to make the choice . . . is not only likely to result in economically efficient outcomes, but in more liberal ones."); Posner, *supra* note 138, at xv ("The party-centered approach corresponds to the emphasis in economics on the free market."). For criticism, see Richardson, *supra* note 5, at 200–01.

161. *Cf.* Florian Rödl, *Private Law Beyond Democracy? On the Legitimacy of Private Law "Beyond the State*,",56 AM. J. COMP. L. Part III (forthcoming 2008).

162. Trachtman, *Economic Analysis*, *supra* note 8, at 4.

C. Between and Beyond Private and International

Despite their differences, both models thus share one important characteristic: they ultimately dispense of choice of law. The private-law model of choice of law has been shown to be merely a model of private law proper; the international-law model of choice of law is merely a model of international law proper. The private-law model disregards the international aspect, and the international-law model disregards the private aspect of private international law. If these two are the only available options, then private international law must be either private law or international law, for it cannot be both. What is more, the decision as to which it is depends in part on one's general ideology (preference for the state or for the individual), in part on one's general idea of law (private law is purely private law, or private law is public law), but not on any conviction specific to private international law. And how could it, if there *is* nothing specific to private international law?

This would be an implausible outcome. At least since Joseph Story established Private International Law as a subfield of international law, distinct from both public international law and domestic private law alike,[163] private international law has existed in tension between private law on the one hand and international law on the other. It seems implausible, to say the least, that all of this was just the fruit of muddled thinking. It seems implausible that all the subtle middle positions the field takes in, so many disputes—between forum preference and universalism, between party autonomy and mandatory rules, between substantive justice and conflicts justice—are merely errors of the mind. If economic models must dispense with such middle positions in order to function, the mistake may lie less with the field under research and more with the economic models.

This makes the combined models more attractive. Indeed, Guzman, for example, realizes the problems with the assumptions of both the private- and the international-law model. Unfortunately, his solution is simply to defer public-choice issues to the realm of empirical facts (with which he is not concerned).[164] Guzman's own approach to party autonomy accords, in principle, with the international-law model: party autonomy has its place only when no third-party externalities exist. Where he disagrees with Trachtman is merely in the largely empirical questions whether such externalities arise or not in certain areas like securities law. Consequently, the impact of choice of law on substantive law is here largely delegated to objective determinations of applicable law. Choice-of-law rules should be designed so as to not give incentives to states to pass laws with considerable externalities.

163. STORY, *supra* note 26, § 9, 13; *cf.* Ralf Michaels, *Public and Private International Law: German Views on Global Issues*, 4 J. PRIV. INT'L L. 121, 127–28 (2008).

164. Guzman, *supra* note 8, at 903–04.

Guzman's model, which focuses on objective determination of applicable law, is supplemented more than contrasted with the literature on regulatory competition. This literature looks at party autonomy precisely as an instrument to force states to abolish inefficient laws that hold them back in the competition for choice of their laws. Of course, the exact impact that party autonomy has on inefficient laws is quite unclear. In many areas, there will likely be no impact at all, because choice-of-law cases are rare. Where there is an impact, it is not always clear whether it is positive or negative. Party autonomy may lead to more-efficient domestic laws, because it forces states to compete over which produces the most attractive rules. The exact opposite may be true as well: party autonomy leads to *less* effective rules if many of the parties disadvantaged by them will, rather than lobby for their abolition, simply opt out of them, and domestic lobbies are not strong enough to change them domestically. The combination of these two effects provides a plausible explanation why states confine the application of certain rules to domestic contracts, or why some countries, in particular socialist countries, have altogether different rules for international transactions than for domestic ones.

More importantly, not only is it difficult to assess whether a specific mandatory rule is desirable or not, it is also not clear from the outset whether individuals or states can better assess this question. This is so even in a domestic context. It is true even more in an international context, where different states have different rules and therefore presumably different views on the desirability of those rules. The focus on only party autonomy does not grasp the full extent of this problem because it merely replicates the simple domestic public–private tension on the international sphere. But there is not only one public in the international sphere. The international tension is much complicated by the partial overlap and partial tension among different state laws and therefore different views of the public. The opposite of private ordering is not merely public ordering but decentralized, multiple public ordering. A fully combined model will establish a complex combination of the relation between party autonomy and mandatory rules *and* carefully calibrated criteria to determine which state provides these mandatory rules in the first place.

The huge (though largely untapped) potential of both the combined models and the regulatory competition literature lies in the fact that they explicitly address the question that the other approaches simply bracket: the combination between the economics of domestic lawmaking (private and public) and the economics of choice of law (private and public). This is a combination that traditional doctrine has not yet addressed adequately and one in which economics can make a true contribution. So far, much of that contribution has been confined to regulatory competition through party autonomy and the question whether this is a good or a bad thing. A proper analysis, by contrast, would ask not whether it is good or bad in the abstract, but whether private or public determination of the applicable law is superior regarding the specific issue in mind, and what regulatory consequences different public

determinations would have. Choice of law, in this vision, will neither fully yield to a market for laws (as the private-law model would have it), nor will it fully replace a market of laws (as the international-law model would have it). Instead, it will become the venue in which global governance takes place in an ever-altering complex mediation between private and public interests.

V

CONCLUSION: CHOICE OF LAW DISCOVERS ECONOMICS

If the analysis presented in this article is correct, then the economic analysis of choice of law has not fulfilled the hopes. The pragmatism it provides has proven to be laden with ideology. Its empirical foundations are mixed with strong and often counterintuitive assumptions. Economics has provided choice of law with theoretical foundation, but instead of one it has offered three such theories—two of which turned out to be mere emanations from other fields. Economics is able to give clear guidelines for problems once a model is chosen, but it cannot give clear guidelines as to which model should be chosen, and the clear guidelines it can give for specific cases rest on a high degree of abstraction. And nonetheless (or better: precisely for these reasons), economics makes hugely important contributions to the field of choice of law.

A first finding is that the economic analyses that have been proposed so far are riddled with the same problems as many normative economic analyses. Abstraction leads to false necessities and circular reasoning, sweeping normative suggestions are built on shaky models, ad hoc appeals to plausibility replace rigorous analysis, more or less plausible assumptions substitute for empirical data, problems are defined away, and abstract general statements are inapplicable in the real world. This critique is not unimportant, but it is relatively uninteresting. It does not capture what is peculiar to the economic analysis of choice of law; similar problems riddle economic analysis more generally, and more careful economists have long accepted and responded to such critiques. If some of the existing economic models are too abstract, or the conclusions too sweeping, perhaps all that is needed are better analyses within these models in order to provide solutions to our doctrinal problems. Moreover, as long as different models compete and lead to different outcomes, any false claim to objectivity is easily refuted.

A second finding concerns the existence of these different models and the results they lead to. Quite remarkably, once the economic models are translated into doctrines, they look similar to existing doctrines—they reach the same results, and they face the same problems. Economic models repeat approaches that are known from doctrine and therefore replicate the outcomes of these old models. The discourse within the models uses the language of economics (though rarely in a purely formalized way), but this language looks to a large extent like a mere translation of familiar doctrinal structures.

This is an important finding because it strips the economic models of both their otherness and their alleged novelty, and because it suggests that, if economic analysts replicate the problems of choice of law, these problems are stickier than previously thought. However, this critique is likewise somewhat facile. Stripping economic models of their economics must necessarily leave them wanting. It is its otherness, not its familiarity, that makes the economic language interesting and potentially enriching to doctrinal models. The charm of the private-law model and the international-law model lies in the way in which they radically disentangle the private and the international aspect of choice of law and then drive them to extremes within their models. Although neither model is successful as a complete theory of choice of law, viewed together they show how radical the tension is that riddles our discipline, how radical its outcomes would be if only one of the two aspects ruled, and how improbable and at the same time fascinating it is that the discipline can keep the two aspects together.

This leaves a third finding that concerns especially the combined model, and this finding does provide something new. The combined models do focus our attention on something that traditional choice-of-law doctrine has largely ignored: the potential impact of choice-of-law rules on the substance of domestic laws. Notably, these models rarely produce specific rules of choice of law. Guzman's model operates at such a high degree of abstraction as to make specific application almost impossible. Also, the distinction between a private-law model and an international-law model is repeated within these combined models, in which one focuses on the optimal allocation of jurisdiction and the other focuses on the salutary impact of party autonomy. But such irremediable differences, although they may be perceived as embarrassing to those seeking clear answers, are immensely helpful. They suggest that choice of law is an additional element of global governance beyond those of private ordering and international relations, and, in combining those two, perhaps even the most important one.

If the economic models fail, both in combination and individually, to provide convincing responses to pressing problems of choice of law, this is not for lack of trying. The ultimate inability of economics to provide a convincing theory of choice of law suggests that, strange as this may sound, such a theory may be best sought within the practice and doctrine of choice of law. The impossibility of translating all problems of choice of law into economics (despite, or perhaps because of, the immense relevance of economics for choice of law) suggests the need for an understanding of choice of law that both highlights and downplays economic constraints and political determination. In the end, it appears that in all the apparent messiness, there is an intrinsic and apparently relatively stable inherent rationality to private international law. Economic models partly fail to grasp this rationality, and then what they grasp often fails to be of relevance. Or economic models replicate this rationality, but

then look inferior to the doctrinal models on which they build. Ultimately, it is up to choice of law as law to solve the problems of conflicting laws.

Choice of law is not economics of law, just as law is not economics. Choice of law is dependent on economics, and it can benefit from economic reasoning. But, ultimately, the economic model cannot replace the need to find proper solutions in the real world. Perhaps economists have felt for a long time that the problems of choice of law are simply too complex, too messy, and based on too many variables to enable holistic attempts at achieving the economic optimum. The doctrine is fortunate that analysts have overcome these concerns and have presented their models. But what it takes away from these models is that, in the end, it will be up to the law, not to another field, to deal with them.