Choice-of-Law in the Internet Age–US and European Rules

Abstract: With use of the Internet, a new form of contract has appeared: the electronic contract, which is concluded online. Most of these involve a relationship of two parties: a consumer who is in a relatively vulnerable position, and a business entity. There are numerous examples of such transactions: youngsters downloading music from a website and paying for it–as they would in a music store. Many physical goods can also be purchased online–e.g. even though they live in Europe, the authors of this article regularly purchase books from the US. There are numerous ways such transactions can take place: one of the most obvious ways is buying goods on Amazon or eBay, on the website of a company, or purchasing goods using e-mail communication. The article attempts to summarize the choice of law rules affecting electronic contracts in the US and in Europe–i.e. to give an overview of which country’s or state’s law would apply to a contract concluded online, what the limits are on such a transaction and which state’s laws can protect us in case of a breach.

Keywords: Private international law, internet law, choice-of-law, electronic contracts, consumer sales, Rome I. Regulation, U.C.C., Restatement (Second) of the conflict of laws

I. Introduction

With widespread usage of the Internet, a special field of private international law has emerged (hereinafter referred to as: “PIL” or, using its US name, “conflict-of-laws”), growing strongly over the last decade: the law of electronic contracts. Consumers conclude contracts through the Internet in developed countries every day: they buy goods, reserve hotel rooms and other services, download paid music from websites, etc. In such transactions, choice-of-law clauses are used regularly. Reviewing the latest developments, we discover numerous cases and statutes in the United States dealing with this topic, with a similar situation in the European Union.

In this area of private international law, we believe that both Europe and the US have a lot to learn from each other. In general, the US leads with proactive thinking in applying new technologies and in reflecting the latest developments in the world. On the other hand, Europe has a tradition–continuously eroding, but still existing–of making clear rules with the public can become relatively easily acquainted. Furthermore, consumer law is traditionally at the centre of EU commercial law and additionally, there is currently an ongoing wave of consumer legislation activity. A new law for consumer contracts was adopted

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at the end of 2011,\(^1\) and a separate proposal was also made for a common European sales law,\(^2\) all indicative of the continued importance of the field.

In this paper we wish to focus on the rules of e-sales and not on provisions related to other contract types. We will be dealing with the laws of consumer contracts; laws governing other kinds of private contract may contain different provisions. Importantly, we will only deal with the problem of applicable law, and will not discuss substantive law, jurisdiction and other related issues.

II. The parties’ choice of law

1. General rules

The question of which law to apply to a contract has an elementary effect on remedies for any breach, since there are enormous differences between the Anglo-Saxon and European continental legal approaches affecting contracts.\(^3\) On the other hand, with the unification efforts of the EU, some parts of the problem in Europe appear to have been resolved. As with substantive law, we rarely find specific, written rules targeted at electronic consumer contracts—in this regard the US and the EU systems are similar. Thus we must consider the general landscape of consumer law and contract law. Equally for applicable law, we need to have a broad view of the general rules in order to consider special cases.

Reviewing the laws applicable to contracts, we discover only small differences between US and EU rules: on both sides of the Atlantic Ocean, the law chosen by the parties must by default be applied to an e-sales contract. In the US, the Second Restatement on conflict-of-laws\(^4\) expresses this idea, and even though it is not a law with binding force, the approach is followed by all states. Article § 187 of the Restatement states the following:

“(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not


\(^{4}\) Restatement (Second) of Conflict of Laws § 187 (1)–(2) (1971).
have resolved by an explicit provision in their agreement directed to that issue, unless either
(a) The chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties choice, or
(b) Application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.
(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen law.”

We find similar provisions in the Uniform Commercial Code (hereinafter referred to as: “U.C.C.”). The U.C.C. cannot be considered a black letter law since it was published as a uniform model act by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). However, since it is built into each state’s law and is applied similarly throughout the US, it has a key role in US sales law. U.C.C. § 1–301 2003 asserts the following:

“Territorial Applicability; Parties’ Power to Choose Applicable Law
(a) Except as otherwise provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties.
(b) In the absence of an agreement effective under subsection (a), and except as provided in subsection (c), [the Uniform Commercial Code] applies to transactions bearing an appropriate relation to this state.
(c) If one of the following provisions of [the Uniform Commercial Code] specifies the applicable law that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:
   (1) Section 2-402
   (2) Sections 2A-105 and 2A-106
   (3) Section 4-102
   (4) Section 4A-507
   (5) Section 5-116
   [6] Section 6-103
   (7) Section 8-110
   (8) Sections 9-301 through 9-307.”

In Europe, Art. 3(2) of the Rome I Regulation on the law applicable to contracts (hereinafter referred to as: “Rome I Regulation” or “Rome I”) grants the parties the right

to make such a choice. The regulation or, to be more precise, Art 6 thereof clearly expresses that the parties may choose the law applicable to a contract.

2. Limitations of choice

In all legal systems, the parties’ choice of law for a contract, and especially for a consumer contract has limitations. Firstly, in the US, the law chosen must have a substantial relationship with the contract. In Europe—in our personal opinion—this is not a requirement.

Secondly, in all jurisdictions including Europe and the US, the application of a law can be rejected if it is in conflict with some important provisions that the forum has to validate. Two types of such rules can be distinguished. Above all other issues, the public policy of the forum may contain such important rules. Art. 9(2) and (3) of Rome I states that nothing in the regulation shall restrict the application of the overriding mandatory provisions of the law of the forum. According to the legal literature, is a reference to the most essential, imperative laws of a country, for example laws protecting consumers and employees. Along with these rules, the overriding mandatory provisions of the law of the country may also be give effect where the obligations arising out of the contract have to be or have been performed, when those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to such provisions, regard shall be

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had to their nature and purpose and to the consequences of their application or non-application.

Moreover, in certain instances, the law of the consumers’ habitual residence also has relevance. In Europe, the rule is expressly stated in Rome I: according to Art. 6(2), the parties may not “lower” the level of consumer protection the consumer would have in the absence of such a choice.10 There’s a similar problem with EU consumer law: its provisions cannot be overridden by the choice of the parties.11 In the US, the situation is more complicated. According to § 187(2)(b) of Restatement (second) of conflict of laws, the law chosen by the parties cannot be applied in case the “[…] application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which […] would be the state of the applicable law in the absence of an effective choice of law by the parties.” We can see that the status of the law which would protect the consumer in the absence of a choice by the parties is governed as a public policy issue. Moreover—surprisingly and strangely for Europeans—the state interest consideration has to be applied to ascertain whether the state has a greater interest in order for the provisions to apply. It is also important to emphasize that in Europe, the only substantive provisions that may be set aside are those that would harm the consumer. In sharp contrast with this, in the US the whole choice becomes invalid. However, since in most cases the results will be the same this is only a theoretical difference.12

It can be ascertained that “[…] the American courts have been inconsistent in protecting consumers by enforcing the laws of their home states”.13 In several cases, fundamental public policy was recognized by the court of a foreign jurisdiction. In most cases, the law of the consumer’s habitual residence either precludes any choice of law or prohibits waivers under the substantive rules.14 In certain cases, however, contrary to the general rule, courts have ruled otherwise.15

Beyond the above, it is important to mention that an earlier version of the U.C.C. in its § 1–301 also contained provisions for some time the provided protection for consumers in a similar way to how it is done in Europe. In 2001, the U.C.C. was amended, but since the states—except for the Virgin Islands—did not promulgate the amendment, the NCCUSL later (in 2007) reverted to the previous legislation.16 According to the 2001 revision, in general, parties would have had more freedom to choose a law, even one with no connection to a contract. However, this did not apply to consumer contracts, where the requirement for a

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10 Article 6(2) Rome I Regulation.

“Such a choice may not, however, have the result of depriving the consumer of the protection afforded to him by provisions that cannot be derogated from by agreement by virtue of the law which, in the absence of choice, would have been applicable […]”

cf. Healy: op. cit. at 536 et seq.

11 Numerous provisions on this issue can be found in consumer law directives. Therefore we only cover their main goal here without deeper analysis.

12 Rühl: op. cit. at 170.

13 See Healy: op. cit. at 536 et seq.

14 Rühl: op. cit. at 169.

15 For such cases see Healy: op. cit.

reasonable relation remained. Yet consumers were also expressly protected, since the
chosen law was not allowed to vary legislation of the state or country in which the consumer
resided. As already mentioned, this legislation was not well received and was revoked in
2007.

3. Special rule for software

Beside the Second Restatement and the U.C.C., we must also consider the rules of the
Uniform Information Transaction Act (UCITA). The National Conference of Commissioners
on Uniform State Laws (NCCUSL) voted to approve the Uniform Information Transaction
Act (UCITA) on July 29, 1999. The Act was intended to become a modification, a new
Article 2B of the U.C.C. At an early stage, the American Law Institute also supported this
work but eventually, the document was adopted solely by NCCUSL. The Act created special
rules for software licenses and transactions. By the time of writing, it has only been adopted
by two states, Maryland and Virginia. In 2003, following harsh criticism, the NCCUSL
withdraw UCITA from consideration for endorsement by the American Bar Association.
Please note that the provisions of UCITA were generally made for software licenses but its
scope also covers the sale of software. In a mixed transaction, where computer software and
physical goods (e.g. a computer) are sold together, UCITA may be only applied to the
software part of the transaction unless the primary subject matter is the sale or licensing of
software. Regarding choice of a law, UCITA § 109 states that “the parties in their
agreement may choose the applicable law. However, the choice is not enforceable in a
consumer contract to the extent it would vary a rule that may not be varied by agreement
under the law of the jurisdiction whose law would apply […] in the absence of the
agreement.”

19 The original text as adopted in 1999 available at http://www.law.upenn.edu/bll/archives/ulc/
20 On the other hand, more than a dozen states have introduced versions of UCITA, but they
21 “Writing a law which makes it almost impossible to sue software publishers for defects is a
poor way to manage the escalating level of software customer dissatisfaction with bad software and
III. The law applicable in the absence of a choice

1. Europe

In the EU, in the absence of any choice of law made by the parties, Art. 4(1)(a) Rome I Regulation, in theory dictates that the law of the habitual residence of the seller should be applied. However, this does not hold in our case, since in order to protect the consumer, Art. 6(1) Rome I Regulation reverses the rule for consumer contracts: in such cases, the habitual residence of the consumer must be applied. Though a condition for this rule is that the professional (the business entity) must conduct activity in the country of the consumer.

The law applicable to contracts for downloading software, music and films over the Internet is generally the law of the country where the consumer has his or her habitual residence, provided that is the location of the download process and that the site presents a request to conclude a contract. A passive website through which concluding a contract is not possible, cannot be considered to be activity in that country. The situation is similar with respect to third states (non-MSs). If a company from a third state maintains a website and contracts can be concluded through the website, the habitual residence of the consumer will likely have relevance. If someone concludes a consumer contract with a New York based company and buys goods from New York via the Internet, the contract may be a consumer contract according to Art. 6 of Rome I, and the general rules of the Regulation—which would lead us to the law of the seat of the company, i.e. to New York law—cannot be applied. Of course, in order to reach this conclusion, the term “directed activity” has to be interpreted, taking into consideration all circumstances of the case (the targeted activity test). In the test, anything may have relevance: the offer on the website, shipping conditions, the e-mails the parties sent each other, etc. A good question is what should happen if the website is passive, but the consumer writes an email to the company in order to purchase something. In this case too, all circumstances of the sale may have relevance: the advertisements on the company’s website offering worldwide delivery, where the contract was concluded, where the parties were based, where the computer was, where the goods were to be delivered, where payment took place, the place of breach, etc. The application of this test merits some criticism, since some vagueness remains in most of the cases after reviewing the circumstances.

23 “[…] a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence”.
24 For the scope of protection see Tang: op. cit. 213–229.
29 Callies: op. cit. at 124–155.
31 Gillies: Electronic Commerce, op. cit. 141.
2. USA

Contrary to the European solution, where there are unified rules, the situation in the US is far more challenging. Even though the parties’ right to the choice of law is granted by all states, the other rules of the Restatement (second) of conflict-of-laws is respected only by approximately half of them (23 jurisdictions). The other states employ different approaches: this is one of the reasons why American choice-of-law rules seem quite chaotic for Europeans. Among these approaches we may find the following main principles as well as combinations thereof:

- The classic “place of contracting” principle (12 states take this approach)
- Centre of gravity test (significant contact approach, used by four states and Puerto Rico)
- Better law approach
- Governmental interest approach (applied, e.g. in California)
- Law of the forum
- Place of performance
- Purpose of the agreement

§ 188 of the Second Restatement uses the following choice-of-law principles:

- The law of the state/country that has the most significant relationship to the transaction and the parties. Under this principle, factors considered are the place of contracting, negotiations and performance, the location of the subject matter of the

33 Hay–Borchers–Symeonides: Conflict of Laws, op. cit. at 1159 et seq.
34 Ibid. at 1175 et seq.
35 The court “must search to find the proper law to apply based upon the interests of the litigants and the involved states”. Reich and Purcell, 67 Cal. 2d 551, 553, 63 Cal. Rptr. 31. 33 (1967)
36 Hay–Borchers–Symeonides: Conflict of Laws, op. cit. at 1164 et seq.
37 Restatement (Second) of Conflict of Laws § 188 (1971)

“(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:
(a) The place of contracting,
(b) The place of negotiation of the contract,
(c) The place of performance,
(d) The location of the subject matter of the contract, and
(e) The domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189–199 and 203.”
contract, and the domicile, residence, nationality, place of incorporation and place of business of the parties.

– The place of negotiations and the place of performance, if they fall in the same state.

Clearly, for international e-commerce transactions this principle is not applicable.

By comparison, the U.C.C. states in its § 1–301(b) that “in the absence of an agreement […] the Uniform Commercial Code applies to transactions bearing an appropriate relation to this state”. The term ‘appropriate relation’ is not defined in the U.C.C. However, it “should be interpreted to mean the ‘most significant relationship’; the term should not be regarded as merely inviting the courts to apply their non-UCC rules”. 38 In this sense, it is similar to Restatement the second.

Surprisingly for European scholars, we do not find specific rules for consumer or e-consumer contracts. In this regard two circumstances may have significance. In certain cases, American courts employ the “public policy trick” to apply the laws of the consumer’s habitual residence. 39 There is also relevant new case law: the court in Boudreau v. Scitex Corp. 40 held that because the e-mails and other communications concerning the contract were received in Massachusetts, the law of that state should be applied. Such case law can be rooted in the legal thinking of an old landmark case, the Chinese hair case, in which a New York based buyer and a Chinese seller concluded a sales contract. The exact location where the parties concluded the contract could not be identified. In that case, because the place of performance was New York, the court applied NY law. 41 However, in other cases it was emphasized that the place of performance (i.e. of delivery) cannot alone constitute a connection to apply the law of the state in which it took place.

Summarizing the above, we may ascertain that if the place of performance and the consumer’s residence are in the same state as in most e-commerce transactions, we may assume that the law of the consumer’s habitual residence will be applied, just like in Europe. However, as in Europe, in an e-contract all circumstances may have relevance. In the US, protection is granted with reference to public policy.

IV. Some other relevant provisions–territorial limits in the US and the country of origin principle in the EU law

1. Territorial limitations in the US

Besides choice-of-law rules, there are some very important provisions that may also have an effect on the law to be applied. A good example can be found in New York State law. 42 Here, the courts held in several instances that the New York General Business Law (G.B.L.),

39 Rühl: Party autonomy…, op. cit. at 169.
42 A well-structured compendium of New York consumer law cases collected by Justice Thomas A. Dickerson (Associate Justice of the Appellate Division, Second Department of the New York State Supreme Court) available on the internet year to year. For the last year (2011) see http://www.nysba.org/Content/NavigationMenu21/CommitteePages/ClassAction/CONSUMERLAW2011.pdf (February 1, 2012)
which contains some important provisions for consumers, prescribes in §349 that the transaction in which the consumer is deceived must occur in New York. “Following this latest interpretation of ‘territorial reach’ by G.B.L. § 349, the court in Truschel v. Juno Online Services, Inc., a consumer class action suit alleging misrepresentations by a New York based internet service provider, dismissed the G.B.L. § 349 claim because the named representative entered into the internet contract in Arizona. Notwithstanding the […] territorial limitation, the Court in Peck v. AT&T Corp, consumer class action involving cell phone service which improperly credited calls causing (the class) to lose the benefit of weekday minutes included in their calling plans, approved a proposed settlement on behalf of residents in New York, New Jersey and Connecticut.” It was emphasized that “it would be a waste of judicial resources to require a different class action in each state […] where the defendants have marketed their plans on a regional [basis]).

2. The country of origin principle in Europe

In the EU as well, there is a serious problem with electronic contracting, involving the country-of-origin principle used in the directive on electronic contracting (hereinafter referred to as: “Directive”). According Art 3 of the Directive,

“1. Each Member State shall ensure that the information society services provided by a service provider established on its territory comply with the national provisions applicable in the Member State in question which fall within the coordinated field.
2. Member States may not, for reasons falling within the coordinated field, restrict the freedom to provide information society services from another Member State.”

This complicated text in practice means that the service provider “brings” its laws to another state, and may have the same benefits as domestically. Consequently, in a case where a corporate website (The Sunday Mirror) caused harm by releasing news about singer Kylie Minogue, the European Court of Justice held that compensation to be paid cannot be higher than in the state where the website is based (in practice, where the

Thus, even if compensation awarded abroad were higher and thus the provider’s obligations were greater, laws of the website’s “homeland” have to be applied—overwriting classic rules of collision.

However, the Directive has some “hidden” provisions for contracts in its Annex, which state that Arts 3(3), 3(1) and 3(2) do not apply to “the freedom of the parties to choose the law applicable to their contract” and to “contractual obligations concerning consumer contacts”. As a result, in our case we do not have to take into consideration the Directive’s provisions regarding applicable law. If these provisions were not included, we would have to apply the seller’s law to the contract, and not that of the consumer.

IV. Conclusions

The system of remedies is significantly different in Europe than in the US. Consequently, in a legal dispute, the question of which law should be applied follows right after the procedural issues not covered by this article (e.g. in which state to sue, or how to enforce a judgment). It is clear that sometimes it may be beneficial for consumers to force the court to apply the law of their habitual residence in order to achieve a successful suit. As we have seen, this is possible in most cases, irrespective of habitual residence or nationality. In this regard the US jurisdiction appears less stable than the European one, but its basic approach is similar in most instances.

46 Joined cases C-509/09 and C-161/10. Judgment of the Court (Grand Chamber) of 25 October 2011. eDate Advertising GmbH v X (C-509/09) and Olivier Martinez and Robert Martinez v MGN Limited (C-161/10), not published yet in the ECR.