

American Enterprise Institute

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[Edited transcript from audio tapes]

3:45 p.m. Registration

4:00 Introduction: Michael S. Greve, AEI

Presenters: Erin A. O'Hara, Vanderbilt University Law School
Larry E. Ribstein, University of Illinois College of Law

Discussant: Max Stearns, University of Maryland School of Law

5:15 Adjournment

Proceedings:

MICHAEL GREVE: ... These are very, very complicated, messy, and messed up legal doctrines. Erin and Larry have made a major contribution, in my estimation, to that broader enterprise. And I can't wait to hear what Larry has to say, and Max's comments.

LARRY RIBSTEIN: I'm very glad to be here, and thanks for the invitation. Erin is sorry that she couldn't make it. I'll try to fill in for her. Actually, she and I decided to do this book together partly because we have different views to some extent on the subject. Not diametrically opposite by any means but, I guess you could say that I'm more hardcore free-market than Erin is, a little bit, and I sometimes find it hard to even understand what the non-free-market position is. So Erin has explained this to me a little bit. So occasionally I will speak in a falsetto to let you know that Erin is now speaking. (Laughter.) But you can probably – I was telling Michael before this thing started that, if you read this book carefully and you knew both of us, you could say, "Now, it's Erin speaking," in the book. But it was very much a joint effort.

So, I think you all are familiar with what I call the joys of federalism here: competition among the states, a variety of state views, the opportunity to experiment without knowing exactly what you're going to get from the experiment – which is a good thing, because it's an uncertain world and we don't know what the answers are. So these are the good

things about federalism. However, federalism has some problems. So I've listed these as some discontents. Some people are concerned that the little state of Delaware is regulating important aspects of corporations that are multi-state and multinational. From the firm's standpoint, if it's not Delaware regulating these states, then they have to deal with 51 or 54 or however you want to count, states, multiplies their problems enormously, makes some kinds of business very hard to transact that would otherwise be easy. Chapter 3 of our book talks about why there's no easy solution to these problems in terms of choice of law rules. You might think there's some Constitutional way to solve the problem but there aren't – there isn't – it's very hard to get federal substantive solutions. It's very hard for the federal courts to deal with these problems under modern – under current rules. So, we're left with a situation where, to some extent, the states inevitably are going to impose their regulation as much as – impose their separate regulations – as much as firms try to get it all centralized in one state or even in the federal government. And what that means – almost inevitably – is that regulatory costs are going to get imposed outside the states while in-state interest groups realize all the regulatory benefits. So that's the problem. And – but – there's a solution here, right? To get rid of these messy things called "states." And we put it all on the federal government, and we get wonderful products from that – like Sarbanes-Oxley. And I could talk at length about that, but I think it's a good example about what you get when you don't really have any competition going on, and you're not worried that firms are going to leave easily, you get Sarbanes-Oxley. And then a lot of people talk about uniform state law solutions, but uniform state law solutions are not uniform and they're not a solution, and they're not – and to the extent that they do solve some of the problems, they just get rid of federalism, so that's obviously not a way to solve the problems of federalism – it's killing the baby, too. So we have a better way, which is the law market. We're dealing with contracts here. We're trying to solve some of these discontents of federalism with contractual solutions. We get rid of the messy 51 or 54 states – you only have one law; it's the law you contract for. But the states compete with each other to provide that law, and they experiment. But you never know where that experiment is going to lead, and they provide a variety of possible solutions. So it's all the things we like about federalism without any of the problems. So this is perfect. Okay. (Laughter.) This is where I would stop.

MICHAEL GREVE: End of talk. (Laughter.)

LARRY RIBSTEIN: So the rest of this is Erin. But before we get to that, you might say – this is totally pie in the sky, in other words, why would states enforce these contracts which basically call on them to defer to other states? Remember, one of the problems with state solutions is that they're realizing regulatory benefits but imposing regulatory costs elsewhere. Which is a great deal for the states and for state lawmakers, so why would they get out of that deal? It seems like the perfect solution for them. And the answer is, basically because their power to do this stops at their borders. They can't

regulate stuff that goes on completely outside their borders. Parties have all kinds of other contracts that they can enter into – this is covered in chapter 4 of the book. They can contract for forum. Well, you might say, why would courts enforce forum contracts – if they're not going to enforce choice-of-law contracts, why would they enforce forum contracts? And the answer, we discuss in the book, which is really in chapter 5, is arbitration. If they don't enforce forum contracts, the parties still have the power to arbitrate, to contract for arbitration. Now, you might say, why do the parties still have the power to contract for arbitration? Why don't they just not enforce arbitration clauses? And the answer is they tried to not enforce arbitration clauses back about 80 years ago, and the response to that was the Federal Arbitration Act. And that's an interesting story because that's an example of federal law importantly making the law market work. So there is a federal role here to keep the unruly states in order, and I think arbitration is a big factor there, which is why it occupies basically the central chapter in the book. But there are political things going on too. When firms exit the state, they leave behind dissatisfied interest groups that used to rely on those firms. And the most important of those dissatisfied interest groups are the lawyers that represented them, whose license only reaches to the borders of the state, so they have to be worried about their clients leaving. But that's only one of the interest groups – there's a lot of interest groups that might be involved. And there's federal law to some extent, and I've already mentioned the Federal Arbitration Act. But one thing to keep in mind is that all of these things that I'm talking about that make the law market work are inherent, endogenous in the structure of the federal system. So they're already sort of embedded in our constitution. You don't need an O'Hara-Ribstein book or solution to make this work – it already works to some extent. And these are some examples of how it works, and I think these are probably our stars in terms of our best examples in the book. The corporate example and the internal affairs doctrine – let me point out here, this is the case we make in the book – that there is no – this may be controversial to some, but there is no constitutional rule that forces the internal affairs doctrine to work, that the operation of the internal affairs doctrine arises out of the structure that we've already talked about in the book, namely firms' ability to physically exit states, including states that don't enforce the choice-of-law contract that's embedded in the internal affairs doctrine. Once the internal affairs doctrine was enforced, then you had corporations effectively being able to track through the law that governs their affairs, and the result of that was an evolution towards sufficient law. So it's an example of what you get when a full-fledge version of the law market is in place. And I want to point out, and Bruce Kobayashi is here so he can back me up on this, this doesn't just apply to big corporations. We've shown that the same forces apply to little firms – LLCs. There's a lot of evidence that we present in the book, and some of it's been done by Ted Eisenberg and Jeff Miller – about a corporate-type market for commercial contracts, mergers and acquisitions agreements, in the Eisenberg and Miller article, and I've got a couple of articles on how it's worked out for all kinds of commercial contracts. But basically what's happened is that you can see states operating – I'm sorry, passing – statutes that require the enforcement of certain choice-of-law contracts. And basically what these states are doing is competing for commercial contracts in the same way that Delaware competes for corporations. So you see a kind of market for commercial contracts that operates like the corporate market. Securities regulation – well, it's a federal law. You say, how can a federal law possibly give rise to

a law market? Federal law is the end of a law market. Well that's what Congress thought, and the SEC thought – well, especially Congress – when it adopted the Sarbanes-Oxley Act. If federal law gets bad enough, there is an offshore solution, and that happened in the cross-list market, where the United States and especially Wall Street were making billions of dollars on cross-listed firms, and they suddenly realized that that business was costing them many millions as it exited – as it left the U.S. and went back to their home country.

Franchise regulation is another thing that I've worked on with Bruce. Well, you don't necessarily see the market operating in as clear a way with as you do with these other contracts that we're talking about, but it's a good example of the exit-affected groups coming into play. You had states like Iowa, for example, passing very onerous franchise restrictions – restrictions on franchise contracts – and forbidding the choice-of-law, choice of forum option, so that led to franchise owners exiting the state, and then what happened is employment started dropping in those states in franchise industries. So that's an exit-affected group that you might not expect otherwise, but you can observe it happening in that area.

Same-sex marriage, well we now have 40 – more than 40 – little DOMAs in the states outlawing same-sex marriage, but we see a counterforce – and you can look at a marriage as kind of a choice-of-law contract. The counterforce is in the employment market, you get big firms like Microsoft that employ same-sex partners and same-sex couples, they offer benefits and so forth, and they cannot easily operate in little DOMA states, and so they provide some significant pressure for same-sex marriage. There's also the market for marriage ceremonies, which is more lucrative than you might imagine. It turns out that same-sex couples have very expensive marriages. So that's another example of the exit-affected groups operating, and we've seen a sort of rebirth of the same-sex marriage market just over the last year or so.

And then the very interesting story that was told by Ralph Zitkoff and Nat Stanzenbeck that we sort of reiterate in the book about trusts and the rule against perpetuities, which was again triggered by a federal law. It basically activated a market in the law of the rule against perpetuities, which ended up eliminating the rule against perpetuities. So it was a fascinating example of the law market working in a place where you wouldn't necessarily expect it. Doesn't operate perfectly, you still get, you could call them, pockets of resistance, or major areas of resistance in the states, consumer groups, litigators, and so forth who want local state regulation, who don't want to enforce the contracted-for choice, and you also get efficiency arguments. Or, I should say, you also get (falsetto) “efficiency arguments,” because I'm now bringing in Erin here. And I guess I'm a little bit sympathetic with these, too. The efficiency arguments are covered in chapter 7, if you want to just quickly move to the efficiency arguments on the law market not working, but the point is that even the most – even if you've got a roomful, which we do not have here, of the most avid opponents of the law market, they're not going to be able to agree on exactly when the law market is working and when it's not. And it's this kind of uncertainty that I think breeds healthy agnosticism about when you want to regulate and when you don't, which is why I think we're offering a good compromise. But the point

is that we think “to some extent, regulation ought to be preserved” – I’m sorry, my voice just can’t do a falsetto today – so we should preserve the ability of states, anyway, to offer regulation and we do incorporate that into our proposal. The problem is that if you just leave the law market to operate, and even if you are willing to concede one way or the other that the states ought to be able to have some area for regulation, that we’re going to preserve some pocket for state regulation, you’re not necessarily going to get the solution that you want in the law market operating on its own. Sometimes it’s just going to go to chaos, as we discuss in chapter 3, and you’re going to get these unruly states stepping at each other. Sometimes the solution to the unruly states is going to be an entirely federal solution so you eliminate all the benefits of federalism.

So what we try to do in the book is we have Chapter 10, which comments on a statute which I view as tweaking – which we view as tweaking the law market – again the law market operates in many different ways. It does quite a good job of operating, but not a perfect job – well of course, nobody’s going to make it perfect, but we’re trying to at least make it better than it can do on its own. So the statute really consists of two sections. This is a general statute, and I think Max is going to have some things to say about this. First section is, basically: “Choice-of-law contracts shall be enforced as a matter of federal law.” The second section is: “Except in some cases.” Now this is a key aspect of our proposal because there’s two ways that you can – theoretically, two ways – that you could handle the exception. One way is, you could say, there are certain things that states should be regulating, and certain substantive areas states should not be regulating, and we are going to sit up there in some God-like way and decide which areas the states should be regulating and which they shouldn’t. But, again, I think there’s a lot of room for healthy agnosticism here, so what we do is we have a process – a process way of doing this, where the states can regulate, but they have to do it by explicit legislation, which says, “This kind of choice-of-law will not be enforced,” and specify in the legislation the non-enforcement. We think this offers two process-oriented improvements. One is predictability, because this is one thing we’re not getting we’re not getting from the chaos of state choice-of-law rules now. And the other thing is that it kind of activates this exit-affected interest group operation that we talked about, where a state legislative overture to regulating the law market, to saying, “the following kind of choice-of-law clause won’t be enforced,” will stir up some interest-group opposition, because they understand that the result of this will be firms leaving, completely avoiding that state, leaving some interest groups in the state high and dry. And, overall, we’re hoping that this three-way competition among interest groups – pro-regulatory, anti-regulatory, and exit-affected – we’ll end up with, over time, an equilibrium where we’re only going to get efficient restrictions, and that inefficient restrictions – and here we rely pretty heavily on Gary Becker’s idea of competition among interest groups. So I’ve given, I think, the overview of the proposal, what underlies it, and one thing I want to add in terms of this slide is that I see this – I haven’t really discussed this particular thing with Erin, so I’ll just do this in “deep voice,” I see this as kind of a template for specific regulation. So even if you don’t like this as an idea of overarching federal law that applies to all kinds of contracts, there still may be specific areas that it could be applied to, and Henry Butler, who’s here, and I, have a proposal for insurance law, that I think this works pretty well with. And then, finally, in Chapter 11, we give some broad

implications of this – it's a way to get federalism in areas where there's some sort of contractual interface. It doesn't have to be what's purely regarded as a contract, so that's why we bring in same-sex marriage, the right to die, gestation contracts, things that are not normally embraced in contract law, but anything where there's a contractual interface, I think you can use our proposal to get to a truer version of federalism than we have operating today.

I think that we have some major implications for contract law. You can no longer think about mandatory laws in the straight sense of a contract is either prohibited or not prohibited, because we open up a three-dimensional space, in which the contract can be prohibited two-dimensionally within the state, but it may or may not be prohibited three-dimensionally, at least from a choice-of-law perspective. That would be like section B of our statute. It's a way to deal with contentious rights, so we can get some read through state competition rather than imposing a federal solution right off the bat. And then finally I think the thing that makes this salient for today, and this is the last point but I think it's actually the most important, is we've got a move on to federalize everything. There's a lot of dissatisfaction with state law. There's a lot of things that people are saying absolutely have to be done at the federal level. I mean, we can't let states regulate when we're talking about a collapse of our economy – systemic risk, that kind of thing. But we're offering a way that we think the states – a real role that's suitable to the world that we have today, can be viably preserved for the states, and preservation can be recognized by maybe otherwise opposing parties to the debate. So now Max is going to tell me why it doesn't work.

MAX STEARNS: Thanks. It's great to be here as what Michael nicely called the George Mason Law School reunion. It's especially nice to be able to read a book by my two former colleagues Erin O'Hara and Larry Ribstein. I remember when they first wrote in the area of choice of law, contractual choice-of-law, in, I think it was 2000, in the Chicago Law Review – I read their article and remember thinking that it was an appropriate placement for an excellent piece of work and, having read this work, I think it's yet another appropriate placement for an excellent piece of work. I'm delighted to see that they took – that they stayed on topic, that they had an initial sojourn into the field and broadened their topic even more, and that they wrote such an ambitious and broad project that resulted in this book. The book is excellent. It's broad in its scope, as Larry's slides make plain, in terms of the range of things that it addresses itself to. It's well-written, it's nuanced, perhaps most importantly, it's short. The book is also cautious. It's cautious in a couple of very interesting ways, and I want to pick up on the cautious notes and sort of take the book from the end, unlike Larry, who, appropriately, started at the beginning and worked toward the end, I'm going to start at the end.

What they're proposing is a federal statute that would in effect mandate that states adhere to contractual choice-of-law provisions. But there are two limitations associated with the federal statute and the imposition or the obligations that the statute would impose upon states. Number one, Larry and Erin [brief aside], would not allow individuals in

contracts to cherry-pick from a multitude of jurisdictional provisions. So, for example, you're not allowed to say, I want Delaware to govern this part of the contract, Connecticut to govern this part of the contract, Massachusetts to govern this part of the contract. You have to pick a jurisdiction, warts and all, to govern your contract. And I think that's an interesting piece and I'll come back to it.

The second limitation on their proposal is the one that Larry just addressed himself to, which is the idea that, in effect, they're advocating a recognition of three categories of contract rules. One is the standard of the rack-rules that we're all obviously familiar with. These are transaction reducing rules in the sense that in the absence of contrary contractual specificity, we rely, or contracting parties rely, on off the rack rules to fill in content, thereby reducing the cost of entering into transactions, and we can think of this as a significant public regarding function that state laws provide to contracting parties. The second category is mandatory rules: rules that say substantively what you cannot contract around, and to some extent, we might think of these as on the edge, problematic. For those who are particularly oriented toward a libertarian or free-market view of the world, anything that's mandatory in the area of contract law at least raises an eyebrow in the sense that, why should the parties not be able to extricate themselves from whatever burdens regulatory – regulating – branches of government may provide when the parties themselves seek to enhance their anticipated well-being by specifying a contractual provision that is contrary to what is articulated as a mandatory rule? And we see all kinds of mandatory rules – for example, in most jurisdictions, you cannot purchase the services of a physician or of a lawyer unless the lawyer or the physician have satisfied the requirements for licensure even if you want to. Even if you want to buy legal services from somebody who's not a member of the bar, or you want to get surgery from somebody who's not a properly licensed physician, notwithstanding that you and the would-be doctor or lawyer are in agreement, a mandatory set of rules in most jurisdictions precludes you from entering into that contract. In most jurisdictions, there are mandatory prohibitions, for example, on the contract of sexual services. Obviously there are some exceptions, but those are mandatory rules. I was reading the book and thinking about how interesting it might be to have drives down certain parts of certain cities where they hold up two different versions of the contract for certain services. If you sign on the line and choose the law of Nevada, you get one price. If you choose the law of subjecting yourself to liability, you get a different price. And that's incorporated into the various regimes. All right. Well in any event, so, there are two limitations embedded in their proposal. One is this idea that you have to choose a particular jurisdiction. The other is that there is a potential way that even mandatory rules that you are allowed to contract around can become super-mandatory. So what Erin and L suggest is that there are contracts that have choice-of-law provisions that allow you to extricate yourself from mandatory rules, but they are sufficiently solicitous of state regulatory powers that they give the states an opportunity to come back with a regulatory rule, so long as the state classifies the rule as "super-mandatory," in which case, even if you could use a contractual provision to get out of the state's mandatory rules, you are brought back in under the guise of super-mandatory rules, and therefore you've got these limitations. And what is interesting to me about this is, is that it invites the possibility of

a critique of the book from the right: it's insufficiently protective of contractual interests. This is a talk that some people in this room might be able to give, to say, if we're going to have a regime of contractual choice-of-law, let's have a regime of contractual choice-of-law. You ought to be able to, number one, impose limitations on states so they cannot impose super-mandatory rules, all rules ought to be at most off the rack, and if we're going to have COL rules you should be able to extricate yourself from those rules without regard to the opportunity of an interest group to come back and say, "No, I really, really do want to come back and impose this obligation on contracting parties." And number 2, why should parties not have the ability to choose from an array of jurisdictions to govern the aspects of their contract, rather than having to pick a particular jurisdiction, warts and all? That's a critique one could offer from the Right; that's not my critique.

Then there are a couple of other critiques that one might be able to offer. One of them comes from the standpoint of thinking about the constitutional foundations of the proposal in Chapter 10. I'm going to talk about that briefly. Then I'm going to talk about a critique more from the perspective of democratic theory, which is obviously from the other side. The gift I give to Larry is that, since I'm going to be critiquing his book from the Right and the Left is that he can come back and say, "See? I'm right in the middle, and therefore this proposal obviously works exceedingly well," and that's free of charge. [Laughter.] Okay, so. The legal critique is not really a critique because, frankly, I'm agnostic. I just throw this out as a question. And it's a question that Larry and I talked about before that they simply don't quite address in the book but here's the question: they propose that Congress pass a statute that creates the regime that I've just described and that L described in more detail a few minutes ago. The question is: from where does Congress's regulatory come from to effectuate this particular regulatory policy, and Larry and Erin offer two primary candidates: the Full Faith and Credit Clause, and the Commerce Clause. Now, I don't think that the Full Faith and Credit Clause works, because I think by and large the Full Faith and Credit Clause has been interpreted to require that states adhere to judicial decrees or judgments by sister states, rather than what they're asking for here, which is a federal statute requiring state courts to adhere to provisions in private contracts designating another state's substantive law. The one precedent under the Full Faith and Credit Clause that Larry and Erin refer to is, interestingly, Federal DOMA. Now, Federal DOMA is a statute that says that states do not have to abide by marriage decrees from other states and one of the interesting things about that is, is that at the time DOMA was being debated, there was a serious question as to whether it was a completely unnecessary statute on the idea that marriages may not fall into the category of judicial decrees for which states are actually obligated to adhere to another state's decision as a matter of law and, number two, even if they are, the public policy exception that courts generally honor would be sufficient to get around that. But whether or not that's true doesn't answer the question as to whether Congress would have the authority to regulate that states courts must adhere to contract provisions that clearly are not in the context of judicial decrees if, for example, you were to make the argument that marriage is a judicial decree. And marriage is kind of a hybrid in the sense that, at a minimum, to get out of the marriage you need a judicial decree, and you need some kind of licensed arrangement to actually confer marriage or rights of marriage within a particular state. But I don't think DOMA answers the Full Faith and Credit question.

The Commerce Clause one is also a little bit tricky. Prior to Lopez, it would have been easy. You would have said, “The general rule is that, if you breathe, Congress can regulate it,” because, you know, your breath here affects commerce somewhere else. Post-Lopez, that’s trickier, there are three categories of permissible federal regulations under the Commerce Clause. One is persons and things traveling in interstate commerce. Second is instrumentalities in interstate commerce. Third is economic activity that has a substantial effect on interstate commerce. Let’s assume we’re talking about two people in a particular jurisdiction, Party One and Party Two. They’re in State A, and they want to designate State B’s law to govern their contact. It’s not entirely clear, depending on the nature of their contract that this would fall – it clearly doesn’t fall into the first two Lopez categories, and it’s just not clear whether it falls into the third. I’m agnostic because, post-Gonzales v. Raich, some life has been breathed back into that category in a kind of curious way that caused an inversion the Court in the situation in which basically liberal jurists come out against the expansion or the exercise of Congressional regulatory powers and the conservative jurists come out in the opposite way. At a minimum, it’s an open question, I don’t think it answers itself. In other words, I think whether Congress has the authority to do what Erin and Larry suggest is a question that requires an independent analysis. I’m simply flagging it as something to think about, and as something that could potentially be a problem.

Now let me get to my actual critique. And it is this: I want to offer a critique not from the perspective of contract theory, but rather I want to offer a critique from the standpoint of democratic theory, the opposite side. In effect, the idea that I want to suggest is this: we have this proposal that says that there are three categories of rules: off-the-rack rules, mandatory rules, and super-mandatory rules. And really the only rules that become truly mandatory are super-mandatory rules because you can effectively contract not only around the off-the-rack rules through a substantive contractual provision, but you can contract around mandatory rules through a choice-of-law provision. So only super-mandatory rules are truly mandatory, and one of the consequences of this, and I think this is a desired consequence, is that it makes it more difficult for interest groups to actually seek protections in a regulatory environment that impose costs or what you might call “rents” that you might impose those captured groups in the particular jurisdiction. That’s an interesting proposal, and it’s clearly internally consistent. If parties want to enter into a contract they’re hindered by the existing legal regime, they can produce an increase in wealth by extricating themselves from that regulatory constraint, and it’s an internally consistent move. There is an article from 1986 by Jonathan Macy, formerly of Virginia and Cornell fame, now he’s at Yale. And he did an article that studied the question of federal judicial construction of statutes. He wrote it in 1986 and it has a striking parallelism to Larry and Erin’s proposal. It goes like this. Number one. There are statutes that are public-regarding. We like them. They are public-regarding. That’s what we want Congress and state legislatures to provide. Number 2. there are statutes that have what he refers to as hidden implicit payoffs, meaning they have embedded payoffs to interest groups but it’s not apparent from the surface of the statutes but you have to read it closely and you have to kind of dig in to see it and decide whether to honor those payoffs. And then the third category is what he calls “open, explicit payoffs” to interest

groups. And his proposal is very much like Larry and Erin's proposal and I'll categorize the two groups of proposals as a kind of "Lochner light." They don't want to have a strict Lochnerian regime with respect to adherence to contract, but they do want contract to be more honored than it is. So it's Lochner light, it's Lochner with an opt-out provision, and the opt-out provision in both cases is the same. In Macy's case it's that you get to have the anti-Lochnerian rule if you make your payoff open and explicit. Larry and Erin, you get to have your mandatory rule so long as you make it super-mandatory so you can't contract around it.

And what's interesting to think about is that it brings me back to an earlier article by Landis and Posner on the independent judiciary written in the mid-70s. And they made the following observation, and I promise to connect it back to the book. They made the following observation: we have this curious creature, the independent judiciary in the federal system, and one of the consequences, they argue, of having a federal judiciary that's independent, as opposed to elected or dependent on a coordinate branch of government, is that an independent judiciary has a relatively greater incentive than a dependent judiciary to prolong the interest group payoffs in statutes. Curious. Why? Well the reason is, that a dependent judiciary, or an elected judiciary, is more likely to be concerned with contemporary, than with contemporaneous, legislative preferences. An independent judiciary has the requisite degree of political insularity to actually maybe care about what motivated the initial piece of statute or legislation that they're called upon to interpret, and in the course of that they may actually look to see what it is the interest groups were motivated by in their efforts to produce this law.

Macy's article actually responds to this Landis and Posner article in some respect and the question becomes in both contexts: well why is it that we would set up an independent judiciary if the purpose is to prolong the life of interest group pieces of legislation, interest group payoffs, in the same question of why is this here? So the question is: is there a cost, to raising the cost, to interest groups, of getting the payoffs they want in legislative processes? Larry and Erin talk about exit-affected groups, so here's the argument. Groups who are motivated to leave a state because of the obligations of a regulatory regime will exert pressure on state regulators to lift those restrictions to invite them to come back. And undoubtedly, on some margins, that may be true. There are also, of course, capture-affected groups – groups for whom the cost of exiting, even contractually, but certainly physically, are much higher, because they don't have the information costs with which to enter into contractual terms to extricate themselves, either from the off-the-rack rules or the mandatory rules and so they're stuck. I suppose that what you might say is this. Maybe it's the case that the combination of exit-affected groups and capture-affected groups manipulating state political processes has the potential – has the potential – to help to improve the law so that the captured individuals within the state have a fighting chance at having the legal system reform itself so they're not stuck with inferior laws in place. In other words, maybe what Landis and Posner are getting at, and maybe the sort of question mark that remains open from this proposal and Macy's proposal is, is there a cost to making it more difficult to interest groups to getting the benefits they seek in a regulatory environment? Maybe the intuition is, it is hard to get legislation passed, and so what we want to say is: if you want to succeed in getting

the legislation passed, you really get the benefit of the legislation being passed. If you actually get the rent, you get the rent and it's meaningful because not because we like the rent – that's the point – the reason that we facilitate rent-seeking isn't because we think the rents are good, it's because we think that the dynamics of the state legislative processes may be improved if everybody has an incentive to play the game. And when you raise the cost to interest group of getting those payoffs, some may simply exit the game. And so it's possible at a minimum to say that the interest group payoffs may correlate with the law that we like – you get more of both, or you can have less of both – in an ideal world, and this is where Larry cut off his Slide 3 and said, “This is perfection, and this is where I stop and where Erin starts.” In an ideal world, we have all benefit and no cost. We'd get all the public interest legislation we want and we wouldn't have to pay any price in terms of special interest costs to have secured it. I'm just not sure – I'm agnostic – whether raising the cost to interest groups of getting special interest legislation might not have the adverse consequence of making it harder simultaneously to get what we do want, which is general-interest legislation. I don't think that legislation comes in boxes; I think the process is complex, and I think it's the interplay that helps to drive groups to work the legislative process absolutely for their benefit but along the way perhaps to improve upon the development of law.

At the very end of the book, the last sentence – oh, I'm sorry, I want to pick up on one other theme. So Erin has an article that she published independently on a public choice analysis of choice-of-law, where she makes the following very interesting posit. Erin says that, curiously, contractual choice-of-law should not be as great a source of enthusiasm for libertarians and as great a source of concern for regulatory minded individuals because if you have contractual choice of law, you reduce the cost to interest groups of getting rents in the legislative process. So it may actually be the case that contractual choice-of-law gets you more rent seeking – beware libertarians – it may be the case of contractual choice of law gets you more regulation – be on the lookout for those of you who are of that particular pro-regulatory bent. It may flip things around. My own view on that proposal is, or on that analysis is, if we assume that interest groups actually don't realize the rules have changed, then maybe they'll pretend that the rules haven't changed and that will be the case. But I think that interest groups actually keep their eye on the ball, they know what's in their interest, they know what it takes to get the rents they want, and they're not going to blindly go forward and invest in something that doesn't have a payoff because parties can freely contract around those payoffs. So at the end of Larry and Erin's book they say that that this isn't going to be the final word and they hope this opens things up for debate. I'll simply say that I think this is an excellent book and it certainly opens it up for debate. I'm delighted to have read it. I don't think anyone who's writing in the field of contractual choice-of-law will do themselves any service if they don't begin with this very, very important piece of scholarship.

MICHAEL GREVE: Thank you, Max. I want to give Larry a chance to respond. I just want to add one question, very much consistent with Max's remarks, and this is the first part, from the Right. [Laughter.] This goes not to the bundling effects Max talked about

– I don't think that is a very serious issue – the problem is with these super-mandatory statutes, whether that is, as you suggested towards the end of the talk, that is a stable solution. I'll give you one reason to believe or to suspect that it might not be. This is the same construction that, once upon a time, we had in American law. There was once a rule where, here's federal law, not with respect to contractual choice-of-law, but with respect to implied terms of contract. And if states pass a statute, they're sort of out of it. So in that case if they say, "sorry, the paper's non-negotiable," then it isn't. That was the regime of *Swift*. How long did that last? Answer: at most, 13 years. I can't remember when exactly *Watson* was decided. But within a very short time, the SC was down to the position that "no sorry if it conflicts with federal common law, and these are contractual agreements, then we'll simply strike it down and invalidate it. Now this is in the teeth of *Swift* but they felt they had to do it, and the reason they felt they had to do it is that otherwise the entire regime would have been undermined and sort of this perfect balance of here's sort of state law and it's allowed to adjust gradually towards sensible rules that are consistent w/ interstate commerce – it never ever worked – you really had to do dramatic things to make the rules stick. Is there any reason to believe that states would be any less obstinate now and that the system would be any less stable?

LARRY RIBSTEIN: Well, maybe not. But the question you always have to ask and answer is, is this an improvement over what we've got and is this a better way to improve it? I guess there are two questions. I'm going to be really brief in responding to Max's points. One is this question I did discuss of whether the federal government has the power, the Constitutional power, to enact the statute that we're suggesting, is a really interesting one. I think he said that Erin and I [aside] this is a question that Erin and I – we said that we didn't give it much thought, I would amend that and say we didn't give it any thought. So it's something we do need to look at. Nevertheless I think it is a possibility for specific areas, for example the insurance that Henry Butler and I have talked about. The second thing is that I take Max's longer critique to be that our proposal may well favor the pro-contractual side in terms of how it works out, so it's not a completely neutral proposal. And I believe that's true. And I think that you need to – one needs to accept not the assumption, but I think we make the case for it – that federalism is good and that contracts are good. If your priors fall sharply the other way, then you're probably not going to go along with even our compromise. But I think I'd like to hear what everyone else has to say.

MICHAEL GREVE: Let's start with Todd.

TODD ZYWICKI: To pick up on Michael's question, my first question is, do you have any thoughts on whether *Swift v. Tyson* as a policy regime or something like *Swift v. Tyson*, where you can choose to throw a fed choice of law scheme into the system is that

a good idea. The second is I would've thought credit cards are good example of efficient choice of law post 1978 and the deregulation of credit cards –

LARRY RIBSTEIN: Ok, two things. I'll talk about the two questions. First of all we really did have a federal choice of law regime under Swift v. Tyson before Erie. And it worked okay. Basically the way it decided cases was according to expectations which was somewhat circular, because your expectations are whatever the law is. And it did break down, because expectations it turned out in cases like Clay, and we talked about this in Chapter 3, ended up not necessarily being the contract. And Allstate v. Hague applied an expectations approach, and the expectations are based on whatever the courts decided to do before that. And I don't think it necessarily works. Refresh my memory on the second question?

TODD ZYWICKI: Credit cards.

LARRY RIBTSEIN: Credit cards, yes. And we talk about credit cards in chapter 7, and the problem there is that the statute you're referring to strikes down state regulation. In other words, you can't get state interest rate regulation. I mean, are we wrong about that, because you're more the expert on credit cards.

TODD ZYWICKI: You can, if –

MICHAEL GREVE: Sorry, Todd – there's a microphone.

TODD ZYWICKI: I think so, I mean. Basically what happened after 1978 is that you could apply for a credit card from South Dakota, or you could apply for a credit card from Arkansas. The problem was with Arkansas, because they had strict usury regulations, and could have interest rates of 20%, so people took them and they gave you an \$800 credit limit, so people obviously preferred South Dakota –

LARRY RIBSTEIN: Right, but the point is that Arkansas couldn't just come in and say, in terms of contracts in our state, we're going to override South Dakota. In other words, there was no possibility for super-mandatory rules.

TODD ZYWICKI: Oh, okay, so it's for super-mandatory rules. Because otherwise anybody in America could get an Arkansas credit card.

LARRY RIBSTEIN: It's for super-mandatory rules. Remember, I stopped after Slide 3. So I'm fine with the federal solution, the National Banking Act solution was fine. But if you believe in this compromise, which Erin and I – and I don't mean to put it all off on Erin, because this is our book, but I want to be sure to give credit where credit's due, because Erin's not here and she understands the non-free-market solutions or answers much better than I do, so she actually educated me. I'm not sure whether the education stuck, so I just wanted to make that clear. But the point is that you have to sign on to the idea that super-mandatory rules are a good idea in order to reject the NBA and since I'm very sympathetic with the really rigid free market position, I guess I'm okay with the NBA.

MICHAEL GREVE: Can I – David, with apologies to David – can I push a little bit – I don't think – correct me if I'm wrong – I don't think you fully answered Todd's initial question, so let me push you, if that's okay, to clarify your position. I don't think Todd's question was whether the particular or expectations-based approach – was Beale right about every detail of this., his question as I understood it was, was that construction – federal common-law, which is an obvious alternative to your super-statute, was that a tenable and attractive approach? And just to – and there's one page in the book where you discuss that, or two pages in the book where you discuss it at some length and the first reason for saying “No we can't do that,” is that there's Klaxon. Well, maybe Klaxon was wrong. Maybe we should just overrule that.

LARRY RIBSTEIN: There's Erie.

MICHAEL GREVE: Well, maybe that was wrong, too. Maybe we should overrule that.

LARRY RIBSTEIN: Well, Klaxon is a product of Erie, it was a direct application of Erie, and so Todd was talking about the Swift v. Tyson era. Klaxon is pretty messy, and the jurisprudence under Klaxon is pretty messy. Zacharoff, now at NYU, has – wants to get rid of Klaxon because he would like federal courts to be more consumer-oriented than they are now and not have to adhere to this Klaxon-type structure. So what you get from getting rid of Klaxon is not at all – it's not clear exactly what you want, that you're going to get what you want. But let me just say in answer to, would we now get a good choice-of-law regime, a good contractual choice-of-law regime, if we got rid of Erie? And by the way, getting rid of Erie means getting rid of Klaxon, so I'm now talking about getting rid of Erie and Klaxon. I don't think you can analyze Klaxon without Erie. If we got rid of Klaxon and Erie and we had federal common law now, we would get an improvement over the system we have now because federal courts have – even if they're – well, I think even when federal courts are sitting in diversity, in other words deciding state issues, non-federal question issues, they tend to be more pro-contractual, and I've got evidence of that that's in an article of mine that's in the book. And so the idea is that if we set them loose of the whole Erie mechanism, they would definitely be pro-contractual. I'm just not sure about that. That's why I just talked about the pre-Erie history, because there they weren't constrained by Erie, and there we got a devolution into this very vague expectation-based test, and I'm wondering whether we'd get that today. Right now I'm just talking about a very marginal difference between the federal diversity cases and the state cases and the federal cases happen to be somewhat more pro-contractual but I'm just – and there's a public choice reason for that, because they're not as tied to state legislatures, obviously, as the state judges are, but they have other concerns. So I'm just not sure we're going to get a totally pro-contractual equilibrium and I'd like to see the equilibrium guided by specific legislation rather than the day-by-day, case-by-case, judgments of judges, even if they are the almost-perfect federal judges, rather than the imperfect state judges.

MICHAEL GREVE: David.

DAVID BERNSTEIN: I read a pretty interesting paper recently – I'm sorry to be vague here, I think Eisenberg was one of the authors, and I think it was published in the American Law and Economics Review, but I could be wrong about both those things. But I do remember the subject of the paper, which was that the authors actually did an empirical survey of contracts between highly sophisticated corporate parties. And what they were looking for specifically was whether the parties chose to waive civil jury trials for any dispute they had and instead put an arbitration clause or something like that in. And what was really surprising to me was that a pretty small percentage of contracts between the sophisticated actors actually had such clauses, and most of them just defaulted to whoever the normal comp trials would be. And it was interesting – there were differences between the types of contracts involved and how likely the parties were to waive jury trials but, I don't think any of them were more than 50% and some of them

were in the single digits. Now the authors concluded from this – one possible conclusion one could draw from this – is that juries, and the civil justice system, state courts – or federal courts – don't do such a bad job. I sort of reject that out of hand. I mean that's ridiculous – the idea that if you have a complicated commercial transaction, that if you're looking at social efficiency, that the best way to resolve that is to take twelve random people off the street and throw all the mechanisms we have in the civil justice system. There are two other mechanisms that struck me the first of which is what I think is probably right which is that there's an incredible amount of inertia among high level lawyers. And if you're a lawyer at a big firm writing a contract and you do anything odd or unusual, and something bad happens, your client gets really angry. If you just default to whatever people normally default to, no one really gets angry at you if it doesn't work out well. So there's a lot of inertia about doing anything other than the standard. So that's obviously – that raises one possible question. Will people, sophisticated commercial actors, actually go to the Erie regime if they're not doing simple things that they could do now, like waive jury trials in favor of arbitration. The second possibility, which is a less happy one for those of us who like freedom of contract, but which can't be written off, out of hand, is that when a sophisticated commercial party is dealing with an unsophisticated consumer as in credit cards, Carnival cruise lines, that sort of things, they impose the arbitration on them, but when they're actually dealing with each other, at least one of them recognizes that the other party is trying to screw them over, or at least one party thinks that having the civil litigation system is likely to benefit them and they will not waive it even if it's socially efficient. Such that the second party is unwilling to give up those rights and negotiating to figure out, is there some compromise we could come to that would benefit both of us is just too expensive, which would suggest that the kind of, if you want to take the anti-contractual view here, what's going to happen here is that people will adopt your choice-of-law provisions in the situation where it's the innocent consumer versus the high-powered corporation with lots of lawyers trying to figure out how to make consumers have no rights. But when it's the big corporations themselves negotiate, there's no way they'll agree to these things.

LARRY RIBSTEIN: Well that's certainly the interpretation, the latter, that's been – the latter one, that's certainly the interpretation that some people have put on. And I've seen – it was in [sounds like: Aliah J], and I've seen it presented two or three times. And it's dealing with one specific database, and there's all kinds of other kinds of contracts that have different kinds of clauses in it. I don't go for the inertia idea because although I do think there is a lot of inertia, I do think the market eventually reacts – I do think the market, inertia can be overcome. So I do think what's going on is that you see a variety of choice-of-law, choice-of-forum solutions in a variety of different contexts, which is exactly what we would predict. We wouldn't predict opting-out in all cases, sometimes the parties are happy with the result that they're already getting without these COL clauses. There's no reason for them to upset the equilibrium. But the one thing I can remember, and I don't remember it in detail, is that there is a peculiarity with the data set. Maybe Bruce remembers exactly what that was, but of course they're driven by the particular data set that they were using for that project.

BRUCE KOBAYASHI: Is it (inaudible)?

LARRY RIBSTEIN: No, that was a different one, this is the one that just came out, actually, it's been a working paper for a long time.

MICHAEL GREVE: Yes, sir.

RAGHUBIR GOYAL: I'm Raghbir Goyal from India Globe and Asia Today. Since we have most of the lawmakers that are mostly lawyers and including President Obama also comes from a law firm, do you see any change under this president with what you are talking about today here? And also we have a new attorney general who's a lawyer...

LARRY RIBSTEIN: Do I think things are going to be different – are you referring to some particular difference, or different in every way? I think you may see some differences from President Bush.

RAGHUBIR GOYAL: How different he will be, as far as, because he has been talking about – against lobbyists and against lobbying.

LARRY RIBSTEIN: I hope that interest groups are with us always, and I don't think there's any question that they will, in fact continue to be. I definitely don't see anything major happening to the political system. The one thing in terms of relevance to our proposal, which I think is extremely relevant, is that there's extraordinary agreement between the president and Congress, that we need to federalize more and more. John Macy has written another article about why Congress defers to the states even though Congress can regulate as Bruce – not Bruce, as Max – said, anything that breathes. It can, under the Commerce Clause, but it hasn't in the past. Well, I think they're going to try to regulate all breathing entities now. And it's not just our president, it's the combination of the president and the Congress. And that's what helps make our proposal more salient, because I think we're offering – I didn't put it this dramatically, but I think your question raises it – I think we're offering the last hope for true federalism at least

with respect to things that involve a contractual interface. To be honest I'm not sure at all that we're going to get a statute like the one we're talking about that applies to all things. But I'm hoping that it's something that's on the table, that Congress can think about as an alternative to just federalizing everything and preserving a role for the states and at least if Congress-people aren't actively thinking about it, then the interest groups that I rely on and love so well will be thinking about it as an option.

MICHAEL GREVE: Larry, can I – sorry Judge – I disagree with this, just as a factual matter. I think it is not right that we're going to federalize everything. I think what you will see is that we're going to de-federalize everything and the first straws are already in the wind. What's their position on global warming? Answer: let California regulate everyone into the ground, we're going to give you a waiver. What's their position on FDA regulation? Answer: repeal whatever pre-emption doctrines people have put in place and let the trial lawyers play wild. If you think that they're going to pre-empt anything that stands in the way of trial lawyers and state AGs laying waste to this nation's financial industries or whatever is left of them, you are gravely mistaken. The central hallmark of federalism today, in my mind, is not at all runaway centralization, but rather sort of centralized disorganization and disintegration of the system. And that's why I was so insistent on Todd's point earlier. In that environment, to think that Congress could bestir itself to say that this has gone far enough and at the end of the day we have to create some sanity and rules of order here, I think is just an illusion and so – Look, don't get me wrong. If you could take this step in the right direction, I'd be all in favor of it. I'm totally sympathetic. I just don't think – I really doubt that it can be on, and so the question then is, what's plan B? I think that the centrally-led disorganization and congressionally-mandated disorganization of the system is the hallmark of contemporary federalism.

LARRY RIBSTEIN: Just a quick response to that. There's a lot to what you just said. And the reference to California and the EPA exemption – I suppose you could say, they're going to federalize everything that shouldn't be federalized, and de-federalize everything that shouldn't be de-federalized. One of the arguments for a national environmental protection act was precisely so we wouldn't see these perverse kinds of regulations by California. So what we see is under the EPA, under the Act, doing exactly what the Act was intended not to do. Having said that, I don't think that devolving stuff to the states in the way that they're talking about with the California pollution regulations is a stable equilibrium because I think that's going to cause so much cost that the ultimate result is going to be re-federalizing that as well as a lot of other things. So I think that sort of saves our position.

MAX STEARNS: I just want to chime in on this because I've always thought that this issue about whether things should be devolved to the states or ratcheted up to the federal government is something that only professors seem to really care about and then, when push comes to shove, political actors care about the resolution of substantive issues in the direction they want them resolved in, and they're completely indifferent to whether it's done at the federal or state level. They'll push it in the direction they want with very few exceptions. But I think what's happening now is that you recognize that structural federalism hasn't been understood. So you've got Massachusetts suing the EPA, so you've got pressure to have a single state driving federal policy, with California and the emissions rules that the Obama administration is going to at least nominally allow to go forward although the general understanding seems to be that California has done this sort of thing before, and at the very last minute, when it's completely clear that an industry can't comply with California, they come up with a run-around policy to avoid the implication of that at the very, very end and everybody knows that's what's going on. But I just think that the idea that – I'm one of those professors that teaches constitutional law and tries to get my students to care about issues like federalism, but policymakers care about issues like policy. I'm just not persuaded that the dimension of the debate actually has the contours that we're talking about here.

MICHAEL GREVE: Judge Williams.

JUDGE STEPHEN WILLIAMS: Could you put back up Slide B? It's hard for me to see that there was any state rule that wouldn't be covered by, I guess, it's subsection 2 of the statute – “that applies to the agreement.” Well, you don't apply something that doesn't apply to the agreement. We seem to have statutes after the statute's been enacted, and everything else before, everything else before –

LARRY RIBSTEIN: Well, you've hit on –

JUDGE WILLIAMS: So the one thing is wild judges concocting rules after this statute has been enacted. But judges are very good at pretending that the rules have always been that way. That's the name of the game.

LARRY RIBSTEIN: That is the Achilles Heel of the statute. The alternative, and I had a lot of sympathy for this, and we discussed this, and this was a joint product – the original version of this didn't have the subsection 2. The alternative was that all of a sudden

every state legislature now realizes that it has this task that it has to enact every super-mandatory rule that it had before because it's no longer valid, and that would put a significant burden on legislators to regulate. So the question – this is my response to max's point a little earlier – the statute, and every little detail in it, comes down to, how do you feel about mandatory rules? And how do you feel about federalism and so forth? I'm strong enough on markets and strong enough on real federalism that I would put states to the burden of re-enacting – explicitly – these rules, and maybe that's the way to go. This is one of those things that, frankly, if I were writing the book alone, I might not have had to, but again it's a joint project, and Erin convinced me that we needed this subsection 2. It's definitely a live question, and you've hit on the exact danger that could befall it.

JUDGE WILLIAMS: It looks like a sellout.

LARRY RIBSTEIN: That's one way to put it.

JUDGE WILLIAMS: That's one thing that came to mind. The other thing is, I haven't heard the magic words, "race to the bottom." I have a question about Obama. He gave a clear, pure, "race to the bottom," in one of those debates in response to McCain's proposal about –

MICHAEL GREVE: It was the Shaddock bill.

JUDGE WILLIAMS: Yes. And it was the standard race to the bottom and as far as I can make out, no one spoke up to criticize him. It's a part of the background assumptions of America today.

LARRY RIBSTEIN: Background assumptions, right. And you haven't heard it from me, because I'm not a Congressman. And I think that's going to be the pushback. And yesterday – now Henry's gone, but at this thing we were at yesterday – somebody mentioned that Chris Dodd said that there was going to be nothing about jurisdictional competition in this Congress or something to that effect. It was as strong – he actually read the statement and it was even clearer than the "race to the bottom" Obama statement that you're referring to. And I think that's because of this – it's not only about this more

federalization, but it's about these state super-mandatory rules. It's a shame but I'm hoping that by providing a clear alternative, we can flush out whatever support we can get for the other side, the opposition to this "race to the bottom" assumption.

MICHAEL GREVE: Ladies and gentlemen, please join me in thanking Max and Larry for a very stimulating discussion.

(Applause.)