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DISPATCHES FROM THE TRENCHES

Choosing Wisely: *The Importance of Forum Selection Provisions*

By Kenneth P. Weinberg

Recent editions of Dispatches from the Trenches contained a few cases regarding choice of law and forum selection provisions. This edition addresses the importance of such clauses and provides some helpful tips.

There is always the chance that a "transaction will go bad" and that the dispute will result in litigation. Whether you are a transactional lawyer drafting an agreement or a litigator enforcing an agreement, it is crucial to understand the provisions commonly referred to as governing law provisions. These provisions are sometimes located in the miscellaneous section of agreements, but other times have their own section.

A "choice of law" provision ensures that the law of a designated jurisdiction will govern the dispute regardless of where the dispute is adjudicated. A "forum or venue selection" clause is a different sort of provision that sets the particular state or court where adjudication will be addressed. Since these concepts are often all addressed in the same section of a document, many lawyers blur them together.

Choice of Law

There are a variety of issues to consider when determining which jurisdiction's laws should govern a particular transaction. Obviously, drafters preparing an agreement or litigators enforcing a document with a choice of law provision need to know the laws of the chosen state as much as possible. In addition, some states have better developed case law in certain areas. For example, New York and New Jersey has a well-developed body of equipment leasing law. Other considerations include whether the chosen law is generally hostile or friendly to the type of client being represented and the type of transaction being documented or litigated. For example, Alabama law is very pro-lender with respect to usury requirements.

Choice of law provisions come in many forms and some of them are considerably more detailed than others. Issues to consider when drafting or enforcing a choice of law provisions:

- * It is common in choice of law provisions to say that the laws of a particular jurisdiction apply "without giving effect to its conflict of law principles." This carve-out is used to make sure that the procedural conflicts of law principles of the chosen state's laws do not result in the application of another state's law, thereby circumventing the intention of the parties. Other ways to address this concept are to say that the "substantive laws" or the "internal laws" of a particular state apply.
- * The types of disputes that are covered by the chosen law are also something that may need to be addressed in a choice of law provision. For example, does the choice of law provision apply only to contractual obligations or disputes or will it also apply to broader categories such as torts that may arise incidental to the agreement? If the parties intend for a particular state's law to govern matters that are only incidentally related to the contract, language to that effect should be used. For example, the agreement could contain a clause which states that the choice of law provision covers all disputes "arising out of or relating to" the agreement.
- * It is also possible to designate multiple jurisdictions so that the law of one jurisdiction will govern certain disputes and the law of another jurisdiction will govern other disputes. This sort of bifurcation is common in the real estate context.

Choice of Law Enforceability

Historically, courts would not enforce choice of law provisions as they were viewed as an attempt by private parties to usurp the legislative function. However, modern courts follow the rule articulated in the Restatement (Second) of the Conflicts of Laws, which provides that governing law provisions are presumptively enforceable as long as there is some relationship between the transaction and the jurisdiction whose law would govern or another reasonable basis for choosing the law for a particular jurisdiction.

There are, of course, a couple of exceptions. First, there is the ever-present "public policy" exception. There are also specific statutory choice of law rules that cannot be modified by contract. For example, choice of law rules in Article 9 of the Uniform Commercial Code (relating to secured transactions), which govern where financing statements are filed and which regulate a sale of repossessed collateral and other similar issues, apply regardless of the parties' wishes. This position is justified for uniformity and because third parties who are not part of the parties' agreement are affected by such things.

It should also be noted that revised Article 1 of the UCC changes the standard rules governing when parties' choice of law desires will be honored under the Code. As of now, Article 1 has been adopted by Alabama, Hawaii, Idaho, Minnesota, Texas and Virginia but is likely to be adopted in all states eventually. The new rule is that, for commercial transactions, parties can choose a law even if it does not bear "reasonable relation" to the transaction. UCC Section 1-301.

Forum Selection

A forum selection provision allows the parties to designate one or more courts that will adjudicate a dispute between the parties. Basically, the parties convey to those courts personal jurisdiction over the parties with respect to controversies that relate to the agreement. This provision is distinct from a choice of law provision which, as discussed above, designates which state's substantive law will govern disputes.

When considering which forum should be applied in litigating any dispute arising under an agreement, the parties must consider several factors.

- * First, the geographical convenience of litigating in a particular jurisdiction is often an important issue. Quite simply, a company generally prefers to send witnesses, documents, and otherwise handle litigation in a place that is geographically convenient.
- * There are also some benefits to litigating in a forum that is well known to the party involved in litigation and its counsel. This is the so-called "home court advantage" where attorneys are more familiar with the local law and courts in the particular forum. One aspect of this advantage is knowing which courts tend to decide in favor of which issues. This tendency can be the result of the particular judge overseeing the proceeding or of the type of jury likely to be selected in that forum. For examples, is the forum pro-environment, pro-plaintiff, pro-business, etc?
- * Additional consideration should be used as to whether federal or state courts are better able to handle a dispute in the most favorable manner and whether jurisdiction should be permissive or mandatory as discussed below.

Exclusive and Non-Exclusive Forum Selection

An exclusive (also referred to as mandatory) forum selection provision requires all litigation to be handled in a specific forum. This sort of clause is beneficial to certain types of companies that need predictability and uniformity when contracting with a variety of parties in many different states. For example, a large lending corporation, which negotiates similar contacts throughout the country might prefer an exclusive forum clause so as to improve the chances that all litigation will occur in one jurisdiction and that it only has to monitor the political atmosphere and changes in that jurisdiction.

When choosing an exclusive forum, it is important to focus on whether litigation should be allowed in either federal or state courts or merely one of them. For example, a bank engaged in financing the acquisition of intellectual property may feel more comfortable with a federal court since intellectual property issues are generally a matter of federal law.

A non-exclusive (also referred to as permissive) forum selection clause affords greater flexibility than an exclusive one and may present certain advantages for the client. This sort of clause would be beneficial if it is difficult to appreciate in advance where would be the best place to litigate a particular dispute. For example, brokers who are assigning leases to multiple funders may need this flexibility. Also, although a bank generally prefers to sue in its own jurisdiction, if the assets of the borrower were located in another jurisdiction that has laws that are familiar and not disadvantageous to the client, the bank may want to sue in the borrower's jurisdiction. Once again, it is necessary to consider whether the permissive jurisdiction should allow litigation in state and/or federal courts.

Forum Selection Clauses Enforceability

Although forum selection provisions are generally enforceable, certain issues must be kept in mind when drafting a forum selection clause or when challenging or enforcing one. First, the party against whom the provision is being enforced must have received "notice" that the provision is contained in the document. This requirement has been relaxed substantially over the last ten to 15 years, but it is not unusual for forum selection provisions to be placed in all caps or other font that makes them stand out.

Second, a forum selection clause can be voided on the grounds that it is unreasonable or against public policy. An example of an unreasonable forum selection clause is one found in the form contract included with a computer purchased through the mail or telephone. (See *Brower v. Gateway*, 1998, N.Y. App. Div. Lexis 8872.) An example of a forum selection that may violate public policy may be found when a particular state has a strong interest in regulating a particular industry or in protecting a certain class of persons. (See *High Life Sales v. Brown-Forman Corp.*, 823 S.W. 2d 493 (Mo. 1992) Finding that enforcing a forum selection provision against a liquor distributor would violate Missouri's statute protecting liquor franchises.)

Drafting forum selection clauses for, or enforcing them in, federal courts raises additional issues. The U.S. Supreme Court, in *Bremen v. Zapata Off-shore Co.*, 407 U.S. 1 (1972), adopted the view "that [forum selection] clauses are prima facie valid and should be enforced unless enforcement is shown

by the resisting party to be 'unreasonable' under the circumstances." The court further said that when "the choice of [the] forum [is] made in an arm's-length negotiation by experienced and sophisticated businessmen, and absent some compelling and countervailing reason it should be honored by the parties and enforced by the courts," and that the correct approach is to "enforce the forum clause specifically unless [the resisting party can] clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching."

It should be noted, however, that the U.S. Constitution establishes the scope of federal subject matter jurisdiction and that scope cannot be expanded by private contract. Assuming that the parties are in federal courts based on federal subject matter jurisdiction, courts presume that the forum selection provision is enforceable. However, there are some distinctions that depend upon whether the subject matter jurisdiction is based on federal question jurisdiction (i.e. the subject matter is one of exclusive federal jurisdiction such as anti-trust, trademark and copyright law) or diversity jurisdiction (i.e. two parties from different states with a minimum threshold amount in controversy). The enforcement of federal forum selection clauses is particularly complex if federal subject matter is based on diversity jurisdiction and depends upon whether the court views a particular issue as substantive or procedural. This is sometimes called the Erie doctrine.

State courts have various approaches in determining the enforceability of forum selection provisions. Many state courts follow the U.S. Supreme Court decision from Bremen. Some courts apply a more flexible approach that is contained in the Restatement and which accords courts considerable discretion to reject a party's forum selection choice.

Under the Restatement approach, the party opposing the forum selection may demonstrate extreme inconvenience in leaving the matter in a selected forum that was not foreseeable at the time the provision was negotiated. However, this sort of tactic generally requires the party desiring to render the provision unenforceable to bear a heavy burden. It should also be noted that there are a few states that refuse to enforce forum selection provisions altogether (such as Idaho and Montana) while others limit enforcement with respect to certain types of contracts.

Enforceability -- Forum Non Conveniens

It should also be noted that there is a gray area in case law with respect to the defense commonly referred to as "forum non conveniens." Basically, a party that submits to a particular forum is not viewed to waive its rights to contest jurisdiction to the extent that the forum, in light of all the circumstances, is not the most convenient place to litigate. As such, it is common for drafters to include an express waiver of the right to object to a forum non conveniens.

Kenneth P. Weinberg is a founding partner of Marks & Weinberg, PC. He and co-founder, Barry Marks, have significant experience in dealing with virtually every type of equipment and facility lease financing, have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. Weinberg has written *Dispatches from the Trenches* since 2002, routinely writes articles in a variety of equipment leasing and financing journals, and has participated in numerous seminars on equipment leasing issues. If you would like more cases or articles on leasing, or have any questions or comments about this column or other leasing issues, please visit www.leaseawyer.com or contact Weinberg at 205-251-8307.



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