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Common Sense Trumps Extra Words in Governing Law Clause

New York's Highest Court Applies New York Substantive Law Where Contract's Choice-of-Law Clause Does Not Exclude Conflict-of-Laws Principles

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In *IRB-Brasil Resseguros v. Inepar Investments*, the New York Court of Appeals held that a court interpreting a contract where the parties have chosen New York law, pursuant to New York General Obligations Law section 5-1401, should apply New York substantive law to the contract. New York substantive law applies regardless of whether the parties explicitly excluded New York conflict-of-laws rules and even if a traditional conflict-of-laws analysis would result in the application of another jurisdiction's substantive law.

Highest Court in New York Rules on Choice-of-Law Clauses

Indentures, fiscal agency agreements, and other significant commercial contracts have choice-of-law clauses. For example, "This contract shall be governed by New York law." Sometimes, however, these contracts provide that they shall "be governed by New York law, without regard to conflict-of-laws principles." Lawyers have debated whether there is any difference between these two provisions,¹ particularly for contracting parties who take advantage of New York's openness to allow parties who are not from New York to choose New York law for their contract. Any difference could change the outcome of a dispute.

¹ In an article in *International Lawyer*, former Shearman & Sterling partner Michael Gruson framed the debate as: Some proponents of governing law clauses that exclude conflict of laws principles have argued that such clauses prevent a court in the forum jurisdiction from applying its objective rules of choice of law despite the governing law clause. This concern is absurd, however, because once a court has held that the governing law clause is effective and must be recognized, that court cannot apply the rules that would be applicable if no effective choice of law clause existed. For the court to apply the objective choice of law principles, it must have held that the choice of law clause is ineffective U.S. courts have, without squarely facing the issue, in fact ignored the exclusionary language of governing law clauses stipulating the law of a U.S. state. Michael Gruson, *Governing Law Clauses Excluding Principles of Conflict of Laws*, 37 INT'L LAW. 1023, 1024, 1029 (2003).

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Last month, the Court of Appeals of New York resolved this question, holding that there is no difference.

As described below, this decision clarifies the applicability of New York substantive law to contracts where the parties have chosen New York law. Some lawyers had raised concerns that a choice-of-law provision stating that the contract would be governed by New York law, but not addressing conflict-of-laws rules, could be read to invite (or require) application of New York's conflict-of-laws principles, which could direct a court to apply the substantive law of a jurisdiction other than New York.

However, in *IRB-Brasil Resseguros, S.A. v. Inepar Investments, S.A.*, No. 08669, 2012 WL 6571286 (N.Y.), decided on December 18, 2012, the New York Court of Appeals held that when a contract contains an express choice of New York law pursuant to New York General Obligations Law ("GOL") section 5-1401, there is no need for a conflict-of-laws analysis. Under section 5-1401, parties to contracts involving \$250,000 or more² may choose New York law to govern the contract regardless of whether any relationship to New York exists. The *IRB-Brasil* holding ensures a court will apply New York substantive law if the parties choose New York law pursuant to section 5-1401, even if a traditional analysis of conflict-of-laws rules would result in the application of another jurisdiction's substantive law. The *IRB-Brasil* decision thus does away with the need to include "without regard to conflict-of-laws principles" in the governing law provision of a commercial contract.

The Facts and Holding of *IRB-Brasil*

The litigation arose out of an issuance of notes in 1996 (the "Notes") by Inepar Investments, S.A., a Uruguayan company (the "Issuer"). The defendant, Inepar S.A. Industria e Construções, a Brazilian company that held a 60% interest in the Issuer (the "Guarantor"), guaranteed payment of principal and interest on the Notes. The guarantee designated New York as the venue for disputes thereunder, and provided that it would be "governed by, and ... be construed in accordance with, the laws of the State of New York" (the "Guarantee").

The plaintiff, IRB-Brasil Resseguros S.A., a Brazilian corporation (the "Holder"), bought Notes in the original offering, stopped receiving interest payments after October 2000, and never received its principal investment following maturity of the Notes in October 2001. The Holder sued the Issuer and the Guarantor to recover payment of its principal and unpaid accrued interest. The Issuer did not respond to the complaint, but the Guarantor moved for summary judgment, arguing that New York conflict-of-laws principles directed the Court to apply Brazilian substantive law, which would void the Guarantee because it was never authorized by the Guarantor's board of directors. The trial court rejected the Guarantor's argument and granted summary judgment on liability

² The statute identifies certain specific exceptions.

to the Holder. The Appellate Division affirmed and the Court of Appeals unanimously affirmed the Appellate Division.

As noted, the Guarantee provided that it would be “governed by” and construed “in accordance with” New York law. The Guarantee’s choice-of-law provision did not, however, include language to the effect that New York’s conflict-of-laws principles affirmatively should not apply to the Guarantee.³ The Guarantor thus argued that the “whole” of New York law applied to the Guarantee, including New York conflict-of-laws rules, and that the Guarantee would have had to expressly exclude application of New York conflict-of-laws rules in order for New York substantive law to apply.

The Court rejected this argument, holding that “[e]xpress contract language excluding New York’s conflict-of-laws principles is not necessary.” The Court noted that the Legislature adopted GOL § 5-1401 to allow parties without New York contacts to choose New York law to govern their contracts to eliminate uncertainty (such as may be engendered by a conflict-of-laws analysis) and to promote and preserve New York’s status as a commercial center. The Court concluded that when parties include in their contract “an ordinary New York choice-of-law provision, such as appears in the Guarantee,” it would frustrate the New York legislature’s purpose of encouraging a predictable contractual choice of New York law to require a conflict-of-laws analysis. The Court further observed that it “strains credulity” that the parties would have intended to leave the question of the applicable substantive law unanswered and subject to a complicated conflict-of-laws analysis. Accordingly, “parties are not required to expressly exclude New York conflict-of-laws principles in their choice-of-law provision in order to avail themselves of New York substantive law.” The Court therefore found that the difference between the language of the choice-of-law provision in the Fiscal Agency Agreement and the Guarantee was “inconsequential as a matter of law.”

³ In contrast, the Fiscal Agency Agreement among the Issuer, the Guarantor, and Chase Manhattan Bank as fiscal and paying agent, which governed the Global Note Program, provided that the Fiscal Agency Agreement, the Notes, and the Guarantee “shall be governed by, and construed in accordance with, the laws of the State of New York, *without regard to conflict of laws principles*” (emphasis added).

Conclusion

Under IRB-Brasil, New York substantive law applies to significant commercial contracts containing ordinary choice-of-law provisions that select New York law. This simplifies the drafting process because parties do not need to exclude New York conflict-of-laws principles to preclude a court from using those principles to apply another jurisdiction's substantive law.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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