

# Consumer Protection in Choice of Law

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## Introduction

Consumer protection in choice of law is a fairly young concept. In fact, the idea that consumers might be as much in need of protection in choice of law as in other areas of law did not loom large before the second half of the 20th century.<sup>1</sup> But once the consumer protection movement gained pace in the 1960s and 1970s, academics, courts, and legislators were quick to transfer the concept into choice of law. The first legislative provisions were enacted in the 1970s with § 41 of the Austrian Act on Private International Law<sup>2</sup> and Article 5 of the European Convention on the Law Applicable to Contractual Obligations (Rome Convention).<sup>3</sup> In the 1980s, Switzerland followed suit with the adoption of Article 120 of the new Swiss Act on Private International Law.<sup>4</sup>

Today, consumer protection in choice of law is an integral part of legal systems around the world.<sup>5</sup> Thus, it comes as a surprise that the pertaining rules and regulations have received very little attention from economic theory. Even though there is now a substantial body of literature that deals with different aspects of conflict of laws from an economic perspective,<sup>6</sup>

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1. Early academic contributions include Ole Lando, *Consumer Contracts and Party Autonomy in the Conflict of Laws*, 15 NORDISK TIDSSKRIFT FOR INTERNATIONALE RET [NITR] 208 (1972) (Den.); Bernd von Hoffmann, *Über den Schutz des Schwächeren bei Internationalen Schuldverträgen*, 38 LABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABELSZ] 396 (1974) (F.R.G.); Philippe Malaurie, *La protection des consommateurs. Rapport général*, 24 TRAVAUX DE L'ASSOCIATION HENRI CAPITANT 389 (1973) (Fr.).

2. Bundesgesetz über das Internationale Privatrecht [Federal Act on Private International Law], BUNDESGESETZBLATT No. 304/1978 (Austria) [hereinafter Austrian Private International Law Act], available at [http://www.ris.bka.gv.at/Dokumente/BgblPdf/1978\\_304\\_0/1978\\_304\\_0.pdf](http://www.ris.bka.gv.at/Dokumente/BgblPdf/1978_304_0/1978_304_0.pdf).

3. 1998 O.J. (C 27) 34 (EC) [hereinafter Rome Convention].

4. Bundesgesetz über das Internationale Privatrecht [Federal Act on Private International Law], Dec. 18, 1987, AMTLICHE SAMMLUNG [AS] 120 (1988) (Switz.) [hereinafter Swiss Private International Law Act], available at <http://www.admin.ch/ch/d/sr/291/index.html>.

5. See *infra* Part II.A.

6. See, e.g., Francisco J. Garcimartín Alferez, *Regulatory Competition: A Private International Law Approach*, 8 EUR. J.L. ECON. 251 (1999); Francisco J. Garcimartín Alferez, *La racionalidad económica del derecho internacional privado*, in CURSOS DE DERECHO INTERNACIONAL Y RELACIONES INTERNACIONALES DE VITORIA-GASTEIZ 87 (Universidad del País Vasco ed., 2001); Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L.J. 883 (2002); Peter Mankowski, *Rechtswahlklauseln und Gerichtsstandsvereinbarungen im Lichte der Spieltheorie*, in Festschrift für Hans-Bernd Schäfer 368 (Thomas Eger & Georg von Wangenheim eds., 2008); Horatia Muir Watt, *Choice of Law in Integrated and Interconnected Markets: A Matter of Political Economy*, 9 COLUM. J. EUR. L. 383 (2003); Horatia Muir Watt, *Aspects économiques du droit international privé*, 307 RECUEIL DES COURS [REC. DES COURS] 25 (2004) (Neth.); Erin A. O'Hara, *The Jurisprudence and Politics of Forum-Selection Clauses*, 3 CHI. J. INT'L L. 301 (2002); Erin A. O'Hara & Larry E. Ribstein, *Conflict of Laws and Choice of Law*, in 5 ENCYCLOPEDIA OF LAW AND ECONOMICS 631 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) [hereinafter *Conflict of Laws*]; Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151 (2000) [hereinafter *From Politics to Efficiency*]; Francesco Parisi & Erin A. O'Hara, *Conflict of Laws*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 387 (Peter Newman ed., 1998); Francesco Parisi & Larry E. Ribstein, *Choice of Law*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 236 (Peter Newman ed., 1998); Michael J. Whincop, *The Recognition Scene: Game Theoretic Issues in the Recogni-*

the question of whether and how consumers should be protected in choice of law is usually neglected. Insofar as the relevant authors deal with the question at all, they confine themselves to very brief statements relating to the reach of party autonomy. For example, Michael J. Whincop and Mary Keyes, the authors of numerous articles and, so far, the only monograph on the economics of conflict of laws,<sup>7</sup> merely have the following to say:

A greater problem is that parties can only make rational decisions with respect to choice of law clauses if they know the differences between the chosen law and the law that would otherwise apply. However, this problem doesn't counsel precluding such choices, except perhaps in the context of lower value consumer contracts.<sup>8</sup>

As a result, the question of how consumer protection should work from an economic perspective in the context of choice of law largely remains unanswered. In this Article I endeavour to fill this gap. More specifically, I analyse how choice of law rules should be designed in order to protect consumers in an efficient way. To this end, I proceed in two steps. In the first step, I analyse the economic rationale for consumer protection in choice of law. In the second step, I analyse different models of consumer protection applied around the world. I conclude that the European model of curtailing party choice of law and applying the law of the consumer's habitual residence in the absence of a choice is a good economic compromise. The same holds true for the American model that reaches similar results in practice. Both models trump all other ways of regulating choice of law in consumer contracts, most importantly the Swiss solution of excluding party choice of law in consumer contracts all together.

## I. Rationale of Consumer Protection

In the legal literature, consumer protection is generally explained, and justified, with the concept of the "weaker party." Consumers are considered to be "weaker" than their contracting partners, the professionals, and assumed to be unable to protect their interests due to inferior bargaining power.<sup>9</sup> In economic theory this reasoning is mirrored by the so-called

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*tion of Foreign Judgments*, 23 MELB. U. L. REV. 416 (1999); Michael J. Whincop, *Conflicts in the Cathedral: Towards a Theory of Property Rights in Private International Law*, 50 U. TORONTO L.J. 41 (2000); Michael J. Whincop & Mary Keyes, *Towards an Economic Theory of Private International Law*, 25 AUSTRL. J. LEG. PHIL. 1 (2000) [hereinafter *Towards an Economic Theory*]; MICHAEL J. WHINCOP & MARY KEYES, *POLICY AND PRAGMATISM IN THE CONFLICT OF LAWS* (2001) [hereinafter *POLICY AND PRAGMATISM*]. Also, see the contributions in JURGEN BASEDOW & TOSHIYUKI KONO, *AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW* (2006).

7. In addition, there is a German monograph forthcoming. GIESELA RÜHL, *STATUT UND EFFIZIENZ. ÖKONOMISCHE GRUNDLAGEN DES INTERNATIONALEN PRIVATRECHTS* (forthcoming 2011).

8. *Towards an Economic Theory*, *supra* note 6, at 31.

9. See generally Hugh Beale, *Inequality of Bargaining Power*, 6 OXFORD J. LEGAL STUD. 123 (1986) (U.K.); JOHN KENNETH GALBRAITH, *THE NEW INDUSTRIAL STATE* 213-20 (1971); Friedrich Kessler, *Contracts of Adhesion: Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632, 640-41 (1943); Spencer N. Thal, *The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness*, 8 OXFORD J. LEGAL STUD.

“exploitation theory.”<sup>10</sup> This theory dominated the economic discussion about consumer protection in the 1960s and 1970s.<sup>11</sup> Focusing on the exercise of market power, exploitation theory argues that consumers are in need of protection for two reasons: First, consumers have few options but to purchase and contract on the terms set by increasingly large and powerful companies.<sup>12</sup> Second, companies are able to exploit significant information and sophistication disparities in their favor.<sup>13</sup> However, exploitation theory has not prevailed, and economists no longer regard the theory as an explanation or justification for consumer protection.<sup>14</sup> The reason for this is that exploitation theory fails to take into account competition between companies and the fact that any bargaining power that companies have vis-à-vis consumers is limited through competition from other companies.<sup>15</sup> Therefore, insofar as consumers are today deemed in need of protection from an economic perspective, it is not because they are considered “weaker” and at risk of exploitation by large companies. Rather, it is because consumers know less about products and contracts than professionals do.<sup>16</sup> Additionally, it is sometimes argued that consumers need

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17 (1988) (U.K.). For a detailed account of this characterization of consumers, also see BARBARA DAUNER-LIEB, VERBRAUCHERSCHUTZ DURCH AUSBILDUNG EINES SONDERPRIVATRECHTS FÜR VERBRAUCHER 109-45 (1983); JOSEF DREXL, DIE WIRTSCHAFTLICHE SELBSTBESTIMMUNG DES VERBRAUCHERS 29-43 (1998); Gillian K. Hadfield, Robert Howse & Michael Trebilcock, *Information-Based Principles for Rethinking Consumer Protection Policy*, 21 J. CONSUMER POL. 131, 133-34 (1998).

10. See George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1299-1302 (1981).

11. See Stefan Haupt, *An Economic Analysis of Consumer Protection in Contract Law*, 4 GERMAN L.J. [GLJ] 1137, 1137-38 (2003) (F.R.G.); Hans-Bernd Schäfer, *Grenzen des Verbraucherschutzes und adverse Effekte des Europäischen Verbraucherrechts*, in SYSTEMBILDUNG UND SYSTEMLÜCKEN IN KERNGEBIETEN DES EUROPÄISCHEN PRIVATRECHTS 559, 559-60 (Stefan Grundmann ed., 2000).

12. See Hadfield, Howse & Trebilcock, *supra* note 9, at 134.

13. See GALBRAITH, *supra* note , at 273-74. Also, see the detailed account in DREXL, *supra* note 9, at 125-26, 139-40.

14. See Haupt, *supra* note 11, at 1138; Schäfer, *supra* note at 560; Alan Schwartz, *Legal Implications of Imperfect Information in Consumer Markets*, 151 J. INSTITUTIONAL & THEORETICAL ECON. [JITE] 31, 35-36 (1995) (F.R.G.); Fernando Gómez Pomar & Nuna Garupa, *Max Weber Lecture: The Economic Approach to European Consumer Protection Law* (Nov. 21, 2007) (transcript on file with the author).

15. See Haupt, *supra* note 11, at 1138; Schäfer, *supra* note , at 560.

16. See Howard Beales, Richard Craswell & Steven Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 501-13 (1981); Shmuel I. Becher, *Asymmetric Information in Consumer Contracts: The Challenge That Is Yet to Be Met*, 45 AM. BUS. L.J. 723, 728, 733-35 (2008); David Cayne & Michael Trebilcock, *Market Considerations in the Formulation of Consumer Protection Policy*, 23 U. TORONTO L.J. 396, 405-07 (1973); Stefan Grundmann, *Verbraucherrecht, Unternehmensrecht, Privatrecht – warum sind sich UN-Kaufrecht und EU-Kaufrechts-Richtlinie so ähnlich?*, 202 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS [AcP] 40 (2002) (F.R.G.); Hadfield, Howse & Trebilcock, *supra* note 9, at 140, 141-45; Iain Ramsay, *Consumer Protection*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 410-11 (Peter Newman ed., 1998); Schwartz, *supra* note 14, at 35-46. See generally Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1979); Alan Schwartz & Louise L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387 (1983); Carl Shapiro, *Consumer Protection Policy in*

protection because they do not always act rationally.<sup>17</sup>

### A. Information Asymmetries

Information asymmetries occur when one party to a transaction knows more about the quality of the product or services offered than the other.<sup>18</sup> These asymmetries are usually regarded as reasons for regulating transactions if the less-informed party is not in a position to acquire the relevant information, or if acquisition of relevant information is too costly.<sup>19</sup> This is the case if consumers cannot ascertain the quality of the product or service by way of inspection before a contract is concluded, i.e. if the product in question is not a search or inspection good, but rather an experience or credence good.<sup>20</sup> Experience goods are characterized by the fact that consumers can only determine their quality after completion of the contract.<sup>21</sup> Examples include diverse products such as body lotions, cereals, or restaurant visits. Credence goods are distinct in that consumers cannot even assess their quality after completion of the transaction.<sup>22</sup> Examples include visits to doctors. As a result, in transactions involving experience and credence goods, consumers cannot determine whether the deal offered is good or bad before entering into the transaction.

This phenomenon, in turn, may lead to adverse selection, and in the worst-case scenario, to a complete break-down of the market in question: If consumers cannot distinguish between good and bad deals, professionals offering low-quality products may ask for the same high price as professionals offering high-quality products.<sup>23</sup> Consumers, however, will not be

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*the United States*, 139 ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT [ZGS] 527 (1983) (F.R.G.).

17. For a detailed account, see Pomar & Garupa, *supra* note 14.

18. See CEN TO G. VELJANOVSKI, *ECONOMIC PRINCIPLES OF LAW* 40-41 (2007).

19. See *id.*; ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 46-47 (2008); MICHAEL FRITSCH, *MARKTVERSAGEN UND WIRTSCHAFTSPOLITIK: MIKROÖKONOMISCHE GRUNDLAGEN STAATLICHEN HANDELNS* 249-54 (2011); Benjamin E. Hermalin, Avery W. Katz & Richard Craswell, *Contract Law*, in 1 *HANDBOOK OF LAW AND ECONOMICS* 3, 34-39 (A. Mitchell Polinsky & Steven Shavell eds., 2007); MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* 58 (1997); Roger Van den Bergh & Louis Visscher, *Consumer Sales Law from an Economics Perspective*, in *EUROPEAN PERSPECTIVES ON PRODUCERS' LIABILITY: DIRECT PRODUCERS' LIABILITY FOR NON-CONFORMITY AND THE SELLERS' RIGHT OF REDRESS* 125, 126-27 (Martin Ebers et al. eds., 2009).

20. Van den Bergh & Visscher, *supra* note 19, at 126. For a detailed account of search goods, experience goods, and credence goods, see Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 *J.L. & ECON.* 67, 68-72 (1973); Phillip Nelson, *Information and Consumer Behavior*, 78 *J. POL. ECON.* 311, 312-18 (1970); DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 443-46, 475-76 (2004); HOLGER FLEISCHER, *INFORMATIONASYMMETRIE IM VERTRAGSRECHT* 118-20 (2001); RUDOLF RICHTER & EIRIK G. FURUBOTN, *NEUE INSTITUTIONENÖKONOMIK: EINE EINFÜHRUNG UND KRITISCHE WÜRDIGUNG* 352-61 (2003).

21. See Darby & Karni, *supra* note 20, at 68.

22. See *id.*

23. See George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 *Q.J. ECON.* 488, 488 (1970). For a detailed account, see CARLTON & PERLOFF, *supra* note 20, at 443-46; FLEISCHER, *supra* note , at 121-23; Van den Bergh & Visscher, *supra* note 19, at 126-27; VELJANOVSKI, *supra* note 18, at 40-41, 117.

willing to pay that price for a high-quality product if it is impossible to determine the quality before completion of the transaction. Since consumers will expect to receive a product of only average quality, they will only be willing to pay a price that equals the price of an average-quality product. Since this price will necessarily be lower than the price of a high-quality product, professionals offering high-quality products will be forced to lower their prices. Lowering prices, however, will require lowering the quality of the products in order to operate cost-efficiently. If professionals offering high-quality products refrain from lowering the quality of their products they will be forced out of the market. In both cases a race to the bottom occurs that leads to a “market for lemons,” i.e. a market on which only low-quality products are traded.

Against this background, what is the situation when it comes to consumer transactions in choice of law? Two points can readily be made: First, information asymmetries of the kind just described may occur in view of the applicable law just as well as in view of the quality of a product.<sup>24</sup> Professionals know the law that they wish to apply better than consumers. They have a cost-justified incentive to invest in information about the applicable law, since they engage in the same kind of transactions on a day-to-day basis. Consumers, in contrast, do not know the law that the professionals wish to apply and, worse, do not have an incentive to invest in the gathering of such information.<sup>25</sup> This is because an individual’s willingness to invest depends on her expected benefits, which are typically low compared to the costs involved: Expected benefits are low because consumer contracts are usually small contracts. Expected costs are high because law is difficult to ascertain to begin with and even more difficult to ascertain if it is a foreign law.

Second, if information asymmetries exist, they may incur the same economic problems in choice of law as in other areas of law.<sup>26</sup> Usually, consumers learn about the quality of law only after conclusion of the contract, namely when problems occur. Sometimes, when no problems occur, the quality of the law remains totally unknown. Just like a patient cannot

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24. See Horst Eidenmüller, *Recht als Produkt*, 64 JURISTENZEITUNG [JZ] 641, 650 (2009) (F.R.G.); *Conflict of Laws*, *supra* note 6, at 649; Parisi & Ribstein, *supra* note 6, at 240. Additionally, for a discussion of choice of forum clauses in consumer contracts, see Lee Goldman, *My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Form Contracts*, 86 NW. U. L. REV. 700, 711-41 (1992).

25. See Wulf-Henning Roth, *Grundfragen im künftigen internationalen Verbrauchervertragsrecht der Gemeinschaft*, in PRIVATRECHT IN EUROPA—VIELFALT, KOLLISION, KOOPERATION 591, 607-11 (Michael Coester et al. eds., 2004).

26. Eidenmüller, *supra* note 24, at 650; *From Politics to Efficiency*, *supra* note 6, at 1186-87; *Conflict of Laws*, *supra* note 6, at 648; Parisi & Ribstein, *supra* note 6, at 240; CLAUS OTT & HANS-BERND SCHÄFER, *Vereinheitlichung des Europäischen Vertragsrechts*, in VEREINHEITLICHUNG UND DIVERSITÄT DES ZIVILRECHTS IN TRANSNATIONALEN WIRTSCHAFTSRÄUMEN 203, 215-16 (2002). For a detailed account of economic problems in general contract terms, see Hans Bernd Schäfer, *Theorie der AGB-Kontrolle*, in KONSEQUENZEN WIRTSCHAFTSRECHTLICHER NORMEN. KREDITRECHT—VERBRAUCHERSCHUTZ—ALLGEMEINES WIRTSCHAFTSRECHT. Festschrift für Claus Ott zum 65. Geburtstag 279, 282-302 (Hans-Bernd Schäfer & Hans-Jürgen Lwowski eds., 2002).

always evaluate a doctor's performance, a consumer cannot always evaluate the law's performance. Therefore, professionals opting for a balanced law, or for a law that is favourable to consumers, have difficulties asking for a higher price. As a result, in the long run it may be the case that only professionals who call for application of a law that discriminates against consumers survive. In the worst case, this downward development leads to a race to the bottom, i.e. the choice of the law with the lowest level of protection.<sup>27</sup> Thus, consumers face the risk that the applicable law will be particularly beneficial to professionals, and provide for the lowest consumer-protection standard.

### 1. *The Self-Healing Powers of Markets*

A market for lemons can be prevented by various mechanisms. The mechanisms that are favored by economic theory rely on the self-healing powers of markets. They are designed to prevent a race to the bottom without regulatory intervention, and to explain why many experience and credence goods are successfully traded on unregulated markets. Two forms of market mechanisms can be distinguished: screening and signalling. They both avoid a market for lemons by providing the consumer with information. They are different, however, in the way the missing information is generated.

#### a. Screening Mechanisms

Screening mechanisms rely on consumers' ability and willingness to gather the relevant information. It is the consumer who takes the initiative to overcome the information asymmetry by trying to learn more about the product offered through her own inquiries or through third parties.<sup>28</sup> In view of the applicable law, some scholars, notably Francesco Parisi, Erin O'Hara, and Larry E. Ribstein, have argued that screening mechanisms can prevent a market for lemons.<sup>29</sup> These authors note that consumers have cheap access to many sources of consumer-oriented information about firms, including third-party rating services, magazines, and the internet. These sources, in turn, have ample incentives to report about problems with choice of law clauses or otherwise applicable laws. Additionally, consumers can do their own research in law libraries or consult a lawyer. It is not very likely, however, that these activities will yield much success—law is extremely complex and, in contrast to many other characteristics of consumer goods, can hardly ever be comprehensively determined by looking at a book or searching the internet. This is even more true if the consumer

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27. See Akerlof, *supra* note 23, at 488.

28. See FLEISCHER, *supra* note 20, at 124; Thomas Wein, *Information Problems and Market Failure: The Perspective of Economics*, in PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET 80, 87-91 (Stefan Grundmann et al. eds., 2001).

29. See Parisi & Ribstein, *supra* note 6, at 239-40; Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 409-11 (2003); see also Harvey S. Perlman, *Products Liability Reform in Congress: An Issue of Federalism*, 48 OHIO ST. L.J. 503, 508-09 (1987) (arguing for free choice of law in product liability cases).

is not interested in answering a particular legal question that might become pressing after a dispute has arisen, but instead needs to understand the impact of a choice of law clause or the otherwise applicable law before entering a contract.

As any lawyer knows who has ever tried to get acquainted with a foreign legal system, the costs necessary to do so are simply enormous. For a layperson such as a consumer, the costs would be prohibitively high. These costs could be reduced, and the chances of getting an apt understanding of the applicable law increased, if the consumer simply turned to information intermediaries, such as lawyers.<sup>30</sup> However, lawyers do not give advice for free. And since consumer contracts are usually for small sums, expected costs usually exceed expected benefits.<sup>31</sup> As a result, screening mechanisms do not seem well-suited to mitigate the problem of information asymmetries in view of the applicable law across the board.<sup>32</sup>

#### b. Signalling Mechanisms

Signalling mechanisms, on the other hand, appear more promising. They rely on the better-informed party's willingness to disclose the relevant information by sending signals that allow the less informed party to learn more about the unobservable quality of the product.<sup>33</sup> In contract law, contractual warranties are a type of signal. Since contractual warranties incur costs, only sellers of high-quality products can offer them without increasing the price. Sellers of low-quality products, in contrast, have to charge a higher contract price since they have to expect more claims on the warranty than sellers of high-quality products. Accordingly, contractual warranties signal to the consumer the otherwise unobservable quality of a product. Therefore, professionals have an incentive to provide consumers

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30. For a detailed discussion of information intermediaries, see Stefan Grundmann & Wolfgang Kerber, *Information Intermediaries and Party Autonomy—The Example of Securities and Insurance Markets*, in PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET 264–310 (Stefan Grundmann et al. eds., 2001).

31. See Michael I. Krauss, *Product Liability and Game Theory: One more Trip to the Choice-of-Law Well*, 2002 BYU L. REV. 759, 811 (2002); Gary T. Schwartz, *Considering the Proper Federal Role in American Tort Law*, 38 ARIZ. L. REV. 917, 938–41 (1996) (arguing that for reasons of asymmetric information, a free choice of law in product liability cases will provoke a race to the bottom rather than a race to the top).

32. Of course, screening mechanisms might work in some cases. If, for example, a case touches upon legal systems that share a common language and a common legal origin, consumers might be able and willing to gather information about the applicable law. From a global perspective, however, these cases can be deemed to be the exception rather than the rule.

33. See FLEISCHER, *supra* note 20, at 123–26; Stefan Grundmann, *Europäisches Verbrauchervertragsrecht im Spiegel der ökonomischen Theorie—Vertragsinformationsrecht im Binnenmarkt*, in VEREINHEITLICHUNG UND DIVERSITÄT DES ZIVILRECHTS IN TRANSNATIONALEN WIRTSCHAFTSRÄUMEN 284, 297 (Claus Ott & Hans-Bernd Schäfer eds., 2002); Markus Rehberg, *Der staatliche Umgang mit Information. Das europäische Informationsmodell im Lichte von Behavioral Economics*, in ÖKONOMISCHE ANALYSE DER EUROPÄISCHEN ZIVILRECHTSENTWICKLUNG 284, 311–17 (Thomas Eger & Hans-Bernd Schäfer eds., 2007); Wein, *supra* note 28, at 80, 85–91; Oliver E. Williamson, *Legal Implications of Imperfect Information in Consumer Markets*, 151 J. INSTITUTIONAL & THEORETICAL ECON. [JITE] 49, 49–50 (1995) (F.R.G.); see also CARLTON & PERLOFF, *supra* note 20, at 446–48.

with information in order to gain an advantage vis-à-vis their competitors.<sup>34</sup>

While it may be possible that signalling mechanisms prevent a market for lemons in some cases, however, it is unlikely that they will do so across the board. Information asymmetries in the context of choice of law differ from information asymmetries in other contexts in a way that calls the effectiveness of signalling mechanisms into question.<sup>35</sup> First, the applicable law influences the professional's reputation, if at all, only at the margin. The risks that are distributed with the help of choice of law clauses materialize only in few cases. The applicable law, therefore, is a credence good whose quality the consumer can neither determine before conclusion of a contract nor after its performance. As a result, the consumer's satisfaction—and, thus, the professional's reputation—usually does not depend on the applicable law, but rather on the immediate characteristics of the good.

Second, a company engaging in cross-border sales is far less likely to lose or to develop a reputation than a company engaging in only one country. The potential customers are too dispersed to interact and exchange information about the firm's performance. Additionally, consumer associations are less organized on an international level and are thereby less effective in exercising their monitoring function. Therefore, firms do not run a major risk when contracting under the laws of a state that shifts as many risks to the consumer as possible. For the same reason, it is more difficult for firms to build up a reputation that might induce the other party to pay a higher price for the same product but with better law. Thus, the incentives to send signals to the consumers in view of the applicable law are rather low.

### c. Empirical Evidence

Against this background, it seems that the self-healing powers of markets cannot prevent the negative effects of information asymmetries in view of the applicable law, and that consumer contracts are indeed prone to developments that can lead to a race to the lowest consumer protection standard. It needs to be emphasized, however, that there is—as of yet—no empirical evidence supporting the notion that a race to the bottom actually occurs in the context of choice of law. Additionally, such empirical evidence would be difficult to gather, since most countries have long been protecting consumers against a market for lemons in choice of law. How-

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34. See Christian Kirchner, *Justifying Limits to Party Autonomy in the Internal Market*, in *PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET* 165, 172 (Stefan Grundmann et al. eds., 2001); Erin A. O'Hara & Larry E. Ribstein, *Rules and Institutions in Developing a Law Market: Views from the U.S. and Europe*, 82 *TUL. L. REV.* 2147, 2155, 2156 (2008); Parisi & Ribstein, *supra* note 6, at 240; Larry E. Ribstein, *Choosing Law by Contract*, 18 *J. CORP. L.* 245, 257-59 (1993); Ribstein, *supra* note 29, at 409-11; see also Perlman, *supra* note 29, at 508-09 (for a discussion of the connection between informational advantages and product liability).

35. Giesela Rühl, *Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency*, in *CONFLICT OF LAWS IN A GLOBALIZED WORLD* 153, 180-81 (Eckart Gottschalk et al. eds., 2007).

ever, there is some anecdotal evidence that renders the above analysis plausible.

First, there are the notorious “Grand-Canary” cases.<sup>36</sup> In these cases, Spanish companies had sold goods to German consumers while on holiday in Spain. The contracts provided for application of Spanish law because Spain at the time had not yet implemented the European Directive on Contracts Negotiated away from Business Premises,<sup>37</sup> which would have allowed the consumers to withdraw from the contract within seven business days.<sup>38</sup> Even though delivery of the goods came through German companies that had been assigned all rights and obligations under the contracts at the time of their conclusion, the German consumers were not able to withdraw from their contract upon their return to Germany.

By the same token, consumers were deprived of the protection afforded by European law in the “Time-Sharing” cases.<sup>39</sup> Here, German consumers on holiday in Spain were talked into acquiring expensive time-shares in Spanish apartments. The contracts were made subject to the law of the Isle of Man, thereby preventing application of the European Time-Sharing Directive.<sup>40</sup> In both cases, companies intentionally called for application of a law that provided for a substantially lower consumer protection standard, thus laying the foundation for a race to the bottom.

## 2. *The Case for Regulatory Intervention*

If a race to the bottom as a result of information asymmetries cannot be prevented with the help of market mechanisms, economic theory calls for cautious regulatory intervention by the state, aimed at the regulation of information or the regulation of transactions.<sup>41</sup> As a matter of principle, economists prefer the first option, the regulation of information, over the second, the regulation of transactions.<sup>42</sup> This is because regulation of

36. For a detailed account of these cases, see ECKART BRÖDERMANN & HOLGER IVERSEN, *EUROPÄISCHES GEMEINSCHAFTSRECHT UND INTERNATIONALES PRIVATRECHT* 387-419 (1994); EVA-MARIA KIENINGER, *WETTBEWERB DER PRIVATRECHTSORDNUNGEN IM EUROPÄISCHEN BINNENMARKT* 320-22, 326-27 (2002); Peter Mankowski, *Zur Analogie im Internationalen Schuldvertragsrecht*, 1991 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS [IPRAX] 305 (1991) (F.R.G.); GERALD MÄSCH, *RECHTSWAHLFREIHEIT UND VERBRAUCHERSCHUTZ* 111-25 (1993); CHRISTIANE RÜHL, *RECHTSWAHLFREIHEIT UND RECHTSWAHLKLAUSELN IN ALLGEMEINEN GESCHÄFTSBEDINGUNGEN* 169-71 (1999).

37. Council Directive, 1985 O.J. (L 372) 31 (EC).

38. *See id.*

39. *See* BRÖDERMANN & IVERSEN, *supra* note 36, at 387-419; KIENINGER, *supra* note 36, at 320-22, 326-27; Mankowski, *supra* note 36, at 205-13; MÄSCH, *supra* note 36, at 111-25; RÜHL, *supra* note 36, at 131-32.

40. Council Directive, 1994 O.J. (L 280) 83 (EC).

41. *See* Wein, *supra* note 28, at 80, 92-96.

42. *See* Beales, Craswell & Salop, *supra* note 16, at 513-14; Stefan Grundmann, Wolfgang Kerber & Sephen Weatherill, *Party Autonomy and the Role of Information in the Internal Market—An Overview*, in *PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET* 3, 7, 10-12 (Stefan Grundmann et al. eds., 2001); Klaus J. Hopt, *Disclosure Rules as a Primary Tool for Fostering Party Autonomy—Observations from a Functional and a Comparative Legal Perspective*, in *PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET* 246, 248-49 (Stefan Grundmann et al. eds., 2001); Hanno Merkt, *Disclosure Rules as a Primary Tool for Fostering Party Autonomy*, in *PARTY*

information aims at offsetting the information imbalance between the parties without touching upon the parties' freedom to contract. The parties' power to structure their relationship according to their needs remains intact which, in turn, increases the probability of efficient contracts. Regulation of transactions, in contrast, limits freedom of contract and, thus, incurs the risk of inducing inefficient contracts. This is why economists resort to direct regulation of transactions only if the regulation of information—for whatever reasons—does not yield the desired results.<sup>43</sup>

#### a. Regulating Information

Regulation of information may help to overcome information asymmetries in two ways: First, through the establishment of a duty of information, and second, through state provision of information.

##### i. Duty of Information

The establishment of a duty of information is the most obvious way to fight the problems associated with information asymmetries.<sup>44</sup> It requires professionals to inform consumers about a choice of law, including the most important features of the chosen law.<sup>45</sup> Since it ensures that the consumer has all relevant information, it may mitigate the information asymmetry and the risk of a market for lemons. This is why some law and economics scholars, notably Erin A. O'Hara and Larry E. Ribstein as well as Michael J. Whincop and Mary Keyes, argue that consumers should be protected against a choice of law, if at all, by the establishment of a duty of information.<sup>46</sup>

However, they ignore two important aspects of international consumer transactions: First, consumers do not have an incentive to read information, unless the benefits associated with reading exceed the expected costs.<sup>47</sup> Most consumer transactions, however, only involve small amounts.

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AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET 230, 231-32 (Stefan Grundmann et al. eds., 2001).

43. See Beales, Craswell & Salop, *supra* note 16, at 513-14; Grundmann, Kerber & Weatherill, *supra* note 16, at 7, 10-12; Hopt, *supra* note 42, at 251-52.

44. For a critical analysis of whether a duty of information is indeed a less intrusive measure, see Wolfgang Schön, *Zwingendes Recht oder informierte Entscheidung—zu einer (neuen) Grundlage unserer Zivilrechtsordnung*, in *FESTSCHRIFT FÜR CLAUS-WILHELM CANARIS ZUM 70. GEBURTSTAG* 1191, 1208 (Andreas Heldrich et al. eds., 2007).

45. Of course, a duty of information may take different forms, ranging from a mere duty to inform about the inclusion of a choice-of-law provision to a duty to inform about the details of the chosen law. In the context of this article—and for the sake of the following arguments—the differences do not matter.

46. *From Politics to Efficiency*, *supra* note 6, at 1186-87; *Conflict of Laws*, *supra* note 6, at 648; Parisi & Ribstein, *supra* note 6, at 240; Ribstein, *supra* note 34, at 257-59; *Towards an Economic Theory*, *supra* note 6, at 31-32; *POLICY AND PRAGMATISM*, *supra* note 6, at 56.

47. See Eidenmüller, *supra* note 24, at 650; Rühl, *supra* note 35, at 180-81; William J. Woodward, *Constraining Opt-Outs: Shielding Local Law and Those it Protects from Adhesive Choice of Law Clauses*, 40 *LOY. L.A. L. REV.* 9, 64 (2006). See generally Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 *STAN. L. REV.* 211, 214-16 (1995); Schön, *supra* note 44, at 1206-08. For a discussion of this issue in the

Therefore, the expected benefit of reading is small and usually smaller than the costs, i.e., time and effort, associated with reading. Rational consumers, thus, will abstain from reading any information that the professional provides.<sup>48</sup> Since empirical studies show that only a negligible percentage of consumers read fine print,<sup>49</sup> a duty of information will probably not fight the information asymmetry, but will instead make international consumer contracts more costly.<sup>50</sup>

Second, even if consumers are willing to read the information provided by professionals, this does not mean that they will actually make better decisions. Empirical studies in the field of behavioral science prove that too much information can actually lower the quality of consumer decisions, a phenomenon known as “information overload.”<sup>51</sup> Apparently, the capacity of consumers to read and process information is limited, and therefore more information does not necessarily lead to more knowledge and better decisions. To the contrary, more information can even lead to worse decisions because consumers do not necessarily read the important information.

In addition, behavioural anomalies may come into the equation.<sup>52</sup> For example, it may happen that consumers miscalculate the probability that a particular legal provision becomes relevant because they overestimate available information (availability heuristic), or because they ignore small risks (law of small numbers). By the same token, they may overestimate their own capacities (self-serving bias). As a result, it seems that a duty of information will not help to overcome the information asymmetries present when consumers enter into international contracts.

## ii. Provision of Information

State provision of information is another way of overcoming informa-

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context of product liability law, see Krauss, *supra* note 31, at 811; Schwartz, *supra* note 31, at 938-41. For a discussion of the costs and benefits of information procurement, see Georg J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

48. See Rühl, *supra* note 35, at 180-82; see also Krauss, *supra* note 31, at 811; Schwartz, *supra* note 31, at 938-41 (arguing that, for reasons of asymmetric information, a free choice of law in product liability cases will provoke a race to the bottom rather than a race to the top).

49. See, e.g., Florencia Marotta-Wurgler, *Does Disclosure Matter?* (2010) (unpublished working paper, on file with the author); Florencia Marotta-Wurgler, Yannis Bakos & David R. Trossen, *Does Anyone Read the Fine Print? Testing a Law and Economics Approach to Standard Form Contracts* (N.Y.U. Ctr. for Law, Econ. and Orgs., Working Paper No. 09-40, 2009), available at <http://ssrn.com/abstract=1443256> (showing that buyers of software do not read the software licensing agreements when purchasing online).

50. See *Towards an Economic Theory*, *supra* note 6, at 31 (arguing that, for this increased cost, choice of law in consumer contracts should be limited or excluded).

51. For a detailed discussion, see Shmuel I. Becher, *Behavioral Science and Consumer Standard Form Contracts*, 68 LA L. REV. 117, 167-77 (2007); Jacob Jacoby, Donald E. Speller & Carol A. Kohn Berning, *Brand Choice Behaviour as a Function of Information Load: Replication and Extension*, 1 J. CONSUMER RES. 33 (1974).

52. For a more detailed account of behavioural anomalies in choice of law, see *infra* I.B.

tion asymmetries without directly regulating consumer contracts.<sup>53</sup> However, just like a duty of information, this way of regulating information does not promise much success. Like information provided by professionals, information provided by the state would probably not be taken into account by consumers before conclusion of a contract. States could, however, not only provide for information about different legal systems; they could provide a basis for easy comparison, for example, by ranking legal systems according to their consumer protection standard. Such rankings are already to be found in the Doing-Business-Reports of the World Bank<sup>54</sup> or the Global Competitiveness Reports of the World Economic Forum,<sup>55</sup> albeit not in the field of consumer law. However, the method and the quality of these rankings have been widely criticized.<sup>56</sup> In fact, there is wide agreement that it is not that easy to quantify a legal system's quality. As a result, ranking legal systems to provide consumers with easy access to information about the quality of the chosen law does not yet seem to be an instrument to avoid a market for lemons.

#### b. Regulating Transactions

If neither the self-healing powers of markets nor the regulation of information remedy the negative effects of information asymmetries in choice of law, the only remaining option for action is the direct regulation of consumer transactions, i.e. the direct regulation of choice of law clauses. Admittedly, this approach entails curtailing the parties' freedom to structure their relationships by limiting their freedom to choose the applicable law. However, compared with a market for lemons, direct regulation seems to be the lesser of two evils, at least if the parties' rights to choose the applicable law is only limited to the extent necessary. I will discuss below how legal systems around the world approach this challenge and which of the models applied deserves praise from an economic perspective.

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53. For a discussion on the reduction of information costs through the state in general, see Beales, Craswell & Salop, *supra* note 16, at 523-27; Alan Schwartz & Louise L. Wilde, *Competitive Equilibria in Markets for Heterogeneous Goods with Imperfect Information: A Theoretical Analysis with Policy Implications*, 13 BELL J. ECON. 181 (1982); Shapiro, *supra* note 16, at 531-32.

54. For a detailed account of the reports, see Christoph Kern, *Die Doing-Business-Reports der Weltbank – Fragwürdige Quantifizierung rechtlicher Qualität?*, 64 JURISTENZEITUNG [JZ] 498 (2009) (F.R.G.).

55. See, e.g., WORLD ECON. FORUM, THE GLOBAL COMPETITIVENESS REPORT 2010-2011 (2010), available at [http://www.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2010-11.pdf](http://www.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf).

56. See Eidenmüller, *supra* note 24, at 643; see also CHRISTOPH KERN, JUSTICE BETWEEN SIMPLIFICATION AND FORMALISM. A DISCUSSION AND CRITIQUE OF THE WORLD BANK SPONSORED LEX MUNDI PROJECT ON EFFICIENCY OF CIVIL PROCEDURE (2007); Priya P. Lele & Mathias M. Siems, *Shareholder Protection: A Leximetric Approach*, 7 J. CORP. L. STUD. 17 (2007); Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' under Consistent Coding* (Harvard Law Sch. John M. Olin Ctr., Discussion Paper No. 7, 2006), available at <http://ssrn.com/abstract=894301>.

## B. Behavioral Anomalies

In addition to information asymmetries, so-called behavioral anomalies are sometimes called upon to justify consumer protection from an economic perspective. Behavioral anomalies occur when consumers do not behave in accordance with the standard economic rational-choice model, which presumes that individuals act to maximize their own welfare.<sup>57</sup> The rational-choice model rests on a number of assumptions:<sup>58</sup> First, individuals determine and compare the costs and benefits of different courses of action before making a decision. Second, individuals have or collect all necessary information before making a decision. Third, individuals have the necessary intellectual abilities to process and to assess this information. Fourth, individuals have robust and stable preferences that are independent of outside factors and do not change over time.

For many years, the rational choice model has dominated the law and economics movement. It has also informed the first economic analyses in the field of choice of law.<sup>59</sup> However, there is now credible, experimental evidence that supports the notion that individuals frequently act in ways that are incompatible with the assumptions of rational choice theory. According to several studies, individuals suffer from serious intellectual limitations that impair their ability to act rationally. For example, individuals do not always determine the costs and benefits of different courses of action before making a decision. Nor do they always collect all necessary information to do so. Instead, individuals use heuristics or rules of thumb that simplify, but distort their decisions.<sup>60</sup> In addition, individuals' preferences are neither robust nor stable.<sup>61</sup> Rather, they are subject to change

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57. For different versions of the rational-choice model, see Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000).

58. See COOTER & ULEN, *supra* note 19, at 21-23; RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 3-10, 17 (2007).

59. *Cf. From Politics to Efficiency*, *supra* note 6; POLICY AND PRAGMATISM, *supra* note 6; Hans-Bernd Schäfer & Katrin Lantermann, *Choice of Law from an Economic Perspective*, in AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW 87 (Jürgen Basedow & Toshiyuki Kono eds., 2006).

60. See generally Christoph Engel & Gerd Gigerenzer, *Law and Heuristics*, in HEURISTICS AND THE LAW 1 (2006); Markus Englerth, *Behavioral Law and Economics*, in RECHT UND VERHALTEN 60, 90-98 (Christoph Engel et al. eds., 2007); Christine Jolls, Cass R. Sunstein & Richard H. Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1477-78 (1998); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499, 1503-06 (1998); Matthew Rabin, *Psychology and Economics*, 36 J. ECON. LIT. 11, 26-31 (1998); Cass R. Sunstein, *Behavioral Law and Economics: A Progress Report*, 1 AM. L. & ECON. REV. 115, 139-43 (1999); ANNE VAN AAKEN, "RATIONAL CHOICE" IN DER RECHTSWISSENSCHAFT 100-03 (2003) [hereinafter RATIONAL CHOICE]; Anne van Aaken, *Das deliberative Element juristischer Verfahren als Instrument zur Überwindung nachteiliger Verhaltensanomalien*, in RECHT UND VERHALTEN 189 (Christoph Engel et al. eds., 2007).

61. See generally Englerth, *supra* note , at 82-83; Jolls, Sunstein & Thaler, *supra* note 60, at 1477-78; Langevoort, *supra* note 60, at 1503-06; Rabin, *supra* note 60, at 13-16; Sunstein, *supra* note 60, at 131-35, 139; Thomas S. Ulen, *Behavioral Law and Economics*, in HANDBOOK OF CONTEMPORARY BEHAVIORAL ECONOMICS 671, 677-80 (Morris Altman ed., 2006); RATIONAL CHOICE, *supra* note 60, at 88-93.

under outside influence and over time.

In light of these findings, many economists argue that consumers need protection, not only because they know less than professionals, but also because they do not always act rationally.<sup>62</sup> In choice of law, this line of reasoning has not yet been employed to justify consumer protection. However, behavioral anomalies may occur in international as well as in national settings. For example, consumers may systematically miscalculate the costs and benefits of a choice-of-law rule because they use heuristics or rules of thumb. They might, for example, agree to a choice of American law because the American legal system is—thanks to jury trials and punitive damages awards—more often in the news than other legal systems (availability heuristic). Or, they might underestimate certain risks and agree to a choice of law that does not sufficiently cover these risks (optimistic bias). The decisive question, therefore, is whether behavioral anomalies can actually explain and justify consumer protection in choice of law.

There are several reasons to doubt that behavioural anomalies can serve this function: First, the empirical findings are not as solid as they appear at first blush. In fact, several studies show that the results found in psychological and behavioural experiments specifically set up to investigate behavioural anomalies cannot always be found in reality.<sup>63</sup> Take credit card agreements as an example. According to many behavioural economists, consumers are systematically lured into contracts that do not mirror their best interests because they are too optimistic about their own spending behaviour, and they underestimate the need to pay credit card fees, e.g.,

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62. See, e.g., Becher, *supra* note 51; Colin F. Camerer, *Wanting, Liking and Learning: Neuroscience and Paternalism*, 73 U. CHI. L. REV. 87 (2006); Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111 (2006); Edward L. Glaeser, *Paternalism and Psychology*, 73 U. CHI. L. REV. 133 (2006); Christine Jolls, *Behavioral Law and Economics*, 30–33 (Nat'l Bureau of Econ. Research, Working Paper No. 12879, 2007); Jeffrey J. Rachlinski, *Cognitive Errors, Individual Differences, and Paternalism*, 73 U. CHI. L. REV. 207 (2006); Alan Schwartz, *How Much Irrationality Does the Market Permit?*, 37 J. LEG. STUD. 131 (2008); Thomas S. Ulen, *Information in the Market Economy*, in PARTY AUTONOMY AND THE ROLE OF INFORMATION IN THE INTERNAL MARKET 98 (Stefan Grundmann et al. eds., 2001); Joshua D. Wright, *Behavioral Law and Economics, Paternalism and Consumer Contracts: An Empirical Perspective*, 2 N.Y.U. J. L. & LIB. 470 (2007). For a critique, see Pomar & Garupa, *supra* note 14, at 24–29.

63. See the overview in Wright, *supra* note 62, and also the studies of Sumit Agarwal, Souphala Chomsisengphet, Chunlin Liu & Nicholas Souleles, *Do Consumers Choose the Right Credit Contracts?* (Fed. Reserve Bank of Chi., Working Paper No. 11, 2006), available at <http://ssrn.com/abstract=843826>; Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not so Crazy?*, 73 U. CHI. L. REV. 63 (2006); Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J. L. & ECON. 421 (2007); John A. List, *Does the Market Experience Eliminate Market Anomalies?*, 118 Q. J. ECON. 41 (2003) [hereinafter *Market Experience*]; John A. List, *Neoclassical Theory Versus Prospect Theory: Evidence From the Marketplace*, 72 ECONOMETRICA 615 (2004) [hereinafter *Neoclassical Theory*]; Florencia Marotta-Wurgler, *Competition and the Quality of Standard Form Contracts: An Empirical Analysis of Software License Agreements*, 5 J. EMP. LEG. STUD. 447 (2008); Nadia Massoud, Anthony Saunders & Barry Scholnick, *Who Makes Credit Card Mistakes?* (Fed. Reserve Bank of Phila. Working Paper, 2007); Eugenio J. Miravete, *Choosing the Wrong Calling Plan? Ignorance and Learning*, 93 AM. ECON. REV. 297 (2003).

late payment fees, over limit fees, and cash advance fees (optimistic bias).<sup>64</sup>

Real world data, however, shows that most consumers are in fact able to predict their future spending behaviour properly, and consumers usually do not enter into credit card agreements that contradict their interests.<sup>65</sup> In fact, consumers who have to choose between two different contracts—low interest rates with an annual fee or high interest rates with no annual fee—usually choose the contract that is beneficial for them in the long run.<sup>66</sup> Second, many studies show that consumers are able to learn and change their behaviour when they realize that they have made a mistake.<sup>67</sup> As a result, even if consumers fail to act in accordance with the standard economic rational choice model, this does not mean that they will continue to do so. Again, take credit card agreements as an example. Here, several studies show that consumers who have to pay late payment fees, over limit fees, or cash advance fees, manage to reduce these fees, on average, by 75% in four years.<sup>68</sup> As a result, at least some consumers are able to correct initial mistakes and miscalculations concerning their spending behaviour over time and, thus, decrease the differences between actual and rational actions.

In view of the initial question—whether behavioural anomalies may explain and justify consumer protection in choice of law—these findings imply that there is, as of yet, too little empirical evidence that shows that consumers systematically and persistently depart from the rational-choice model. In choice of law, empirical studies analysing consumer behaviour, most importantly, consumers' attitudes towards choice-of-law clauses, are completely lacking. As a result, behavioral anomalies may not, at least not at the moment, serve as a justification for consumer protection in choice of law. However, this might change if more empirical studies, especially studies covering choice-of-law situations, are available. In that case, it is more than likely that the discussion about consumer protection in choice of law will then gain momentum and move in new directions.

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64. Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004); Xavier Gabaix & David I. Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q. J. ECON. 505 (2006). For a detailed treatment of the topic, see Wright, *supra* note 62, at 475–77.

65. See Agarwal, Chomsisengphet, Liu & Souleles, *supra* note 63. For a detailed treatment of the topic, see Wright, *supra* note 62, 477–82.

66. See Agarwal, Chomsisengphet, Liu & Souleles, *supra* note 62, at 16.

67. See, e.g., Agarwal, Chomsisengphet, Liu & Souleles, *supra* note 63; Sumit Agarwal, John C. Driscoll, Xavier Gabaix & David Laibson, *Stimulus and Response: The Path from Naiveté to Sophistication in the Credit Card Market* (Aug. 20, 2007) (unpublished working paper); Peter Fishman & Dennis G. Pope, *The Long-Run Effects of Penalizing Customers: Evidence from the Video-Rental Market*, (June 2007) (unpublished working paper) (on file with University of California at Berkeley, Department of Economics); *Market Experience*, *supra* note 63; *Neoclassical Theory*, *supra* note 63; Miravete, *supra* note 63; see also Roland Bénabou & Jean Tirole, *Willpower and Personal Rules*, 112 J. POL. ECON. 848 (2004); Dilip Soman & Amar Cheema, *When Goals are Counterproductive: The Effects of Violation of a Behavioral Goal on Subsequent Performance*, 31 J. CONSUMER RES. 52 (2004) (describing mechanisms that people use to overcome cognitive disabilities).

68. Agarwal, Driscoll, Gabaix & Laibson, *supra* note 67.

## II. Models of Consumer Protection

As indicated earlier, consumer protection in choice of law is an integral part of most modern legal systems.<sup>69</sup> The pertaining rules share the virtue of applying the same basic approach: They modify the rules about free party choice of law and the rules that determine the applicable law in the absence of a choice of law. For everything else, there is little agreement. Differences appear both in view of the content of the pertaining rules and the regulatory technique applied. Whereas some national laws and international regulations provide specific choice-of-law rules for transactions involving consumers, others rely on general clauses or rather vague concepts.

The first regulatory technique is to be found, for example, in Article 5 of the Rome Convention,<sup>70</sup> Article 6 of the Rome I-Regulation,<sup>71</sup> Article 11 of the Japanese Private International Law Act,<sup>72</sup> Section 27 of the Korean Private International Law Act,<sup>73</sup> Article 1212 of the Russian Civil Code,<sup>74</sup> Article 120 of the Swiss Private International Law Act,<sup>75</sup> and Article 26 of the Turkish Private International Law Act.<sup>76</sup> It is also applied in the United States, to the extent that consumer protection is granted, by Section 109(a) sentence 2 of the Uniform Computer Information Transaction Act,<sup>77</sup> Section 51:1418 of the Louisiana Revised Statutes,<sup>78</sup> and Section 3(4)(a) of the Oregon Act Relating to Conflict of Laws Applicable to Contracts.<sup>79,80</sup>

The second regulatory technique, in contrast, prevails under the Inter-American Convention on the Law Applicable to Contractual Obligations (Mexico Convention).<sup>81</sup> Even though it was closely modelled after the Rome Convention, it does not provide for specific choice-of-law rules for consumer contracts.<sup>82</sup> However, consumers may be protected with the help

69. See *infra* Part II.A.1.

70. Rome Convention, *supra* note 3.

71. Council Regulation (EC) No. 593/2008 of 17 June 2008, 2008 O.J. (L 177) 6 [hereinafter Rome I-Regulation].

72. Hō no Tekiyō ni kansuru Tsūsoku-hō [General Act on the Application of Laws], Law No. 28 of 2006, [hereinafter Japanese Private International Law Act].

73. Gukjesabeop [Act on Private International Law], Law No. 6465 of Apr. 7, 2001 [hereinafter Korean Private International Law Act].

74. Sobranie Zakonodatel'stva Rossijskoj Federacii [SZ RF] [Russian Federation Collection of Legislation] 2001, No. 147-FZ, Item 1212 [hereinafter Russian Civil Code].

75. Swiss Private International Law Act, *supra* note 4.

76. Milletlerarası Özel Hukuk ve Usul Hukuku Hakkında Kanun [Act on Private International Law and Civil Procedure], Law No. 5718 of Nov. 27, 2007, Resmi Gazete [RG] No. 26728 of Dec. 12, 2007 [hereinafter Turkish Private International Law Act].

77. U.C.I.T.A. § 109(a) (1999).

78. LA. REV. STAT. ANN. § 51:1418 (2001).

79. OR. REV. STAT. § 81.105(4)(2009).

80. Note that Section 1-301(e) of the Uniform Commercial Code in the revised version of 2001 also contained a choice-of-law rule specifically designed for consumer contracts. However, the provision was withdrawn in 2008. See *infra* note 100.

81. Convención Interamericana sobre Derecho Aplicable a los Contratos Internacionales [Inter-American Convention on the Law Applicable to Contractual Obligations], Mar. 17, 1994, available at <http://www.oas.org/juridico/English/treaties/b-56.html>.

82. See Mo Zhang, *Party Autonomy and Beyond: An International Perspective of Contractual Choice of Law*, 20 EMORY INT'L L. REV. 511, 548 (2006).

of the very flexible provisions that determine the law applicable in the absence of a choice of law, as well as with the help of overriding mandatory provisions.<sup>83</sup> The second regulatory technique is applied in the United States, insofar as consumers are protected under the fundamental public policy doctrine expressly enshrined in Section 187(2) Restatement (Second) of Conflict of Laws,<sup>84</sup> and also read into Section 1-301 of the Uniform Commercial Code.<sup>85</sup>

### A. Party Choice of Law

Around the world, international contracts are governed by the law chosen by the parties.<sup>86</sup> In fact, with the exception of some South American countries,<sup>87</sup> the principle of party autonomy claims widespread application, and is often termed a “universal approach.”<sup>88</sup> When it comes to consumer transactions, however, most legal systems restrict the parties’ freedom to choose the applicable law in one way or another. In the following section, I will first provide a comparative overview of the models applied to protect consumers, and then offer an economic analysis.

#### 1. Comparative Overview

When looking into national legal systems and international treaties, three basic models of consumer protection can be distinguished: The first

83. See ALEXANDER GEBELE, *DIE KONVENTION VON MEXIKO* 111-12 (2002); Eugenio Hernández-Bretón, *Internationale Handelsverträge im Lichte der Interamerikanischen Konvention von Mexiko über das auf internationale Verträge anwendbare Recht*, 1998 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS [IPRAX] 378, 384 (1998) (F.R.G.); Jürgen Samtleben, *Versuch über die Konvention von Mexiko über das auf internationale Schuldverträge anwendbare Recht*, 1998 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS [IPRAX] 385, 391 (1998) (F.R.G.).

84. For a detailed discussion on the subject, see PETER HAY, PATRICK J. BORCHERS & SYMEON C. SYMEONIDES, *CONFLICT OF LAWS* 1098-129 (2010); Giesela Rühl, *Konvergenz im Internationalen Vertragsrecht? Zu jüngeren Entwicklungen im europäischen und US-amerikanischen Kollisionsrecht*, 47 ZEITSCHRIFT FÜR RECHTSVERGLEICHUNG, INTERNATIONALES PRIVATRECHT UND EUROPARECHT [ZfRV] 175, 181-82 (2006); Rühl, *supra* note 35, at 167-71.

85. HAY, BORCHERS & SYMEONIDES, *supra* note 84, at 1155-56; Eberhard Röhms & Robert Koch, *Choice of Law in International Distribution Contracts: Obstacle or Opportunity?*, 11 N.Y. INT’L L. REV. 1, 7 (1998).

86. Russell J. Weintraub, *Functional Developments in Choice of Law for Contracts*, 187 RECUEIL DES COURS [REC. DES COURS] 239, 271 (1984) (Neth.); SYMEON C. SYMEONIDES, WENDY C. PERDUE & ARTHUR T. VON MEHREN, *CONFLICT OF LAWS: AMERICAN, COMPARATIVE, INTERNATIONAL* 339 (2003).

87. Specifically, Bolivia, Brazil, Colombia and Uruguay. However, in both Brazil and Uruguay, proposals to reform the law and to recognize party autonomy were made in 2004 and 2009 respectively and are expected to be adopted in the near future. For a detailed account of these proposals, see María Mercedes Albornoz, *Choice of Law in International Contracts in Latin American Legal Systems*, 6 J. PRIV. INT’L L. 23, 43-48 (2010) and Didier Opertti Badán & Cecilia Fresnedo de Aguirre, *The Latest Trends in Latin American Private International Law: the Uruguayan 2009 General Law on Private International Law*, 11 YB. PRIV. INT’L L. 305, 332-35 (2009) (Switz.).

88. Patrick J. Borchers, *Choice of Law in the American Courts in 1992: Observations and Reflections*, 42 AM. J. COMP. L. 125, 135 (1994); see also Weintraub, *supra* note 86, at 271.

model excludes party choice of law in consumer transactions altogether. The second model limits the parties' choice to certain laws. And the third model curtails the effects of a party choice of law.

a. The First Model: Excluding Party Choice of Law

The first model exists in Switzerland. It is very straightforward because it simply excludes party autonomy in consumer contracts. According to Article 120(2) of the Swiss Act on Private International Law, there is no choice of law in consumer contracts.<sup>89</sup> Similar provisions are found in the Oregon and Louisiana codifications on choice of law: According to Section 51:1418(C) of the Louisiana Revised Statutes and Section 3(4)(a) of the Oregon Contracts Conflict Act,<sup>90</sup> a choice of a foreign law—including the law of another state—will not be enforced if the consumer is a resident in one of these two states, and if the transaction was concluded or initiated there.<sup>91</sup> As a result, Louisiana and Oregon will refuse to enforce a choice of law clause in consumer transactions providing for a foreign law if the transaction has a connection to their territory. However, in contrast to Switzerland, both states will honor a choice of foreign law if the consumer is not a resident of Louisiana or Oregon, or if the transaction does not have the specified connection to these states.<sup>92</sup>

b. The Second Model: Limiting Party Choice of Law

The second model of consumer protection exists in the European Union. In contrast to the first model, it does not exclude choice of law in consumer transactions, but it limits party autonomy to certain laws. According to Article 5(2), sentence 3 of the Rome I-Regulation, parties to a contract of carriage may only choose the law of the passenger's habitual residence, the law of the carrier's habitual residence or central place of administration, the law of the place of departure, or the law of the place of destination.<sup>93</sup> By the same token, Article 7(3), sentence 1 of the Rome I-

89. Swiss Private International Law Act, *supra* note 4.

90. See Symeon C. Symeonides, *Codifying Choice of Law for Contracts: The Oregon Experience*, 69 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABELSZ] 726, 730 (2003) (F.R.G.).

91. For details, see OR. REV. STAT. § 81.105(4)(2009); LA. REV. STAT. ANN. § 51:1418 (2001).

92. See James A. R. Nafziger, *The Louisiana and Oregon Codifications of Choice-of-Law Rules in Context*, 58 AM. J. COMP. L. 165, 191-92 (2010).

93. For a detailed account of Article 5 of the Rome I-Regulation, see Gianluca Contaldi, *Il contratto internazionale di trasporto di persone*, in LA NUOVA DISCIPLINA COMUNITARIA DELLA LEGGE APPLICABILE AI CONTRATTI (ROMA I) 349 (Nerina Boschiero ed., 2009); Peter Mankowski, *Entwicklungen im Internationalen Privat- und Prozessrecht für Transportverträge in Abkommen und speziellen EG-Verordnungen*, 2008 TRANSPORTRECHT [TRANSPORTR] 339 (2008) (F.R.G.); Arnt Peter Nielsen, *The Rome I Regulation and Contracts of Carriage*, in ROME I REGULATION 99 (Franco Ferrari et al. eds. 2009); RICHARD PLENDER & MICHAEL WILDERSPIN, *THE EUROPEAN PRIVATE INTERNATIONAL LAW OF OBLIGATIONS* 205-22 (2009); Sara Tonolo, *La legge applicabile ai contratti di trasporto nel Regolamento Roma I*, RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE [RIV. DIPP] 309 (2009); Rolf Wagner, *Neue kollisionsrechtliche Vorschriften für Beförderungsverträge in der Rom I-VO*, 2008 TRANSPORTRECHT [TRANSPORTR] 221-24 (2008) (F.R.G.); Rolf Wagner,

Regulation essentially limits parties' choice in insurance contracts to the law of the state where the risk is situated at the time of conclusion of the contract, or the law of the country where the policyholder has his habitual residence.<sup>94</sup> In the context of life insurance, Article 7 additionally allows the choice of the law of the state of which the policyholder is a national.<sup>95</sup> For insurance contracts covering risks limited to events occurring in a state other than the state where the risk is situated, the parties may also choose the law of that state.<sup>96</sup> As a result, Articles 5 and 7 of the Rome I-Regulation protect passengers and policyholders by limiting party autonomy to laws that have a connection to either the parties or the transaction.<sup>97</sup>

In other countries, limitations such as those in Articles 5 and 7 of the Rome I-Regulation are unknown.<sup>98</sup> However, Section 187(2) of the Restatement (Second) of Conflict of Laws provides that a party choice of law will only be enforced if the parties or the transaction bear a substantial relationship to the chosen law.<sup>99</sup> By the same token, Section 1-301(1) of the Uniform Commercial Code requires a reasonable relationship.<sup>100</sup> American

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*Die EG-Verordnungen Brüssel I, Rom I und Rom II aus der Sicht des Transportrechts*, 2009 TRANSPORTRECHT [TRANSPORTR] 281, 286-88 (2009) (F.R.G.).

94. See Rome I-Regulation, *supra* note 71. For a detailed account of Article 7 of the Rome I-Regulation, see Martin Fricke, *Das Internationale Privatrecht der Versicherungsverträge nach Inkrafttreten der Rom I-Verordnung*, 2009 VERSICHERUNGSRECHT [VERS]R] 443 (2009) (F.R.G.); Urs Peter Gruber, *Insurance Contracts*, in *ROME I REGULATION* 109 (Franco Ferrari & Stefan Leible eds., 2009); Christian Heinze, *Insurance Contracts under the Rome I Regulation*, 2009 NEDERLANDS INTERNATIONAAL PRIVAATRECHT [NIPR] 445 (2009) (Neth.); Helmut Heiss, *Insurance Contracts in Rome I: Another Recent Failure of the European Legislature*, 10 Yb. PRIV. INT'L L. 261 (2009) (Switz.); Dirk Looschelders & Kirstin Smarowos, *Das Internationale Versicherungsvertragsrecht nach Inkrafttreten der Rom I-Verordnung*, 2010 VERSICHERUNGSRECHT [VERS]R] 1 (2010) (F.R.G.); Louise Merret, *Choice of Law in Insurance Contracts under the Rome I Regulation*, 5 J. PRIV. INT'L L. 49 (2009); Rosa Miquel Sala, *El nuevo Derecho internacional privado de los seguros en el reglamento Roma I*, 8 ANUARIO ESPAÑOL DE DERECHO INTERNACIONAL PRIVADO [AEDIPR] 425 (2008) (Spain); PLENDER & WILDERSPIN, *supra* note 93, at 270-96; Stefan Perner, *Das Internationale Versicherungsvertragsrecht nach Rom I*, 2009 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS [IPRAX] 218 (2009) (F.R.G.); Paola Piroddi, *I contratti di assicurazione tra mercato interno e diritto internazionale privato*, in *LA NUOVA DISCIPLINA COMUNITARIA DELLA LEGGE APPLICABILE AI CONTRATTI (ROMA I)* 247 (Nerina Boschiero ed., 2009); Caroline Van Schoubroeck, *The New European Conflicts-of-Law Rules from an Insurance Perspective*, 2009 REVUE EUROPÉENNE DE DROIT DE LA CONSOMMATION [R.E.D.C.] 729, 755-64 (2009) (Belg.).

95. See Rome I-Regulation, *supra* note 71. art. 7.

96. See *id.*

97. Note that Articles 5 and 7 of the Rome I-Regulation are not limited to consumer contracts. Rather, they cover, and protect, all types of policyholders and passengers because they are perceived as weaker parties. This, in turn, raises the question of whether, in addition to consumers, other persons need protection against party-driven choice of law across the board. This question, however, is beyond the scope of this article.

98. Note, however, that Article 121(3) of the Swiss Act on Private International Law applies the second model in view of employment contracts. Swiss Private International Law Act, *supra* note 4, art. 121.

99. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971).

100. The current version of Section 1-301 of the Uniform Commercial Code was adopted in 2008 and essentially corresponds to Section 1-105 of the original Uniform Commercial Code. In 2001, attempts to abandon the reasonable relationship require-

law thus looks to broader connections to the chosen law than European law, which is limited to contracts of carriage and insurance contracts.

However, just like in Europe, the relationship requirement is informed by the desire to avoid evasion of mandatory laws designed to protect weaker parties, most importantly consumers.<sup>101</sup> This understanding is confirmed by a look to the case law relating to Section 187(2) of the Restatement (Second) and Section 1-301(1) of the Uniform Commercial Code. Whereas courts regularly enforce choice-of-law clauses in commercial contracts, even if the connection to the chosen law is rather weak, they are more reluctant to do so when consumers are involved.<sup>102</sup> As a result, the American substantial or reasonable relationship doctrine may actually be understood as a means of consumer protection, making it a variation of the second model of consumer protection to be found in Articles 5 and 7 of the Rome I-Regulation.

### c. The Third Model: Curtailing Party Choice of Law

The third model of consumer protection neither excludes party choice of law altogether, nor limits the choice to certain laws. Instead, it curtails the effects of a party choice of law. It applies in the European Union, Japan, Korea, Russia, Turkey and the United States. According to Article 5(2) of the Rome Convention,<sup>103</sup> Article 6(1) of the Rome I-Regulation,<sup>104</sup> Article

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ment for business-to-business contracts were unsuccessful because most states chose to keep the original version. The 2001 version was, therefore, withdrawn in 2008 and replaced with the current version that basically restores Section 1-105 of the original Uniform Commercial Code. For a detailed account of the legislative history of the provision, see HAY, BORCHERS & SYMEONIDES, *supra* note 84, at 1152.

101. See Dennis Solomon, *The Private International Law of Contracts in Europe: Advances and Retreats*, 82 TUL. L. REV. 1709 (2008); Symeon C. Symeonides, *Party autonomy in Rome I and II: An Outsider's Perspective*, 2010 NEDERLANDS INTERNATIONAAL PRIVAATRECHT [NIPR] 191, 195-96 (2010) (Neth.). To be sure, just like Articles 5 and 7 of the Rome I-Regulation, Section 187(2) of the Restatement (Second) of Conflict of Laws and Section 1-301(1) of the Uniform Commercial Code are not limited to consumers.

102. HAY, BORCHERS & SYMEONIDES, *supra* note 84, at 1109-15; Rühl, *supra* note 84, at 181-82; Rühl, *supra* note 35, at 168-71.

103. For a detailed account of Article 5 of the Rome Convention, see BERNARD AUDIT, DROIT INTERNATIONAL PRIVÉ 671 (2006); Jürgen Basedow, *Internationales Verbrauchervertragsrecht*, in 1 Festschrift für Erik Jayme 3, 13-17 (Heinz-Peter Mansel et al. eds., 2004) [hereinafter *Internationales Verbrauchervertragsrecht*]; Jürgen Basedow, *Consumer Contracts and Insurance Contracts*, in ENFORCEMENT OF INTERNATIONAL CONTRACTS IN THE EUROPEAN UNION IN A FUTURE ROME I-REGULATION 269, 277-82 (Johan Meeusen et al. eds., 2004) [hereinafter *Consumer Contracts*]; DOMINIQUE BUREAU & HORATIA MUIR WATT, 2 DROIT INTERNATIONAL PRIVÉ 337-38 (2007); LAWRENCE COLLINS, DICEY, MORRIS AND COLLINS ON THE CONFLICT OF LAWS 1638 (2006); LEANDER D. LOACKER, DER VERBRAUCHERVERTRAG IM INTERNATIONALEN PRIVATRECHT 97 (2006); Ulrich Magnus, in STAUDINGERS KOMMENTAR ZUM BGB, art. 29 EGBGB, ¶ 96 (Christian Armbrüster et al. eds., 2002); Peter Mankowski, *Strukturfragen des Internationalen Verbrauchervertragsrecht*, 1993 RECHT DER INTERNATIONALEN WIRTSCHAFT [RIW] 453, 459 (1993) (F.R.G.); Dieter Martiny, in INTERNATIONALES VERTRAGSRECHT 682, ¶ 823 (Christoph Reithmann & Dieter Martiny eds., 6th ed. 2004); Dieter Martiny, in MÜNCHENER KOMMENTAR ZUM BGB, art. 29 EGBGB, ¶ 54 (Kurt Rebmann, Franz Jürgen Säcker & Roland Rixecker eds., 4th ed. 2006); MARIE-LAURE NIBOYET & GÉRAUD DE GEOUFFRE DE LA PRADELLE, DROIT INTERNATIONAL PRIVÉ 25 (2007).

11(1) of the new Japanese Private International Law Act,<sup>105</sup> Section 27(1) of the new Korean Private International Law Act,<sup>106</sup> Article 1212(1) of the Russian Civil Code,<sup>107</sup> and Article 26(1) of the Turkish Private International Law Act,<sup>108</sup> the parties may choose the applicable law even if one of the parties is a consumer.

However, the choice may not deprive the consumer of the protection afforded to him by the mandatory provisions of the law of his habitual

104. See Jan De Meyer, *International Jurisdiction and Conflict of Law Rules for Consumer Claims: A Survey of European Legislation*, 2009 REVUE EUROPÉENNE DE DROIT DE LA CONSOMMATION [R.E.D.C.] 631, 655-56 (2009) (Belg.) (providing a detailed account of Article 6 of the Rome I-Regulation); Stéphanie Francq, *Le Règlement "Rome I" sur la Loi Applicable aux Obligations Contractuelles. De Quelques Changements . . .*, 136 JOURNAL DU DROIT INTERNATIONAL [J. DR. INT.] 41, 62-63 (2009) (Fr.); Jonathan Hill, *Article 6 of the Rome I Regulation: Much Ado About Nothing*, 2009 NEDERLANDS INTERNATIONAAL PRIVAAT-RECHT [NIPR] 437 (2009) (Neth.); Hughes Kenfack, *Le règlement (CE no 593/2008 du 17 juin 2008) sur la loi applicable aux obligations contractuelles ("Rome I"), navire stable aux instruments efficaces de navigation?*, 136 JOURNAL DU DROIT INTERNATIONAL [J. DR. INT.] 3, 30-33 (2009) (Fr.); Aurelio López-Tarruella Martínez, *Contratos internacionales celebrados por los consumidores: las aportaciones del nuevo artículo 6 reglamento Roma I*, 8 ANUARIO ESPAÑOL DE DERECHO INTERNACIONAL PRIVADO [AEDIPr] 511 (2008) (Spain); Aurelio López-Tarruella Martínez, *International Consumer Contracts in the New Rome I Regulation: How Much Does the Regulation Change?*, 2009 REVUE EUROPÉENNE DE DROIT DE LA CONSOMMATION [R.E.D.C.] 345 (2009) (BELG.); Peter Mankowski, *Die Rom I-Verordnung—Änderungen im europäischen IPR für Schuldverträge*, 2008 INTERNATIONALES HANDELSRECHT [IHR] 133, 140-41 (2008) (F.R.G.) [hereinafter *Die Rom I-Verordnung*]; Peter Mankowski, *Consumer Contracts Under Article 6 of the Rome I Regulation*, in LE NOUVEAU RÈGLEMENT EUROPÉEN "ROME I" RELATIF À LA LOI APPLICABLE AUX OBLIGATIONS CONTRACTUELLES 121, 140-41 (Eleanor Cashin Ritaine & Andrea Bonomi eds., 2009) [hereinafter Mankowski, *Consumer Contracts*]; PLENDER & WILDERSPIN, *supra* note 93, at 227-54; Francesca Ragno, *The Law Applicable to Consumer Contracts under the Rome I Regulation*, in *ROME I REGULATION* 129 (Franco Ferrari & Stefan Leible eds., 2009); Francesco Seatzu, *Contratti con i consumatori e Regolamento Roma I*, in LA NUOVA DISCIPLINA COMUNITARIA DELLA LEGGE APPLICABILE AI CONTRATTI (ROMA I) 299 (Nerina Boschiero ed., 2009); Solomon, *supra* note 101, at 1717-19, 1730-34.

105. See Yuko Nishitani, *Die Reform des internationalen Privatrechts in Japan*, 2007 PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS [IPRAX] 552, 554-55 (2007) (F.R.G.) [hereinafter *Die Reform*]; Yuko Nishitani, *Party Autonomy and Its Restrictions by Mandatory Rules in Japanese Private International Law*, in JAPANESE AND EUROPEAN PRIVATE INTERNATIONAL LAW IN COMPARATIVE PERSPECTIVE 77, 92-94, 94-100 (Jürgen Basedow, Harald Baum & Yuko Nishitani eds., 2008) [hereinafter *Party Autonomy*]; Yasuhiro Okuda, *Reform of Japan's Private International Law: Act on the General Rules of the Application of Laws*, 8 YB. PRIV. INT'L L. 145, 152-54 (2006) (Switz.) [hereinafter *Reform*]; Yasuhiro Okuda, *Aspects de la Réforme du Droit International Privé au Japon*, 134 JOURNAL DU DROIT INTERNATIONAL [J. DR. INT.] 899, 906-08 (2007) (Fr.) [hereinafter *Aspects*]; Koji Takahashi, *A Major Reform of Japanese Private International Law*, 2 J. PRIV. INT'L L. 311, 320-25 (2006); Hironori Wanami, *Background and Outline of the Modernization of Japanese Private International Law*, in JAPANESE AND EUROPEAN PRIVATE INTERNATIONAL LAW IN COMPARATIVE PERSPECTIVE 61, 67-68 (Jürgen Basedow, Harald Baum & Yuko Nishitani eds., 2008).

106. See Knut B. Pissler, *Einführung in das neue Internationale Privatrecht der Republik Korea*, 70 LABELS ZEITSCHRIFT FUER AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABELSZ] 279 (2006) (F.R.G.) (providing a detailed account of the new Korean law); Knut B. Pissler, *Internationales Privatrecht*, in EINFÜHRUNG IN DAS KOREANISCHE RECHT 115 (Korea Legislation Institute ed., 2010).

107. Russian Civil Code, *supra* note 74.

108. Turkish Private International Law Act, *supra* note 76.

residence (preferential law approach).<sup>109</sup> The provisions instead require an issue-by-issue comparison between the chosen law and the mandatory law of the consumer's habitual residence. If the chosen law provides for more protection, it governs the contract. If, however, the chosen law provides for less protection, the contract is governed by a law mix, consisting of the chosen law and the mandatory provisions of the law at the consumer's habitual residence. The mandatory provisions of the consumer's habitual residence, thus, provide for the minimum standard of consumer protection.

The third model is also found in the United States insofar as consumer protection is provided by the fundamental public policy doctrine enshrined in Section 187(2) of the Restatement (Second) of Conflict of Laws and read into Section 1-301(1) of the Uniform Commercial Code.<sup>110</sup> Under this doctrine, consumers are protected against a choice of law that violates a fundamental public policy of the law at the consumer's habitual residence.<sup>111</sup> And since American courts usually find a violation of a fundamental public policy if a choice-of-law clause provides for application of a foreign law that would deprive the consumer of the protection afforded to him by the law of his habitual residence,<sup>112</sup> American courts engage in the same kind of comparison between the chosen law and the law of the consumer's habitual residence as courts in Europe, Japan, Korea, Russia, and Turkey. The only difference between the American version of the third model and the version used in Europe, Japan, Korea, Russia, and Turkey, is that the latter applies a law mix if the chosen law provides for less protection than the law at the consumer's habitual residence. Under the American fundamental public-policy doctrine, in contrast, the choice of law is completely set aside with the result that the consumer's law governs the transaction completely.

All in all, consumers in Europe, Japan, Korea, Russia, Turkey, and the United States are protected against an undesirable choice of law with the

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109. Note that the preferential law approach does not apply to all consumer contracts but only to those that meet certain requirements. According to Article 6(1) of the Rome I-Regulation, for example, application of the consumer protection regime requires that the professional pursue his commercial or professional activities in the country where the consumer has his habitual residence, or by any means, directs such activities to that country or to several countries including that country, and the contract falls within the scope of such activities. In other countries, similar provisions are in place. Unfortunately, a detailed discussion of the requirements that need to be met for the preferential law approach to apply is beyond the scope of this paper. For a detailed account, see Paul Cachia, *Consumer Contracts in European Private International Law: The Sphere of Operation of the Consumer Contract Rules in the Brussels I and Rome I Regulations*, 34 *EUR. L. REV.* 476 (2009).

110. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971).

111. According to Sections 191 and 196 of the Restatement (Second) of Conflict of Laws, the law at the consumer's habitual residence is the law that applies in the absence of a choice of law.

112. Rühl, *supra* note 84, at 181-82; Rühl, *supra* note 35, at 168-71. Also, for a recent, though more skeptical account of the fundamental public policy doctrine and its application to class action waivers and credit card agreements, see James J. Healy, *Consumer Protection in Choice of Law: European Lessons for the United States*, 19 *DUKE INT'L & COMP. L. J.* 535, 536-46 (2009).

help of the preferential law approach. Differences, however, remain in the way the protection is activated. According to Article 6(1) of the Rome I-Regulation and Section 27(1) of the Korean Act on Private International Law, courts must determine, compare, and possibly apply the mandatory provisions of the consumer's habitual residence *ex officio*.<sup>113</sup> In contrast, according to Article 11(1) of the new Japanese Private International Law Act, consumers must plead and prove the content of the mandatory provisions of their habitual residence.<sup>114</sup> It is, therefore, the consumer who must find and determine the applicable law. The same holds true for the United States, where parties generally have to plead and prove foreign law.<sup>115</sup>

## 2. Economic Analysis

The large number of different models designed to protect consumers in choice of law, including their different versions, leads one to wonder which of these models deserves praise from an economic perspective.<sup>116</sup> The answer depends on two factors: the ability of the models to effectively avoid a market for lemons caused by asymmetric information, and their ability to reduce the costs of regulation.

### a. Avoiding a Market for Lemons

The first factor, the avoidance of a market for lemons, lies at the heart of consumer protection in choice of law. A model that does not stem the risks flowing from information asymmetries does not fight the economic problem of consumer protection in choice of law and, thus, cannot stand from an economic perspective. For the most part, however, the models described above do well in this context. The first model, which excludes party autonomy, does not allow the parties to choose the applicable law. As a result, consumers do not need to fear that professionals will choose the law with the lowest consumer-protection standard. The danger of a race to the bottom is effectively avoided. The same holds true for the third model, the preferential-law approach, in its different versions. This model ensures that consumers will not lose the protection afforded to them by the law of their habitual residence. As a result of the need to compare the chosen law with the mandatory provisions of the law of the consumer's habitual residence, the second model guarantees that a choice of law can only make consumers better off, never worse off. A race to the bottom resulting in a market for lemons may therefore not occur.<sup>117</sup>

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113. See Rome I-Regulation, *supra* note 71, art. 6; Korean Private International Law Act, *supra* note 73.

114. *Die Reform*, *supra* note 105, at 554-55; *Party Autonomy*, *supra* note 105, at 94-96; *Reform*, *supra* note 105, at 153-54; *Aspects*, *supra* note , at 907; Takahashi, *supra* note , at 321-22.

115. See HAY, BORCHERS & SYMEONIDES, *supra* note 84, at 602-04; SYMEON C. SYMEONIDES, *AMERICAN PRIVATE INTERNATIONAL LAW* 89-91 (2008).

116. Of course, consumer protection may also be based on non-economic grounds. However, this article primarily deals with efficiency.

117. Of course, this only holds true under the assumption that the standards of conflict of laws are enforced in practice. If not, the professional can rely on the consumer's

Finally, a market for lemons might also be prevented under the second model, which limits parties' choices to certain laws. Under the condition that the eligible laws provide for a minimum standard of consumer protection, and under the condition that laws with no or little consumer protection may not be chosen, a race to the bottom cannot occur,<sup>118</sup> or at least it will not have the disastrous effects that may eventually result in a complete breakdown of the market. The second model, however, poses practical implementation problems: How can the laws be identified that provide for a sufficient level of consumer protection? It does not seem feasible to explore all legal systems of the world and to draw up a list of those that provide for enough consumer protection. The time and resources necessary to complete such a list and to keep it updated would very likely exceed the associated benefits.

This is probably why Articles 5 and 7 of the Rome I-Regulation and Section 187(2) of the Restatement (Second) of Conflict of Laws follow a different path to determine the eligible laws—they both require a relationship between the chosen law on the one hand, and the parties or the transaction on the other. The criterion of relationship, however, may not effectively prevent a race to the bottom. To begin with, a relationship between the chosen law and the parties or the transaction has nothing to do with consumer protection. The parties or the transaction may have a relationship to a certain law, but the law can still lack a sufficient degree of consumer protection. In addition, professionals may be able to influence the relevant connecting factors and, thus, the eligible laws. For example, under Article 5(2) of the Rome I-Regulation, the parties may submit a contract of carriage to the law at the carrier's habitual residence or place of central administration.<sup>119</sup> And since carriers may influence both their habitual residence and their place of central administration, they may effectively provide for application of a law with little or no consumer protection. The same holds true for the American substantial-relationship doctrine, embodied in Section 182(2) of the Restatement (Second) of Conflict of Laws. Here, professionals may easily create contacts to the chosen law and, thus, effectively choose a law with a low consumer-protection standard.<sup>120</sup> As a result, no matter whether the relationship criterion is implemented by precisely enumerating the laws the parties may choose, or by using general terms, it does not effectively prevent a race to the bottom.

Against this background, the second model can only convincingly fight a market for lemons if the parties' choice is limited to laws of states that are members of a federation or union with a common constitution or quasi-constitutional framework that guarantees a minimum standard of

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lack of knowledge and choose the law that benefits the professional the most. See Peter Mankowski, *Art. 5 des Vorschlags für eine Rom I-Verordnung—Revolution im Internationalen Verbrauchervertragsrecht*, 106 ZEITSCHRIFT FÜR VERGLEICHENDE RECHTSWISSENSCHAFT [ZVGLRWISS] 120, 159–60 (2006) (F.R.G.); *Die Rom I-Verordnung*, *supra* note 104, at 140–41; Mankowski, *Consumer Contracts*, *supra* note , at 141–42.

118. *From Politics to Efficiency*, *supra* note 104, at 1187.

119. See Rome I-Regulation, *supra* note 71.

120. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 182(2) (1971).

consumer protection. In the United States, the second model could be implemented, for example, by limiting the parties' choice to the laws of the U.S. states.<sup>121</sup> Likewise, in Europe, the parties' choice could be limited to the laws of member states of the European Union. However, this version of the second model would solve the problem of consumer transactions only on a regional, but not global, level. As a result, the second model does not amount to an economically viable solution to the problem of information asymmetry present in international consumer transactions. The following discussion, therefore, will focus on the first and third models of consumer protection.

#### b. Reducing the Costs of Regulation

The first factor, the ability to effectively avoid a market for lemons, does not suffice to make a final judgment about the economic efficiency of different models of consumer protection. It is merely the first economic test that a model must pass. In addition to effectively managing the risks of information asymmetry, an efficient model of consumer protection must keep the costs of regulation as low as possible, i.e., it must provide for legal certainty and meet parties' preferences as far as possible. As I will show, neither the first nor third model of consumer protection manages to succeed in both dimensions.

#### i. Legal Certainty

The first model, which excludes party autonomy altogether, excels in view of legal certainty.<sup>122</sup> It provides a clear-cut rule because parties know that they are not allowed to choose the applicable law. In contrast to the third model, parties and courts need not engage in a complex comparison of the chosen law and the mandatory provisions of the law of the consumer's habitual residence. Instead, parties and courts may focus on the rules that determine the applicable law in the absence of a choice of law. Thus, the first model provides for legal certainty and reduces both transaction and litigation costs.

The third model, in contrast, provides less legal certainty: It requires parties and courts to compare the chosen law and the mandatory provisions of the law at the consumer's habitual residence, and to apply either the chosen law or the law of the consumer's habitual residence. The Euro-

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121. See *From Politics to Efficiency*, *supra* note 6, at 1187 ("But lawmakers concerned about rogue jurisdictions should restrict the available choices rather than ban all choice. For example, the parties might be permitted to choose only the laws of U.S. states, which are governed by a common constitution, a common legal system, and common cultural norms.").

122. See JONATHAN HILL, *CROSS-BORDER CONSUMER CONTRACTS* 329 (2008); Stefan Leible, *Rechtswahlfreiheit und kollisionsrechtlicher Verbraucherschutz*, 1995 *JAHRBUCH JUNGER ZIVILRECHTSWISSENSCHAFTLER* [Jb. J. ZWiss.] 245, 259 (1995) (F.R.G.); see also De Meyer, *supra* note 104, at 656; Mankowski, *supra* note 117, at 151-52; Peter Mankowski, *Der Vorschlag für die Rom I-Verordnung*, 2006 *PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS* [IPRAX] 101, 106 (2006) (F.R.G.); Sophia Zheng Tang, *Parties' Choice of Law in E-Consumer Contracts*, 3 *J. PRIV. INT'L L.* 113, 127-28 (2007).

pean, Japanese, Korean, Russian, and Turkish version may also require courts to combine both laws, depending on the issue at stake, leading to application of an artificial law mix. It goes without saying that this way of dealing with international consumer contracts is much more complicated than excluding party autonomy altogether. It makes it very difficult for the parties, especially for consumers, to predict which law will eventually apply to their contract. It also makes it very hard for courts to determine the applicable law. The same holds true for the actual application of the law. As a result, the third model provides for significantly less legal certainty than the first model. By the same token, it incurs substantially higher transaction and litigation costs.

## ii. Party Preferences

The first model is weaker on party preferences than on legal certainty. This is because the exclusion of party autonomy reduces the parties' choices and brings about costs for both professionals and consumers.<sup>123</sup> For professionals this finding does not come as a surprise. The very idea of consumer protection in choice of law is to reduce professionals' choices in order to avoid a market for lemons. However, the exclusion of party autonomy also results in costs for consumers.

To begin with, consumers are effectively deprived of the potential benefits of a choice of law. For example, consumers may not agree to a professional choice of law in order to reduce the costs of the transaction and, thus, the contract price. Since the professionals must adjust their contracts to a foreign law, chances are that consumers will have to pay a higher price for goods and services.<sup>124</sup> In the worst-case scenario, consumers are effectively barred from buying a product or from accepting a service because professionals refuse to sell their products or to offer their services in certain national markets.<sup>125</sup> Consumers may also incur costs because exclusion of party autonomy excludes competition among legal systems and the potential benefits associated with it. States become monopolists in view of consumer law and might have an incentive to protect local consumers at the expense of international professionals.<sup>126</sup> The result may be negative cross-border external effects that increase prices and limit the range of available products and services to the disadvantage of local consumers.

However, whether and to what extent the above-described costs occur depends on consumers' preferences. As Carl Shapiro puts it:

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123. See generally Shapiro, *supra* note 16, at 538-39.

124. See Pomar & Garupa, *supra* note 14, at 8-13; Ramsay, *supra* note 16, at 413-14; see also Patrick J. Borchers, *Categorical Exceptions to Party Autonomy in Private International Law*, 82 TUL. L. REV. (2008) 1645, 1658-59. See generally Lucian A. Bebchuk, *The Pursuit of a Bigger Pie: Can Everyone Expect a Bigger Slice?*, 8 HOFSTRA L. REV. 671 (1980); Harold Demsetz, *Wealth Distribution and the Ownership of Rights*, 1 J. LEG. STUD. 223 (1972); Koichi Hamada, *Liability Rules and Income Distribution in Product Liability*, 66 AM. ECON. REV. 228 (1976).

125. See Ramsay, *supra* note 16, at 413.

126. See Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, in *THE FALL AND RISE OF FREEDOM OF CONTRACT* 325, 339-46 (F. H. Buckley ed., 1999).

[P]roduct regulation amounts to trading off two effects: regulation decreases the variety of products . . . harming those who wish to buy the banned varieties, while regulation protects consumers from unknowingly purchasing a product which they would not choose were they informed. The heterogeneity of consumers' tastes (and incomes) must be balanced against their lack of information.<sup>127</sup>

Thus, the first model does not impair consumers' preferences if consumers are in fact not interested in choosing the applicable law. The situation would then be comparable to products and services that nobody wants.<sup>128</sup> Take, for example, the service of a surgeon without professional training.<sup>129</sup> It certainly reduces consumers' choice to allow only trained surgeons to practice. It also increases the price for the service offered by trained surgeons. However, since nobody wants to undergo surgery unless the surgeon is competent, allowing only trained surgeons to practice does not create any costs. In other words, banning products and services that nobody wants may only improve welfare. The same would hold for the exclusion of party autonomy if consumers were in fact not interested in a choice of law.

The problem, however, is that consumer preferences are very hard to determine. In contrast to the service of untrained surgeons, it is hard to tell whether consumers, or at least a sufficiently large number of consumers, are happy if they have no choice as to the applicable law. Of course, in light of the risks flowing from information asymmetries, it can be assumed that many consumers do not mind if they do not have a choice. However, chances are high that at least some consumers would prefer to have a choice. As a result, the first model of consumer protection indeed seems to impair the parties' preferences.<sup>130</sup>

In contrast, the third model of consumer protection does a better job with respect to the parties' preferences. It does not exclude party autonomy altogether, but allows a choice of law insofar as it makes consumers better off. As a result, it establishes minimum quality standards<sup>131</sup> comparable to so-called "partly mandatory" provisions of substantive laws that may only be modified to the benefit of the consumer.<sup>132</sup> In contrast to the first model, the third model reduces consumers' choice only insofar as a choice would make them worse off. In fact, it reduces only the freedom of choice of those consumers who would be willing to accept a lower standard of consumer protection for a lower price, while it does not touch upon the

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127. Shapiro, *supra* note 16, at 539.

128. *Id.* at 538-39.

129. This example was taken from *id.* at 538-39.

130. See also *From Politics to Efficiency*, *supra* note 6, at 1186-87; Ribstein, *supra* note 34, at 257-58.

131. For a detailed account, see Hayne E. Leland, *Quack, Lemons, and Licensing: A Theory of Minimum Quality Standards*, 87 J. POL. ECON. 1328 (1979).

132. See Michael Martinek, *Unsystematische Überregulierung und konstraintentionale Effekte im Europäischen Verbraucherschutzrecht, in SYSTEMBILDUNG UND SYSTEMLÜCKEN IN KERNGEBIETEN DES EUROPÄISCHEN PRIVATRECHTS* 511, 530-32 (Stefan Grundmann ed., 2000); WULF-HENNING ROTH, *INTERNATIONALES VERSICHERUNGSVERTRAGSRECHT* 505-06 (1985).

freedom of choice of consumers who are willing to pay more for more consumer protection. It follows that the third model impairs parties' preferences significantly less than the first model.

iii. Economic Efficiency

The preceding discussion has important implications for the overall efficiency of the first and third models of consumer protection. To begin with, neither the exclusion of party autonomy nor the limitation of its effects is a perfect solution to the problem of information asymmetries in international consumer contracts. The exclusion of party autonomy incurs significant costs because it ignores some consumers' preferences. The limitation of its effects incurs costs because it is complex and difficult to apply.

The decisive question, therefore, is which of the two models is the better economic compromise? I submit that it is the preferential law approach—the second model—because the perceived advantages of the first model are not as significant as they first appear. More specifically, the first model does not provide for as much legal certainty as one might think. In fact, its application may turn out to be as complicated as the application of the preferential law approach. This is because the first model excludes party autonomy and, thus, submits consumer contracts to the law applicable in the absence of a choice of law, i.e., the law of the consumer's habitual residence.<sup>133</sup> This law, however, usually allows modifications and deviations insofar as its provisions are not mandatory. The parties, thus, may agree that the non-mandatory provisions of the law of the consumer's habitual residence, i.e., the default rules, are replaced by other rules, for example, the rules of a foreign law. As a result, application of the first model may—like the third model—lead to application of a law mix, consisting of the mandatory provisions of the law of the consumer's habitual residence and other provisions the parties wish to apply.

On the other hand, this also means that the first model does not limit party autonomy as much as it appears to at first glance. However, in contrast to the third model, it does not allow parties to deviate from the mandatory provisions of the law of the consumer's habitual residence if this makes the consumer better off.<sup>134</sup> It follows that the first and the second model incur about the same transaction and litigation costs in practice, whereas the third model involves lower regulatory costs because it curtails parties' choice to a lesser extent, i.e., only to the extent necessary.

Against this background, the third model can be classified as an economically viable compromise that is to be preferred over the first model.<sup>135</sup> Of course, application of the preferential law approach is complicated and

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133. See *infra* II.B.1.

134. The only exceptions to this rule are the above-mentioned partly mandatory rules. They grant a minimum standard of protection and allow contractual deviations for the benefit of the consumer. If and to the extent that the law at the consumer's habitual residence provides for such substantive rules, the first and the third model incur the same economic costs and benefits.

135. See also Eidenmüller, *supra* note 24, at 651.

causes costs in practice. However, the above considerations show that it is impossible to grant free party choice of law, protect consumers, and avoid complex rules at the same time.<sup>136</sup>

## B. Applicable Law in the Absence of a Party Choice of Law

### 1. Comparative Overview

With regard to the law that applies in the absence of a choice of law, there is more agreement around the world. In most national legal systems and international regulations, the law of the consumer's habitual residence governs consumer contracts. This follows, for example, from Article 5(2) of the Rome Convention,<sup>137</sup> Article 6(1) of the Rome I-Regulation in view of consumer contracts in general,<sup>138</sup> Article 11(2) of the Japanese Private International Law Act,<sup>139</sup> Section 27(2) of the Korean Private International Law Act,<sup>140</sup> Article 1212(2) of the Russian Civil Code, Article 120(1) of the Swiss Private International Law Act,<sup>141</sup> Article 26(2) of the Turkish Private International Law Act,<sup>142</sup> and Section 109(b), sentence 2 of the Uniform Computer Information Transaction Act.<sup>143</sup> For contracts of carriage, Article 5(2) of the Rome I-Regulation calls for application of the law of the consumer's habitual residence, provided that the consumer's habitual residence is also the place of departure or the place of destination.<sup>144</sup> For insurance contracts, Article 7(2), sentence 3 of the Rome I-Regulation provides that the law of the country applies where the risk is situated.<sup>145</sup> However, in the case of mass-risk insurance contracts, this is usually the place

136. See also ROTH, *supra* note 132, at 497.

137. See AUDIT, *supra* note 103, at 670-71; *Internationales Verbrauchervertragsrecht*, *supra* note 103, at 17; *Consumer Contracts*, *supra* note 103, at 282; BUREAU & WATT, *supra* note 103, at 338-39; COLLINS, *supra* note 103, at 1645; LOACKER, *supra* note , at 100-03; Magnus, *supra* note 103, at 112-15; INTERNATIONALES VERTRAGSRECHT, *supra* note 103, at 685-86; MÜNCHENER KOMMENTAR ZUM BGB, *supra* note 103, at 62; NIBOYET & DE GEOUFFRE DE LA PRADELLE, *supra* note 103, at 25.

138. See Meyer, *supra* note 104, at 654-55; Francq, *supra* note 104, at 62-63; Kenfack, *supra* note 104, at 30-33; Martinez, *supra* note 104, at 362; Mankowski, *Consumer Contracts*, *supra* note 104, at 142-43; Seatzu, *supra* note 104, at 307-13; Solomon, *supra* note 101, at 1717-19, 1730-34.

139. See *Die Reform*, *supra* note 105, at 555; *Party Autonomy*, *supra* note 105, at 97; *Reform*, *supra* note 105, at 154; *Aspects*, *supra* note 105, at 908; Takahashi, *supra* note 105, at 322.

140. See Pissler, *Einführung in das neue Internationale Privatrecht der Republik Korea*, *supra* note 106, at 308-09; Pissler, *Internationales Privatrecht*, *supra* note 106, at 134.

141. See IVO SCHWANDNER, *EINFÜHRUNG IN DAS INTERNATIONALE PRIVATRECHT* 255 (1998); FRANK VISCHER, LUCIUS HUBER & DAVID OSER, *INTERNATIONALES VERTRAGSRECHT* (2d ed. 2000).

142. Turkish Private International Law Act, *supra* note 76.

143. U.C.I.T.A. § 109(b) (1999).

144. See Contaldi, *supra* note 93, at 376-78; Mankowski, *supra* note 93, at 348; Nielsen, *supra* note 93, at 107-08; PLENDER & WILDERSPIN, *supra* note 93, at 216-17; Tonolo, *supra* note 93, at 321-23; Wagner, *Neue Kollisionsrechtliche Vorschriften für Beförderungsverträge in der Rom I-VO*, *supra* note 93, at 223; Wagner, *Die EG-Verordnungen Brüssel I, Rom I und Rom II aus der Sicht des Transportrechts*, *supra* note 93, at 288.

145. See Fricke, *supra* note 94, at 449; Gruber, *supra* note 94, at 116-18; Heinze, *supra* note 94, at 450; Heiss, *supra* note 94, at 276-77; Looschelders & Smarowos, *supra* note 94, at 7; Merret, *supra* note 94, at 60-61; Sala, *supra* note 94, at 439; Perner, *supra*

of the consumer's habitual residence.<sup>146</sup>

The law of the consumer's habitual residence is also the applicable law under the Restatement (Second) of Conflict of Laws, even though there is no express provision providing for this result.<sup>147</sup> However, according to Restatement Sections 189 to 197, contracts are generally subject to the law of the party who receives the goods and services.<sup>148</sup> Since this is usually the consumer, the Restatement usually calls for application of the law of the consumer's habitual residence. In contrast to most other legal systems, there is, therefore, no need for an express provision dealing with consumer contracts.

## 2. Economic Analysis

The global application of the law at the consumer's habitual residence is also welcome from an economic perspective. First, it effectively prevents a market for lemons caused by asymmetric information. Of course, it may come as a surprise that there is a risk of a market for lemons to begin with if there is no choice of law. However, most of the connecting factors that determine the applicable law can easily be manipulated. As a result, professionals may influence the applicable law even without a choice of law clause. The risk of a market for lemons can, therefore, only be effectively prevented if the applicable law is determined through a connecting factor—such as the consumer's habitual residence—that cannot be influenced by the professional. If, in contrast, the professional's habitual residence would determine the applicable law, professionals could determine the law—similar to a choice of law—by, for example, moving the seat of the company or founding a subsidiary or regional office.

Second, in contrast to other connecting factors, which also cannot be influenced by the professional, looking to the consumer's habitual residence reduces the costs associated with the determination of the applicable law. With regard to consumers, this finding flows from the fact that they are most acquainted with the law of their habitual residence. Furthermore, it can be assumed that consumers have the best access to information about the law of their habitual residence.<sup>149</sup> With regard to professionals, the reduction in determination costs may be attributed to the fact that the consumer's habitual residence is easier to identify than other connecting factors, e.g., the nationality of the consumer, which the professional also could not manipulate. Of course, applying the consumer's habitual residence raises the professionals' costs compared to a connecting factor

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note 94, at 220; Piroddi, *supra* note 94, at 288-90; PLENDER & WILDERSPIN, *supra* note 93, at 284-86.

146. See Rome I-Regulation, *supra* note 71, art. 7; see also Fricke, *supra* note 94, at 447 n.31; Gruber, *supra* note 94, at 116-18; Heinze, *supra* note 94, at 448 n.64; Heiss, *supra* note 94, at 276-77; Looschelders & Smarowos, *supra* note 94, at 2-4; Merret, *supra* note 94, at 61; Sala, *supra* note 94, at 439; Perner, *supra* note 94, at 218-19; Piroddi, *supra* note 94, at 288-89; PLENDER & WILDERSPIN, *supra* note 93, at 278.

147. See Rühl, *supra* note , at 181-82; Rühl, *supra* note , at 167-71.

148. See Solomon, *supra* note , at 1717.

149. Rühl, *supra* note 35; see also Roth, *supra* note 25, at 613.

located in the professionals' sphere. However, the overall costs associated with looking to the consumer's habitual residence are still lower than the costs associated with any other factor. Since professionals are repeat players and, thus, repeatedly enter into the same kind of transaction on the same foreign market, they are able to spread the costs associated with the determination of the consumer's habitual residence over multiple contracts. Professionals, therefore, are the cheapest cost avoiders.<sup>150</sup>

Third, application of the law of the consumer's habitual residence avoids a split of jurisdiction and applicable law. This is because the pertaining rules and regulation on jurisdiction in consumer contracts—in the European Union Article 15 of the Brussels I-Regulation<sup>151</sup>—usually assign disputes relating to consumer contracts to the court of the consumer's habitual residence. As a result, courts usually do not need to engage in the cost-intensive inquiry of foreign law, but may apply their own law. Since consumer cases usually involve small claims, this reduces litigation costs.<sup>152</sup> In addition, avoiding a split of jurisdiction and applicable law increases the chance that consumers will actually enforce their rights. This, in turn, reduces the chance that professionals will outsmart the consumer.

## Conclusion

Cross-border consumer transactions are among the most frequent transactions conducted around the world. As a result of globalization, increased regional integration, and the internet, consumers enter into international and interstate sales contracts, services contracts, and other types of contracts on a day-to-day basis, very often without being fully aware of their contract terms. In most cases, these contracts are governed by general contract terms provided by the professional. And in many cases, these terms provide for a choice of law clause. From an economic perspective, these clauses pose serious problems. However, this is not because consumers are strategically “inferior” to, or “weaker” than professionals; rather, it is because consumers know less about the applicable law and have no incentive to invest in the gathering of relevant information. Professionals, in contrast, enter into a large number of similar contracts on the same market. As a result, they have an incentive to gather information about the applicable law in order to choose the law that provides the most benefits for them and the least benefits for consumers. Since consumers are not able to distinguish between professionals who choose consumer-friendly laws and those who do not, this may lead to a race to the bottom and a market for lemons.

To avoid such a development, several mechanisms can be applied. To begin with, the law can rely on the self-healing powers of markets, most

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150. See Mankowski, *Consumer Contracts*, *supra* note 104, at 142; Roth, *supra* note 25, at 607–11.

151. Council Regulation (EC) No. 44/2001 of 22 December 2000, 2001 O.J. (L 12) 1.

152. See *Internationales Verbrauchervertragsrecht*, *supra* note 103, at 14; *Consumer Contracts*, *supra* note 103, at 278.

importantly screening and signalling mechanisms. However, both mechanisms are unlikely to avoid the problems flowing from information asymmetries in consumer contracts because they rely on consumers' ability and willingness to gather information about the applicable law. A duty to inform imposed on professionals is unlikely to yield more success. Therefore, the only way to prevent a race to the bottom and a market for lemons is to directly regulate consumer transactions by modifying the general provisions determining the applicable law.

From the various models that are applied around the world, the general European model, which is also found, albeit with differences in detail, in Japan, Korea, Russia, Turkey, and the United States, promises the greatest benefits in terms of efficiency. It does not exclude a free party choice of law but merely limits the parties' freedom to choose the applicable law with the help of the preferential law approach. According to this approach, a choice of law may not deprive consumers of the mandatory provisions of the law of their habitual residence. The preferential law approach, thus, provides for a minimum standard of consumer protection, which effectively prevents a market for lemons. Since it limits free party choice of law only to the extent necessary, it is to be preferred over both the complete exclusion of choice of law found in Switzerland and the limitation of the parties' choice to certain laws found in the European Union relating to insurance contracts and contracts of carriage.

In the absence of a party choice of law, the European model—and likewise the American, Japanese, Korean, Russian, and Turkish model—calls for application of the law of the consumers' habitual residence. Since the habitual residence is outside the professional's influence, this approach effectively prevents a market for lemons and reduces the cost of determining the applicable law. Under the European, the American, the Japanese, the Korean, the Russian, and the Turkish models, consumers are, thus, well protected against the risks flowing from information asymmetries. As a result, the respective rules and regulations enhance efficiency, even though they were not drafted with economic theory in mind.

