

## New York Court of Appeals Confirms that New York Governing Law Clauses Should Be Enforced to Result in the Application of New York Substantive Law

The New York Court of Appeals unanimously ruled on December 18, 2012, in *IRB-Brasil Resseguros, S.A. v. Inepar Investments, S.A.*, that a contract that provides it is governed by New York law and is otherwise subject to New York General Obligations Law Section 5-1401 must be interpreted and enforced according to New York substantive law, even if applying New York conflict-of-laws rules would not yield that result. This ruling should end any prior uncertainty as to whether a court would rule that such a contract should be interpreted according to the laws of another jurisdiction where applying New York's conflict-of-laws rules would so require, on the ground that the "whole" of the contractually-specified "New York law" includes not only New York substantive law, but also New York's conflict-of-laws rules. It should also simplify the drafting of governing law clauses, by eliminating the need to expressly exclude the application of New York's conflict-of-laws rules from a contract's designation of New York law as its governing law.

### Background

Following several unexpected court rulings in the early 1980s, contract drafters who wished for their contracts to be governed by New York substantive law began to supplement their governing law clauses to provide not only for New York substantive law to apply, but also to explicitly exclude New York's conflict-of-laws rules. They did so in order to avoid a court's application of those rules in a manner that would result in the contract being interpreted and applied under the substantive law of another jurisdiction, if New York's conflict-of-laws rules – which focus on such factors as the parties' contacts with New York, the location of their expected performance and other indicia of the contract's relationship to New York – would yield that result. *See, e.g., Carlos v. Philips Business Systems, Inc.*, 556 F. Supp. 769, 774, n.4 (E.D.N.Y. 1983) (interpreting a contract under New Jersey law, despite a governing law clause specifying New York law, on the ground that "New York law" includes its conflict-of-laws rules, and applying those rules indicated that New Jersey law should apply). Thus, despite the enactment in 1984 of New York General Obligations Law Section 5-1401, which expressly provides for the enforcement of a New York governing law clause whether or not the contract containing that clause "bears a reasonable relation" to New York, practitioners reframed their governing law clauses to provide, in one illustration, not merely that "This contract and any dispute arising thereunder shall be governed by and construed in accordance with the laws of the State of New York," but rather that "This contract and any dispute arising thereunder shall be governed by and

construed in accordance with the *internal* laws of the State of New York, *without regard to any conflicts of law principles thereof that would result in the application of the laws of any other jurisdiction.*” (emphases added)

### The Court of Appeals’ Ruling

In its unanimous ruling in *IRB-Brasil Resseguros, S.A. v. Inepar Investments, S.A.*, the Court of Appeals confirmed that if a contract is subject to New York General Obligations Law Section 5-1401 – which generally covers all contracts concerning transactions involving in the aggregate not less than \$250,000, and that are not agreements for labor, personal, family or household services – and provides that the contract is governed by New York law, the parties’ rights and duties must be determined according to New York substantive law, even if the contract does not expressly exclude New York’s conflict-of-laws rules, and those rules would point toward applying the law of another jurisdiction.

This ruling arose from a disagreement between two foreign corporations concerning a guarantee of obligations arising under certain notes. While the agreement underlying the guarantee provided that “[t]his Agreement, the Notes, and the Guarantee shall be governed by, and construed in accordance with, the laws of the State of New York, without regard to conflict of laws principles,” the guarantee itself provided only that it was “governed by, and ... be construed in accordance with, the laws of the State of New York.” When a claim was made under the guarantee, the guarantor argued that the guarantee was governed by Brazilian substantive law, because that result was dictated by New York’s conflict-of-laws rules, which had not been explicitly excluded from the guarantee’s governing law clause.

In a unanimous opinion written by Chief Judge Lippman, the New York Court of Appeals affirmed the lower courts’ rejection of the guarantor’s contention. In doing so, the Court emphasized that the Legislature had adopted Section 5-1401 of the General Obligations Law “in order to allow parties without New York contacts to choose New York law to govern their contracts,” in the interests of predictability and of maintaining New York’s standing as a source of well-developed commercial jurisprudence and a global commercial and financial center. The Court added that “[i]t strains credulity that the parties would have chosen to leave the question of the applicable substantive law unanswered and would have desired a court to engage in a complicated conflict-of-laws analysis, delaying resolution of any dispute and increasing litigation expenses.” The Court’s conclusion was unequivocal: “Express contract language excluding New York’s conflict-of-laws principles is not necessary. The plain language of General Obligations Law § 5–1401 dictates that New York substantive law applies when parties include an ordinary New York conflict-of-laws provision, such as appears in the Guarantee, in their contracts.” The Court added that, when contracting parties do wish to be governed by New York’s conflict-of-laws rules to determine the substantive law that will govern their rights and duties, “they can expressly so designate in their contract.”

Conclusion

The Court's ruling restores a measure of common sense and certainty to the interpretation of New York governing law clauses in agreements concerning substantial commercial and financial transactions, and eliminates the need to explicitly exclude the application of New York's conflict-of-laws rules in order to secure the application of New York substantive law.

If you have any questions concerning this subject, please contact any of our partners and counsel, including those listed under Litigation in the "Practices" section of our website at <http://www.clearygottlieb.com>.

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