This is the debut installment of The Sanity Clause, a regular column by Eric Fishman examining contract issues faced by in-house counsel.

Parties to contracts routinely agree that the laws of a particular jurisdiction will govern their relationship. The objective, of course, is simple: to ensure that a well-developed body of law will be applied in the event any dispute should arise between the parties and, correspondingly, to avoid the laws of jurisdictions thought to be less predictable or favorable.

Despite their prevalence, choice-of-law provisions often do not apply when needed most. A typical clause reads as follows:

This contract shall be governed by and interpreted in accordance with the laws of [a designated State], excluding such State's conflict of law principles.

This type of clause will usually be enforced by courts in determining what law to apply to contract claims, even where the contractual relationship otherwise bears no relationship to the forum of the chosen law.

But disputes arising out of contracts often involve more than contract claims. For example, an unrestricted search on Google Scholar for “breach of contract” in New York yields 27,400 hits; of that universe, 7,540 cases—more than 25 percent—also concern “fraud.” Tort claims are a common part of contract disputes because, when successfully asserted, they can result in relief not otherwise available under the contract.

So the question arises: Will a standard choice-of-law clause be applied to tort claims arising in connection with the contractual relationship? The answer in many jurisdictions is “no.” Thus, for example, the Second Circuit explained in Krock v. Lipsay (1996) that a choice-of-law provision, providing that a contract will be construed in accordance with the laws of a particular jurisdiction, will not be held to apply to a fraud-in-the-inducement claim—an outcome consistent with reasoning in many other jurisdictions.

The Krock decision went on to provide an important, but often overlooked piece of drafting advice: “In order for a choice-of-law provision to apply to claims for tort arising incident to the contract, the express language of the provision must be ‘sufficiently broad’ as to encompass the entire relationship between the contracting parties.” Id.

While the laws of any given jurisdiction should be consulted in
connection with drafting a choice-of-law clause, the teaching of the case law is that the following language is apt to increase the chances of pulling non-contract claims under a choice-of-law provision:

This contract shall be governed and construed in accordance with the laws of [selected State], excluding that State’s choice-of-law principles, and all claims relating to or arising out of this contract, or the breach thereof, whether sounding in contract, tort or otherwise, shall likewise be governed by the laws of [selected State], excluding that State’s choice-of-law principles.

This is not merely an academic exercise. The law applied to a dispute will often have a decisive impact on the outcome. There are, for example, material variations in state law concerning whether an intention not to perform a contractual duty can state a fraud claim, whether economic losses can be recovered in tort, whether private contractual relationships can give rise to unfair trade practices, amongst many other issues.

To ensure that the law selected by the parties governs all of the claims that may arise out of their contractual relationship, the drafter would be well advised to consider modifying their standard choice-of-law provision to cover not only how the contract should be construed, but also to cover all of the different types of claims that may arise out of or in connection with their contractual relationship.

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