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Choice of Law, Brexit and the 'Ice Cream Flavour' Dilemma

Gustavo Moser (Swiss International Law School (SiLS)) · Wednesday, November 14th, 2018

The title of this post may, at a first sight, seem rather odd, but this author submits that choice of a governing contract law can actually be explained using *ice cream* as an analogy.

Assuming an individual generally likes ice cream, a question that arises is whether any thought has ever gone into why someone chooses a particular ice-cream flavour over another? It could be the consistency, the colour, the calories, the nutrients, the preparation or cultivation of the ingredients, ethical, environmental or religious considerations, or it may even be part of a certain diet. Alternatively, an individual may choose a flavour because they have (or have not) chosen that particular flavour before, or they were taught to choose one over the others; or a third party (someone we like or not) once recommended a particular flavour, or because the individual simply enjoyed that particular flavour on a previous occasion. Perhaps one has absolutely no idea what the thought processes behind ice-cream flavour choices are at all. And here lies the main point of the post: choices and (un)certainties.

The analogy is not as equivocal as one would have thought at the outset: like with governing contract laws, we also decide on the ice cream's choice based on some level of rationality as listed above. However, the rational and non-rational elements are not easily balanced during the decision-making process. We therefore turn to Daniel Kanheman's works to aid our understanding and reflect on how Brexit impacts on the topic.

1. **Kanheman's Systems 1 and 2**

Daniel Kahneman, a psychologist and 2002 Nobel prize winner in Economic Sciences, distinguishes between two systems in the mind for decision-making: System 1– the subconscious, which operates quickly and efficiently; and System 2– conscious and directed thought, which nevertheless operates in a rather slow and inefficient fashion.

1.1 System 1

System 1 has learned associations between ideas (*e.g.*, an individual associating law of country X with a good choice in governing contract law because a colleague had a recent successful experience in a case where X law was applied, or associating Y law in a governing contract law as being efficient because of numerous published reports about the efficiency of Y courts); it has also learned skills such as reading and understanding nuances of social situations. This knowledge is stored in memory and accessed without intention or effort. In our example above, the association of X law with success equals not the idea of success.

Mental actions that are governed by System 1 are completely involuntary; *e.g.*, the same individual thus concluding without further thought in a governing contract law decision that Y courts are efficient. System 1 is fast and efficient, but Kahneman postulates that it is unable to estimate the values and probabilities associated with each available option. Therefore, to run System 1 and execute decisions in a timely fashion we rely on intuition (discussed under item 2 below).

1.2 System 2

Under Kahneman's System 2, in choosing a governing contract law, parties would process all available information, make choices, and execute behavior(s) in a way that is calculated to maximise their expected utility, *i.e.*, the differential between expected benefits and expected costs. In other words, on this basis contracting parties make decisions utilising a cost-benefit analysis to achieve Pareto-efficient results. A scenario is considered Pareto-efficient if it is impossible to change it so as to make at least one person better off (in their own estimation) without making another worse off (again, in their own estimation).

However, assessment and comparison of all available options would only be possible with an extraordinary amount of energy and time. This may be unattainable in certain decision-making settings, in addition to a human being's limited computational skills. Accordingly, in these scenarios it would seemingly be inappropriate for decisions to be made under Kahneman's System 2, where the mind is slower, rule-based, analytic and controlled and where reason dominates. Hence, in situations where there are time, financial and energy constraints, such as in decisions involving a governing contract law, a decision may have to be taken under System 1, although it may not be a conscious decision by the contracting party.

2. **The use of mental shortcuts**

Perhaps not surprisingly, in a business context, people work under pressure, tight timeframes and busy schedules, the result of which being that choice of governing contract law is typically deferred to the last phase of negotiation. This choice is not infrequently – yet equivocally – treated as the "last minute" clause, being the final "detail" in the design of the contract. It is also regrettable that the governing law clause is typically positioned at the very end of the agreement, rather than at the outset when attention would arguably be at a higher level.

Parties may or may not choose a particular law or rules in order to: (i) prevent the application of less 'credible' laws or rules and parties' benefitting from a more acceptable legal framework; (ii) avoid a particular law or rules so as to escape the application of other laws (for various reasons, including the lack of trust of some of players in that law's or rules' application by state court judges); or (iii) ensure that a given legal framework concerning which the parties have bargained would apply fully. Players may also contextualise their negotiation deals as to whether one or the other choice was made in accordance with the other side's jurisdiction or whether they had included an arbitration agreement.

Choices of governing contract laws are therefore rather often grounded on a parties' success or failure in a real-world environment and not according to logical and/or arithmetical rules. There is, arguably, a good reason to do so: if you spent time and resources on a litigation/arbitration matter, regardless of whether you succeeded or not, it is likely that you have acquired knowledge in, or a better grasp of, that particular law or rules and will or will not use it again (at least you are more inclined to come to this realisation due to the so-called *sunk costs*!). Therefore, using mental shortcuts to make these decisions (*e.g.*, opt into law Z given the score obtained previously) may save time and could thus be particularly appealing in time-pressure situations. However, no two cases are the same and players may fall into the trap of making insufficient adjustments to distinguish case A from B. To add a further complication to this mix, especially in the context of the choice of law being England and Wales, are the complexities brought about by Brexit.

3. **Brexit**

In current times, it is sensible for parties to discuss as to whether or not to revise their standard contracts, boilerplate clauses, and choice of law strategies, in light of the Brexit uncertainties. It is necessary to realise that cognitive biases may however drive this decision, in particular given the presence of 'status quo' bias in our decision-making processes.

The 'status quo' bias refers to an individual's tendency to prefer an option which is consistent with the current state of affairs, *i.e.*, the player would be more acquiescent to a risk-averse approach to, or less appetite for, changes. 'Status quo' bias would apply to standard contracts, boilerplate clauses and choice of law strategies more generally. This could explain why contracting parties will likely keep a certain practice such as opting-in or out of certain laws, *e.g.*, England and Wales or using standard contracts where governing contract laws are already defined without further consideration. Long story short: we are generally risk-averse to changes but changes can also be positive!

In view of the above, parties need to be conscious not to fall into the trap of relying on the 'status quo', especially given the uncertainties surrounding Brexit. This includes whether Rome I and Rome II Regulations will be incorporated into national legislation. Parties will need to be mindful

that in the event Rome I and Rome II Regulations are not immediately incorporated into national legislation, then the UK will revert to pre-existing common law framework. If so, if an issue arose relating to governing law before the English courts, at least in respect of contractual obligations, it is unlikely that the existing position will change significantly because the common law principles are similar to those in Rome I. However, the position is less clear with regard to the governing law in respect of non-contractual obligations as Rome II does not reflect the English common law so closely. Uncertainty in this area is likely to be burdensome on parties from a time and cost point of view as parties dispute the interpretation of non-contractual obligations.

On the other side of the spectrum, parties should also be conscious not to fall into the trap of the 'halo' effect, *i.e.*, once a good or bad impression is formed, that impression can often be extended and exaggerated. Hence, in the context of Brexit, parties should not be complacent about the effects of their choice of law decisions, but equally, should not panic over the choice of law being England and Wales in existing and future agreements, and the potential consequences of this choice. There are, and there will continue to be, vast benefits of choosing English law. It is also useful to bear in mind that the rules on governing law may not extend to arbitration, and Brexit is likely to have minimal immediate impact on this area of dispute resolution.

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