

DRAFTING AND INTERPRETING GOVERNING LAW AND JURISDICTION
CLAUSES – A PRACTICAL GUIDE

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1. INTRODUCTION

When drafting a contract, typically only a cursory glance is given to the governing law and jurisdiction provisions which form part of the boilerplate clauses at the end of the contract. However, to give these clauses such little attention is to underestimate the vital role they play in, firstly, identifying the nature and scope of the rights and obligations of the parties to the contract; and secondly, how disputes over those rights and obligations are to be resolved.

It is important to ensure that every contract – no matter how brief or apparently straightforward – contains clear and comprehensive versions of each of these clauses. A failure to include any provisions on governing law and jurisdiction, or the inclusion of unclear and contradictory provisions, can lead to complex, lengthy and therefore expensive disputes over the governing law and dispute resolution procedures to be applied to a contract. This was summed up in the English High Court case of *Apple Corps Ltd v Apple Computer Inc.* [2004] EWHC 768 (Ch), in which Mann J said:

The evidence before me showed that each of the parties was overtly adamant that it did not wish to accept the other's jurisdiction or governing law, and could reach no agreement on any other jurisdiction or governing law. As a result, [the relevant agreement] contains no governing law clause and no jurisdiction clause. In addition, neither party wanted to give the other an advantage in terms of where the agreement was finalised. If their intention in doing so was to create obscurity and difficulty for lawyers to debate in future years, they have succeeded handsomely.

This paper will identify key considerations relating to governing law and jurisdiction clauses, practical drafting tips, and guidance on how the courts will interpret these clauses (or the lack of such clauses) by reference to recent decisions of the English courts and others.

2. GOVERNING LAW

(a) *Guide to governing law clauses*

The governing law clause identifies the substantive law that will govern the rights and obligations of the parties to the contract.

Sample clause: “This agreement and any dispute or claim arising out of or in connection with its subject matter or formation (including non-contractual disputes or claims) shall be governed by and construed in accordance with the law of England and Wales.”

Most legal systems will uphold an express choice of governing law by the parties. (Note that for contracts made on or after 17 December 2009 where one or more of the parties to the contract is based in the European Union, the Rome I Regulation applies which will (with some limited exceptions) uphold the choice of law by the parties; in the absence of any such choice the governing law will be determined in accordance with the provisions of that Regulation).

However, in order for a governing law clause to be upheld, it is important to be precise as to the law which is chosen and ensure that an effective governing law is selected. For example:

- while some contracts have attempted to select “the laws of the United Kingdom” as their governing law, this leads to difficulties as the laws of the United Kingdom in fact encompass the laws of several countries, including English law and Scottish law, which contain some marked differences (particularly in relation to contract law).
- some jurisdictions will only uphold a governing law that is the law of a country and not a non-national system of law – in *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain* EC [2004] EWCA Civ 19, the English Court of Appeal rejected a governing law clause which provided that “*Subject to the principles of the Glorious Sharia'a, this Agreement shall be governed by and construed in accordance with the laws of England*”, and instead held that the only applicable governing law was English law.

The choice of governing law can be of great significance – different legal systems will have different rules on, for example, formation of a contract, methods of terminating a contract, availability of damages, and rights of third parties.

A failure to choose a governing law clause can lead to uncertainty for the parties as to which law will be applied to the contract, and can result in costly and lengthy disputes.

(b) Choosing a governing law

Choosing the governing law of a contract can be a complex affair, particularly where the transaction which is the subject of the contract is of an international nature. For example, where a party based in Qatar headquartered in the USA enters into a contract with a company in England to provide goods/services obtained from Switzerland to Oman, there are a number of potential choices of governing law.

To help parties choose the most appropriate governing law, the following factors should be considered:

- where are the parties based, and, if different, where is the contract to be performed?
- where have the parties selected as the jurisdiction for the resolution of disputes? Typically, the governing law should be the same to avoid complexity although this is by no means essential - courts which deal with international disputes regularly are experienced in applying foreign law to a dispute. While this will increase costs as it will require expert evidence on foreign law issues, it can be an acceptable compromise.
- with which legal system and laws are the parties to the contract most familiar?
- would the application of a particular governing law be more favourable to one party than the application of another governing law?
- does the proposed governing law recognise the subject matter/key aspects of the contract? For example, while some legal systems – such as England – recognise the existence of a “trust”, or accept that property can be owned by different parties legally and beneficially, other legal systems will not.

3. JURISDICTION

The jurisdiction (or “dispute resolution”) clause identifies how and where disputes arising from the contract are to be determined. In the event of any difficulties in determining this (for example, where such a clause has not been included, or there are difficulties in interpreting it), this must be resolved before the substantive dispute can be determined. Such a determination can be a lengthy and costly process, and it is therefore important to ensure that an effective jurisdiction clause is included at the outset.

(a) Litigation or arbitration?

Firstly, the parties must decide whether disputes should be resolved by litigation or arbitration, or some other method.

Arbitration is a popular choice of dispute resolution in commercial transactions (particularly in international transactions involving parties from different jurisdictions). There are a number of reasons for this, including:

- retention of control by the parties over the arbitral process by selecting their own rules;

- parties' ability to select their own arbitrators, and constitute a tribunal with experience in the subject matter or area of the contract/dispute;
- confidentiality of arbitral proceedings;
- parties' ability to avoid the home courts of the other contracting party;
- enforceability of awards - the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which has 149 parties, requires the courts of contracting states to enforce arbitration agreements and to recognise and enforce arbitration awards made in other contracting states;
- finality of decisions – although arbitration awards may be challenged, the grounds of challenge can be limited either by the parties themselves or by the operation of laws of the seat (location) of the arbitration (for example, England's Arbitration Act 1996 allows for limited challenges to arbitrations only on the grounds of a challenge to the tribunal's substantive jurisdiction (Section 67); a challenge on the grounds of serious irregularity affecting the tribunal (Section 68); and an appeal on a point of law (Section 69), and these criteria are interpreted strictly by the English courts).

Sample clause: "Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause. The number of arbitrators shall be [one/three] [include provisions as to how arbitrators are to be chosen]. The seat, or legal place, of arbitration shall be [City and/or Country]. The language to be used in the arbitral proceedings shall be []. The governing law of the contract shall be the substantive law of []."

However, in some circumstances, litigation may be seen by the parties as more appropriate – in particular, as arbitration is a consensual process which relies on the consent of each of the parties, there are difficulties in adding third parties (who did not sign the arbitration agreement) or joining related disputes. In contrast, courts typically have wide powers which enable them to add parties or disputes where relevant to the proceedings at issue.

Where litigation is seen as the preferred means of resolving disputes, a number of factors need to be considered in determining which country's courts are most appropriate, including:

- the choice of governing law in the contract;
- the procedures and attributes of the courts in a particular jurisdiction (including whether specialist courts exist to deal with particular types of disputes (such as the Commercial Court in England and Wales); the reputation of the judiciary; the time taken in order to resolve a disputes; the interim measures available; and rules on evidence, disclosure and legal privilege);
- where the contracting parties' assets are located (in the event that it is necessary to enforce judgments against a defaulting party);
- should the jurisdiction of the selected courts be exclusive (so parties can only bring actions in those courts) or non-exclusive (so parties can bring proceedings in any courts)? While a non-exclusive jurisdiction clause does allow flexibility, with this

comes the uncertainty of not knowing in what jurisdiction proceedings may be brought in the event of any disputes.

Sample clause: “Each party irrevocably agrees that the courts of England and Wales shall have [exclusive OR non-exclusive] jurisdiction to settle any dispute or claim that arises out of or in connection with this agreement or its subject matter or formation (including non-contractual disputes and claims).”

(b) One-way jurisdiction clauses

Some dispute resolution clauses provide for more favourable choice of jurisdiction options for one party. Such clauses will typically be inserted where a party has greater bargaining power than the other, and are often used in financing transactions where lenders want the ability to enforce against defaulting borrowers in any jurisdictions in which they may hold assets, but also want the certainty of knowing that if the lender is sued, it will be in a specific jurisdiction.

Sample clause: “The courts of England have exclusive jurisdiction to settle any dispute arising out of or in connection with this Agreement (including a dispute regarding the existence, validity or termination of this Agreement). This Clause is for the benefit of the Lender only. As a result the Lender shall not be prevented from taking in any other courts in any jurisdiction. To the extent allowed by law the Lender may take concurrent proceedings in any number of jurisdictions.”

The enforceability of such a clause varies widely between jurisdictions. The English courts will uphold these clauses, as most recently shown in the case of *Mauritius Commercial Bank Ltd v Hestia Holdings Ltd & Anor* [2013] EWHC 1328 (Comm) on 24 May 2013 which stated that such clauses were contractual bargains to which the court should give effect. However, similar clauses have been rejected by courts in, amongst others, Russia and France – see, for example, *ZAO Russkaya Telephonnaya Companiya (RTC) v OOO Sony Ericsson Mobile Communications Rus* (Resolution 831/12) in which the Russian courts found that asymmetrical arbitration clauses are ineffective in Russia, given their inherent unfairness; and *Ms "X" v Banque Privée Edmond de Rothschild* (Court of Cassation, No 11-26.022; 26 September 2012). Accordingly, it is important that if parties to a contract wish to include such a clause, it must be enforceable under the governing law of the contract.

(c) Multi-tiered dispute resolution clauses

Parties may also choose to include a tiered (or “multi-tiered”) jurisdiction clause in their contract. In its simplest form, this is a clause which requires parties to engage in some form of alternative dispute resolution before attempting arbitration – for example, by referring disputes to mediation prior to the commencement of litigation or arbitration, or providing that any disputes should firstly be negotiated by senior management from each party. A tiered dispute resolution clause can provide for one step before arbitration/litigation, or multiple steps.

Such clauses have the benefit that they can result in disputes being solved more quickly and cost-effectively. However, there is a risk that if a clause is not well-drafted, it can allow parties to tactically delay resolution of a dispute between the parties. For that reason, it is important that any clause which provides for multiple steps in the dispute resolution process should include clear and certain time limits on when each process can begin and when it ends.

Any party wishing to include such a clause must take care to ensure that it is enforceable under the governing law of the contract. While under English law, such a clause is, in principle, enforceable, the English courts have, on a number of occasions, refused to uphold such clauses as the obligations contained in such clauses were insufficiently certain or precise.

In *Sulamerica CIA Nacional de Seguros SA and others v Enesa Engenharia SA and others* [2012] EWCA Civ 638, the Court of Appeal held that a tiered dispute resolution clause which provided for mediation before arbitration had not sufficiently certain and therefore there was no obligation on the parties to mediate. While the Court of Appeal did not specify precisely what an enforceable clause should say, it did state that certain factors were required, including (a) a definite undertaking to enter into a mediation, (b) clear provisions to appoint a mediator, and (c) a clearly defined mediation process.

(d) Complex transactions

In complex transactions, a number of agreements may be used to give effect to one transaction – for example, a financing transaction may include not only the main loan agreement, but also separate security documents and guarantees.

Where a transaction comprises of more than one agreement, it is crucial that the jurisdiction agreements contained in each of those agreements are consistent; or that if the same form of dispute resolution is not provided for in each agreement, that it is clear how disputes arising under from each contract (particularly where those disputes could potentially fall under the auspices of more than one agreement) are to be resolved.

Failure to carefully consider these provisions can lead to lengthy battles over which is the appropriate jurisdiction in relation to a particular dispute, or alternatively satellite litigation in a multitude of jurisdictions.

There have been a number of decisions in the English courts in recent years which demonstrate how the courts will interpret such clauses.

In *UBS AG and Ors v HSH Nordbank AG* [2009] EWCA Civ 585, the transaction between the parties consisted of a number of related agreements which contained a mixture of New York courts and English courts jurisdiction clauses. The New York jurisdiction clause, which was contained in the principal agreement, was held to apply. The Court of Appeal stated that where a dispute arose in such complex transactions, it must be intended that such a dispute would be resolved in accordance with the dispute resolution provision that was “at the commercial centre of the transaction”. Commercial parties who had entered into such arrangements would clearly not have intended that disputes would be subject to conflicting jurisdiction clauses and resolved in a multiplicity of forums.

However, there are limits on the “commercial centre” approach. In *Sebastian Holdings Inc v Deutsche Bank AG* [2010] EWCA Civ 998, the transaction consisted of a number of agreements which contained a mix of New York court and English courts jurisdiction clauses. In that case, the Court of Appeal held that the different claims brought by Sebastian Holdings and Deutsche Bank should not be treated as a single dispute that should be governed by the New York jurisdiction clause in the contract at the “commercial centre” of the dispute – it was clear from the agreements between the parties that they had intended that some disputes would be resolved through the English courts. Although it was a general principle that parties who had entered into a series of related agreements did not normally intend for disputes arising from those arrangements to be decided in different forums, the court still had to consider the intentions of the parties and the specific contractual arrangements.

e) Drafting tips

- Consider carefully whether litigation or arbitration is more appropriate in the event of any dispute arising between the parties, bearing in mind in particular the ease of enforcing an award or judgment against a defaulting party.
- Ensure that the chosen jurisdiction clause is enforceable under the governing law of the contract – this is particularly important in the case of asymmetrical and tiered dispute resolution clauses.
- In complex transactions which comprise multiple agreements, ensure that the jurisdiction provisions in each of the documents are consistent; or that there are clear provisions setting out which dispute resolution clauses apply to which type of disputes.
- If parties choose to include a tiered jurisdiction clause, ensure that strict time limits are included to prevent parties from tactically delaying resolution of any disputes.

4. DRAFTING AN EFFECTIVE ARBITRATION CLAUSE

(a) Introduction to drafting an effective arbitration clause

Arbitration is a consensual dispute resolution process, meaning that parties must have agreed to send any disputes to arbitration and what form this arbitration should take. Accordingly, drafting an effective arbitration clause can be an involved process as parties need to ensure that such a clause will operate in the way and to the extent the parties want.

A great deal of literature has been produced on how to draft an effective arbitration clause, not least by the International Bar Council which in October 2010 adopted the “IBA Guidelines for Drafting International Arbitration Clauses”.

As a preliminary point, drafting an arbitration clause is something that requires experienced legal counsel. The following summary is intended as a guide only, and legal advice should always be sought when including an arbitration clause in a contract.

(b) Key points

An effective arbitration clause must, at the very least, address the following matters:

- Scope of the arbitration clause;
- Rules of the arbitration;
- Number and selection of arbitrators;
- Language of the arbitration;
- Seat of the arbitration; and
- Governing law of the arbitration agreement

The parties may also include other provisions at their discretion, including those relating to confidentiality, disclosure, interim measures, and the conduct of the arbitration.

Scope of the arbitration agreement

Parties should first consider the scope of the arbitration clause. Under English law, where an arbitration clause is included in a contract, there is a presumption that the commercial parties are likely to have intended to use arbitration as the only forum to resolve all their disputes (unless there is clear wording to the contrary).

However, there is no such presumption where the parties provide for some disputes to be litigated and others arbitrated. Such a clause was considered in *Guidance Investments Ltd v Guidance Hotel Investment Company BSC* [2013] EWHC 3413, in which the management agreement between the parties provided that the English courts had jurisdiction, but that any dispute arising out of or in connection with an Event of Default would be resolved by arbitration under the rules of the London Court of International Arbitration. While having such a clause may seem complicated, it can make good commercial sense in some circumstances as it enables important but defined disputes to be dealt with by a relatively speedy means with no right of appeal in law, and avoids the resolution of that dispute being caught up with other disputes which may arise between the parties generally. However, parties should ensure that the clause is clearly drafted.

Rules of the arbitration - ad hoc or institutional arbitration?

At the outset, parties have a choice of ad hoc or institutional arbitration. Institutional arbitration is arbitration which is administered by a specialist institution (such as the London Court of International Arbitration or the International Court of Arbitration of the International Chamber of Commerce). Where institutional arbitration is chosen, typically the rules of that institution will be used to govern the arbitration and the institution itself will deal with the administrative side of the arbitration (such as scheduling hearings, communications between the parties and arbitrators, etc).

In contrast, ad hoc arbitration is carried out without the assistance of an institution. While parties are free to draft the rules of the arbitration themselves, this can be an expensive and time consuming exercise (particularly if parties want to ensure that all eventualities are covered), and therefore parties will often select a set of rules (such as the UNCITRAL arbitration rules).

Even if a set of rules is chosen for the arbitration, those rules do not have to be applied entirely – parties can specify in the arbitration clause to modify or delete certain rules so the arbitration is carried out in the way that they wish.

Choosing the arbitrator(s)

An arbitration clause should also set out how many arbitrators are to determine the dispute, and how the arbitrators are to be selected.

- An odd number of arbitrators will typically be chosen in order to avoid the prospect of a deadlocked panel:
- One arbitrator is likely to be more appropriate for smaller cases as it will reduce costs. It is also more likely to lead to a swifter decision as there is less difficulty involved in scheduling hearings than when trying to coordinate three arbitrators.
- The means of choosing the arbitrator(s) will depend on the number of arbitrators to be appointed. Typically, where one arbitrator is to be used, then an independent means of selecting that arbitrator will be used to avoid any allegations of bias. Where three arbitrators are to be selected, parties will often select one arbitrator each, with those two arbitrators then selecting a chairman.
- Parties should also consider whether any particular criteria are to be applied to the arbitrator, and if these should be set out in the arbitration agreement – for example, whether the arbitrators should have experience in a particular field, specific qualifications or be drawn from a specified professional organisation, or should have a legal background. The criteria to be applied to arbitrators (if any) will often depend on the type of dispute the parties envisage may arise.

Choosing a seat of arbitration

The “seat” of arbitration is the place where the arbitration will take place – this is a key element of the arbitration clause as it is the laws of the seat that govern certain procedural aspects of the arbitration (for example, the powers of arbitrators and the judicial oversight of the arbitral process). Many countries will have their own arbitration laws, such as the Arbitration Act 1996 in England.

The courts of the seat of arbitration will also be able to exercise some control and influence over the arbitral process itself – by ordering stays of arbitration, imposing interim measures, and, of particular importance, hearing challenges to any arbitration award.

Language

The choice of language will typically be more important where the parties are from different jurisdictions – the language of the arbitration will normally be the language of the contract and supporting documentation, but it is worth bearing in mind the likely language of other documentation, correspondence between the parties, witnesses, and the identity of potential arbitrators. Where the language of the arbitration is not specified in the arbitration agreement, it will be decided by the arbitrators which can increase cost and delay of proceedings.

Governing law of the arbitration

Previously, parties may have assumed that the governing law of a contract would also be the governing law of the arbitration agreement included in that contract. However, following the English Court of Appeal decision in *Sulamérica Cia Nacional De Seguros S.A. v Enesa*

Engenharia S.A. [2012] EWCA Civ 638, parties are advised to ensure that they also specify a governing law in the arbitration agreement itself.

In *Sulamérica*, a dispute arose as to whether the governing law of the arbitration agreement was Brazilian law or English law. The Court of Appeal held that the governing law was English law on the grounds that the arbitration was intended to take place in London and the choice of seat of arbitration must suggest that the parties intended the law of that country to govern the arbitration. This conclusion was reached despite the express choice of the law of Brazil as the law governing the insurance policy at issue; the agreement that the courts of Brazil should have exclusive jurisdiction in respect of any disputes in connection with the policy; the close commercial connection between the policy and the state of Brazil; and the inclusion of a mediation provision, governed by the law of Brazil requiring the parties to attempt mediation as a pre-condition to any reference to arbitration.

Confidentiality

One of the main reasons that contracting parties select arbitration is the belief that, unlike in litigation, the proceedings between the parties and any eventual award can be kept confidential. However, confidentiality is not always guaranteed in arbitration, and will often very much depend on the laws of the seat of the arbitration and the arbitral rules chosen by the parties.

Accordingly, parties may wish to include an explicit provision in their arbitration agreement that the arbitration proceedings and any eventual award will be kept confidential. It should be noted that such a provision will only bind the parties to the agreement – should it be necessary to bind third parties, a separate agreement with those third parties will have to be executed.

(c) Drafting tips

- Ensure that the arbitration clause contains, at the minimum, the main points –number of arbitrators, applicable rules, seat, language and governing law of the arbitration.
- If it is important that arbitrators have certain qualifications or knowledge, identify these in the arbitration clause to avoid later disputes over whether arbitrators have sufficient knowledge of the area.
- Consider whether different types of arbitration should apply to different types of disputes – for example, whether specialist arbitration is required in relation to a more technical matter, or whether low-value disputes should be determined by only one arbitrator. If such distinctions are to be made, ensure that the scope of these differing arbitration provisions are clearly and precisely set out.
- Make sure the scope of the arbitrator’s power is clearly set out - at the time of drafting the contract, parties may well consider it prudent to include parameters and limits on the power of a decision maker (see, for example, the case of *Gas Natural Aprovechamientos, SDG, S.A. v Atlantic LNG Co of Trinidad and Tobago*, 2008 WL 4344525 (S.D.N.Y. Sept. 16, 2008), in which the arbitral tribunal, in an LNG price review case, imposed its own preferred pricing structure, which neither of the parties had requested in its submissions or approved).
- When choosing the seat of arbitration, ensure that parties are familiar with the extent to which the laws of that place will exercise control or influence over the arbitral process.

- If confidentiality is important, ensure that this is specifically provided for in the arbitration agreement.

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