"Governing Law" and "Jurisdiction" Clauses

Introduction

In previous e-bulletins we have looked at a number of clauses that are commonly found in commercial contracts but are often poorly drafted and misunderstood. This month we discuss two more: "Governing Law" and "Jurisdiction".

While relatively straightforward in fact, these important concepts can appear at first sight to be complicated and technical. This e-bulletin therefore explains the concepts and the differences between them, and recommends how to address them in contracts. We will also highlight several traps that can arise.

The Clauses: Purpose and Principles

Governing Law clauses

A commercial contract is a legal relationship. This raises the immediate question: a relationship under which laws? Different countries have different laws and the content and effect of those laws can vary greatly.

It is therefore sensible to state in a contract which set of laws will govern it. Otherwise, if the contract terms become relevant later in a dispute between the parties, there will be a risk of a wasteful preliminary battle about which set of laws should be used to interpret the parties' obligations.

This is a particularly important issue in an international context, where a contract may be connected with several places. For example, the parties may be in different countries and the place for performance may be a third country. In such cases there are several legal systems with potential relevance to the contract, making it all the more necessary to decide expressly what system of law will govern.

A governing law clause does this by setting out expressly the parties' choice of the law that will apply.

Jurisdiction clauses

It is inevitable that contracts will produce disputes from time to time. How will those disputes be handled?

Sometimes parties choose to resolve disputes by arbitration, in which case they include an arbitration clause in their contract (see our e-briefing of September 2007 for drafting tips). On other occasions, however, parties are happy to rely on the courts to handle any disputes. In which case the question arises: which courts? As with governing law, there is otherwise a risk of costly, time-consuming and wasteful preliminary battles about whether disputes should be handled in the courts of country A or country B, and also a risk of multiple claims proceeding in parallel in several different jurisdictions simultaneously.

A jurisdiction clause therefore states that the parties have agreed to the courts of a named country taking jurisdiction over (in other words, having the right to hear) any disputes that may arise.
Usually a jurisdiction clause will provide for either "exclusive" or "non-exclusive" jurisdiction. The interpretation of these terms may vary across legal systems, but in broad terms "exclusive jurisdiction" means that only the specified courts will have jurisdiction to hear disputes; and "non-exclusive jurisdiction" means those courts can hear disputes but the parties are not prevented from litigating in other courts as well or instead if they think it is appropriate to do so.

**Drafting tips**

Do not attempt to deal with governing law and jurisdiction in the same wording. The two concepts are different and the contract should address them separately, expressly and clearly (though they can conveniently be placed together as separate sub-paragraphs of a 'Governing Law and Dispute Resolution' clause).

**Governing law**

Here is a typical governing law clause: "This Agreement is governed by and shall be construed in accordance with the laws of [Thailand/England/Singapore/etc]."

While this wording is straightforward, there are several important factors to note:

- The choice of governing law is not a "my law or your law" battle of strength. It may be the case that "my law" is not in fact the best choice, which is why some international contracts are governed by laws that have nothing to do with either party (eg, international parties all over the world regularly choose English or New York law to govern their contracts). Nor is it wise to choose a neutral third-country law as a kind of compromise, unless one is sure that the chosen law is reliable. The key point to understand is that the choice of legal system can have fundamental, sometimes unintended consequences, even affecting the basic validity of the contract. Therefore it is vital to get informed advice and to ensure that the chosen law is reliable and effective.

- A common mistake is to refer to a country which has more than one legal system, eg, "USA" or "China". Sometimes the ambiguity can be resolved by considering the wider context, but it is better to be clear by referring to, say, "New York" or "Hong Kong".

- Simple is best. You should avoid phrases such as "publicly available laws of []" or the like. Similarly, you should avoid splitting the governing law (eg, "issue X shall be governed by the law of [place A] and issue Y shall be governed by the law of [place B]"). Such wording is a recipe for parallel litigation and the associated costs and delays.

- For similar reasons, one should generally avoid over-clever formulae "excluding the conflicts of laws rules of that country", or similar. Occasionally it can be appropriate to include such a formula, but this is a highly technical issue on which professional advice should be obtained.

**Jurisdiction**

Here is an example of a jurisdiction clause:

"The parties submit all their disputes arising out of or in connection with this Agreement to the exclusive jurisdiction of the Courts of []".

Again, there are a number of factors to consider in drafting a clause of this type:

- A jurisdiction clause represents the parties’ decision to resolve their disputes in court. It is therefore an alternative to arbitration. If in doubt, you should choose a jurisdiction clause or an arbitration clause, not both. Sometimes it can be appropriate to provide for arbitration and to include a clause conferring jurisdiction on certain courts to support the arbitration and to enforce awards, but again this is an issue on which professional advice should be obtained.

- If you want to provide for particular courts only the clause should clearly state that the jurisdiction is "exclusive". Conversely, if you want to
include a non-exclusive jurisdiction clause (eg, because you want to preserve your ability to sue the counterparty in a number of possible venues), you should spell out exactly what your intention is. That is because courts in different places have taken different approaches as to what is meant by the shorthand phrase "non-exclusive jurisdiction".

- As with governing law clauses, simple is usually best. Trying to assign different types of disputes to different jurisdictions frequently gives rise to problems, although there can be workable solutions in some particular cases. You should also avoid words that create uncertainty and ambiguity (eg, it is better to say that courts "shall" have jurisdiction, not that they "may" have).

- Consider carefully whether the clause will be effective in legal and commercial terms. Will a court take jurisdiction just because the parties have chosen it in their contract? Will a judgment from that court be enforceable in the place where the defendant's assets are located? Depending upon the answers to these questions, incorporation of an arbitration clause may be a better option on some occasions.

We have looked at the purpose of governing law and jurisdiction clauses to explain why they are important and should be included in commercial contracts. We have also outlined a number of common drafting mistakes. However, it is important to bear in mind that there is no single definitive form to use; particular contracts or circumstances may require specific solutions and wording (eg, some places may impose restrictions on the parties' ability to specify the jurisdiction of their choice).

Ideally, professional advice should be obtained on the form and content of governing law and of jurisdiction clauses for any particular contract. However, where this is not practicable, the principles outlined above may assist in avoiding some of the problems that can arise.

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