Negotiating governing law and dispute resolution clauses in international commercial contracts

When negotiating international commercial contracts, it is important that the parties carefully consider their choice of governing law and dispute resolution clauses and that both are expressly set out in the contract. In this newsletter, we consider: (i) which systems of law should be considered when negotiating governing law; (ii) how the parties’ choice of governing law is given effect; and (iii) the interrelationship between the choice of governing law and dispute resolution forum.

Which systems of law should be considered?

The law selected by the parties to govern the contract is used to interpret the contract and determine the rights and obligations of the parties flowing from it. Parties should, therefore, seek specific legal advice from lawyers qualified in the jurisdiction in question before making their choice. As a general rule, it is advisable to choose a legal system that:

- has a good reputation in the international business community for providing contractual and regulatory fairness and certainty;
- is commonly used as governing laws in international commercial contracts in general and in the relevant industry in particular; and
- provides easy access to sufficient numbers of high quality experienced commercial lawyers (this factor will become important in the event of a dispute under the contract).

English law is one of the most widely used systems of law in international business. The primary reason for this is that its comprehensive precedent system of commercial law judgments developed over the centuries plays a central role in how disputes are determined. This provides parties with a considerable degree of certainty and the ability to foresee, to a large extent, how any future disputes under the contract would likely be determined.

Other widely used systems of law include: French, German and Swiss law in Europe; New York law in the US; and Japanese, Hong Kong and Singaporean law in Asia. A decision when choosing is whether to adopt a common law or a civil law system. There are of course differences between the common law and civil law systems in terms of how they regulate the rights and obligations of contracting parties. Nonetheless, it should be remembered that for many practical international business purposes, both common law and civil law systems which meet the aforementioned criteria will often offer broadly similar protection to the parties.

Lastly, in certain circumstances, there may be merit in one system of law applying to certain clauses in a contract and another system applying to the remainder. For example, as a compromise in negotiation, the parties may agree that the dispute resolution clause is governed by a different system of law to the rest of the contract. As a general rule, however, we recommend parties select one national law (for example, English or Japanese law) as the governing law.

Parties’ choice of governing law – express v. implied

The parties’ express choice of law will be respected by most national courts and arbitral tribunals. For example, if a sales agreement between a Japanese seller and a French buyer provides that the agreement is governed by English law, English law will generally be applied to the greatest extent possible when considering a dispute arising from that sales agreement.

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1 In addition, parties should consider the applicability of rules such as the United Nations Convention on Contracts for the International Sale of Goods (the “CISG”). For more information on the CISG, please click on our July and August 2009 newsletters
2 Other countries’ laws may still be applied in some circumstances. For example, national courts of European Union states will not apply the law selected by the parties if the choice reflects an attempt to avoid the application of rules which should otherwise apply, or if doing so contravenes public policy (Articles 9 and 21 of Rome I and Articles 16 and 26 of Rome II (defined below)).
However, if the parties have not expressly chosen a governing law, the law which will govern the contract will be determined by applying the applicable "conflict of laws" rules. Conflict of laws rules are complex and resolving international conflict of laws disputes is almost always very expensive for the parties concerned. This reinforces the importance for the parties of expressly choosing a governing law in their contract.

For example, in arbitration, the general conflict of laws position is that the arbitral tribunal shall determine the governing law, subject to any mandatory principles of the law applicable in the seat of the arbitration. In the national courts of European Union states, the applicable conflict of laws rules provide that, first, there is an attempt to infer the parties' intention from the terms of the contract and the general circumstances of the case, and, if an intention cannot be inferred, the law applied will usually be that to which the contract has its closest and most real connection. This can lead to unexpected results.

Dispute resolution – litigation or arbitration?

At the same time as determining the governing law, the parties need to consider and agree the "forum" for resolving any future disputes. "Forum" refers to the dispute resolution process and the country where such process takes place.

If the parties wish to use litigation to resolve any disputes, parties most commonly agree to litigation in the country of the governing law of the contract (for example, the English courts where the contract is governed by English law). However, depending upon the particular circumstances, a party who has agreed to litigation in the counterparty's country will often be at a disadvantage. This is because the counterparty will often be more familiar with the court's processes and language than the other party and likely have easier access to lawyers who are experts in litigation in those courts.

Arbitration largely mitigates this problem. The parties can easily choose to conduct the arbitration in a country which is not the country of the governing law of the contract (for example, arbitration in Hong Kong regarding an English law governed contract). Further, the parties can choose the language and particular procedures for use in the arbitration and often there is considerable flexibility in choosing lawyers to represent the parties in arbitral hearings. Most importantly, awards rendered in arbitrations seated in a New York Convention state may, at least in principle, be enforced in any of the other current 143 signatory states.

Conclusion: should you compromise on governing law or forum?

It is common to negotiate the governing law and forum at the same time. Many companies are extremely reluctant to compromise on their preferred choice for governing law, but more willing to negotiate on forum. However, in our experience, the selection of the forum is equally important in terms of maximising the likelihood of a successful resolution of disputes. Accordingly, when faced with the choice of compromising on either governing law or forum, on the strict proviso that the governing law meets the aforementioned criteria, there may be merit in conceding to the governing law proposed by the counterparty provided they agree to your choice of forum.

In light of the above, we recommend that, when entering into international commercial contracts of value, the advice of international counsel should be sought in relation to governing law and the dispute resolution forum. Should you wish to discuss any of the issues raised in this newsletter, please feel free to contact a member of our team.

3 See, for example, Article 22.3 of the LCIA Arbitration Rules and Article 17(1) of the ICC Arbitration Rules.
4 Harmonized rules apply throughout the EU for determining the law applicable to contractual obligations (Regulation E 593/2008/EC) ("Rome I") and non-contractual obligations (Regulation 864/2007/EC) ("Rome II").
5 Article 3(1) of Rome I requires clearer evidence than the Rome Convention that the parties have made an implied choice of governing law. However, Recital 12 to Rome I indicates that choice of jurisdiction in a contract will be a strong factor that the parties intended the law of that country to be applied to the contract (see Compagnie Tunisienne de Navigation SA v Compagnie d'Armement Maritime SA [1971] AC 672).
6 Article 4 of Rome I.
7 For example, in Iran Continental Shelf Oil Co v IRI International Corp [2002] EWCA Civ 1024, the Iranian party argued that Iranian law governed the contract, the US party argued that Texan law governed the contract, and the English Court of Appeal held that the contract was governed by English law (which neither litigant argued applied to the contract).