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BREXIT CLIENT CALL NO 2: SHOULD BREXIT AFFECT THE POPULARITY OF ENGLISH GOVERNING LAW AND JURISDICTION CLAUSES?

July 2016

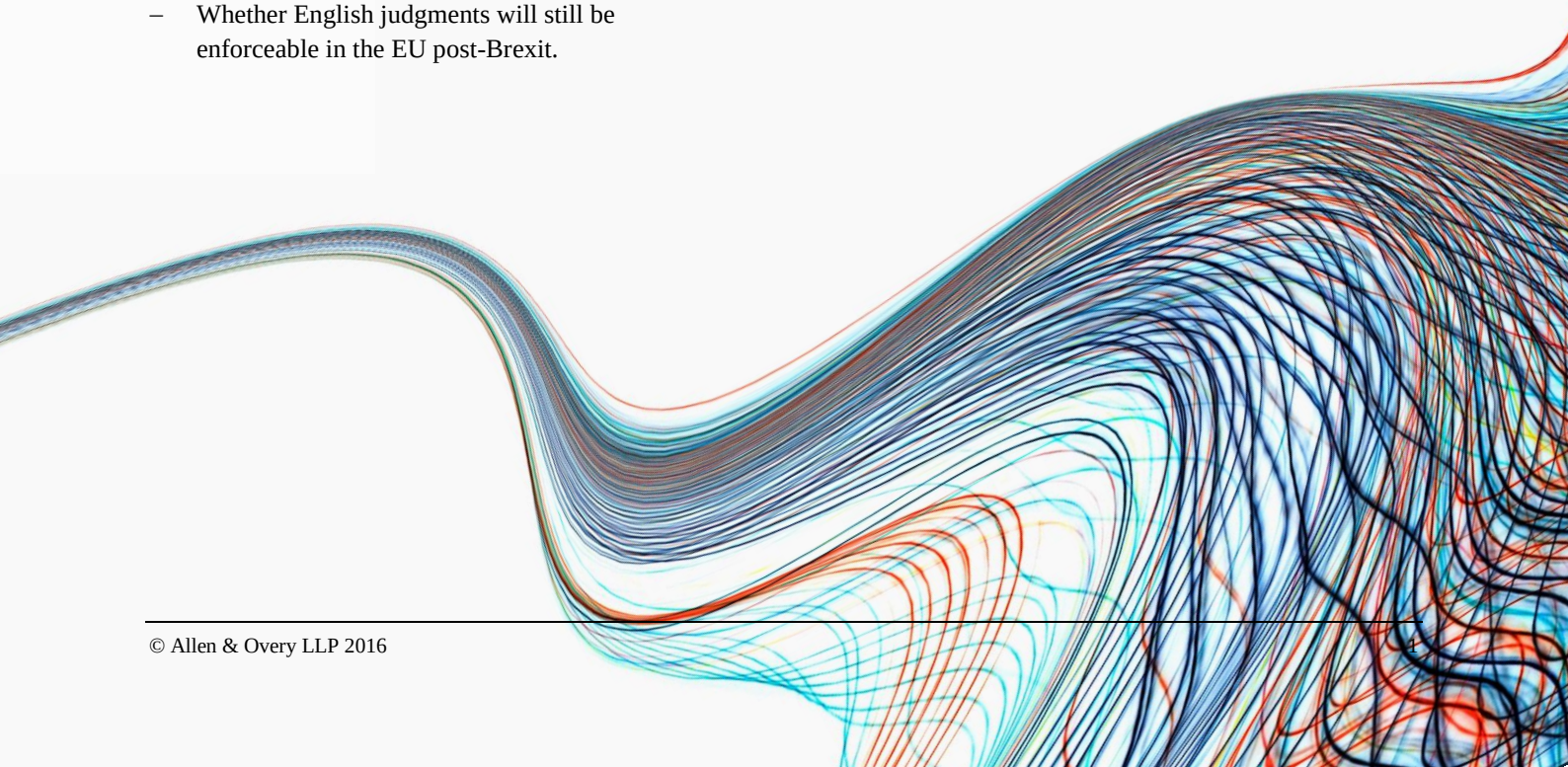
Overview

Led by Philip Wood CBE, QC (Hon), Sarah Garvey and Karen Birch, this discussion considers whether clients should change their approach to including English governing law and English jurisdiction clauses in their commercial contracts. The speakers discuss issues such as:

- Whether the Brexit vote has an impact on the certainty, predictability or commerciality of English law as a governing law;
- Whether EU courts will continue to give effect to English governing law and jurisdiction clauses post-Brexit;
- Whether English judgments will still be enforceable in the EU post-Brexit.

This script is provided as a reference for our clients to accompany the recording of the call, which is available here. If you would like to discuss any specific points in relation to the subject area, please do not hesitate to get in contact with any of the speakers or your usual A&O contact.

Please also visit our website, www.allenovery.com/brexit, where we have a suite of specialist papers and materials for our clients.



1. Introduction (Philip Wood)

Welcome to our conference call on the choice of English law and courts in wholesale contracts after Brexit. This is the second in our series of calls on the consequences of Brexit for our clients.

My name is Philip Wood and I am head of the A&O Global Law Intelligence Unit which is a think tank.

I am accompanied by Sarah Garvey and Karen Birch who are Counsel in our litigation department and who frequently advise on these questions.

The reason for our choice of topic today is that a number of our clients have been asking questions about whether Brexit should impact their approach to negotiating governing law and jurisdiction clauses in their commercial contracts.

We have a great many offices around the world and we routinely advise under many different legal systems and laws. We hope this puts us in a position to comment objectively and rationally on the issues arising in this context.

We also routinely compare different legal systems and laws in the same way as we compare tax regimes. We are not undertaking that kind of exercise this morning but we would observe that you typically cannot say that one legal system is better than another. This is generally a matter of opinion as to what is best. Legal systems sometimes have different policies about the choices they make and so ultimately the question becomes one of suitability for the particular transaction. One can overdo the distinctions between legal systems. For example, legal systems in the developed world often share similar policies and the differences are on the fringe.

English law and courts are international public utilities, so far as their use in major financial, corporate and other contracts are concerned. They are a public utility in the same way that Delaware is a corporate public utility in the U.S. and that the UCP codes on letters of credit or DTC or Euroclear or Clearstream or Swift are international public utilities. They are effectively de-nationalised and only anchored in a specific territory because these things have to have a home. Nevertheless they are shared and the home country is charged with a responsibility of looking after the utility for the international community.

English law is of course not the only governing law international public utility. There is plenty of competition and that is exactly as it should be to keep legal systems on their toes. When a legal system serves this particular purpose it is constrained in its legal policy choices because it has got customers of a particular kind. Those customers expect their chosen legal system, if they are to continue to use it, to reflect their expectations in the markets they operate in and they expect those who administer the legal system to be aware of their responsibilities.

We are focused today on the impact of Brexit on governing law clauses and jurisdiction clauses. We do not cover the position regarding the impact of Brexit on conflict of law rules more widely, which is more complex.

Nor are we covering the position in relation to consumer, employment or insurance contracts or the points that arise in the insolvency context.

I should also flag one point on terminology. When we discuss governing law, we are talking about the system of law governing rights and obligations. When we refer to jurisdiction, we are referring to the courts that will determine a dispute. For non-litigators it is always important to keep in mind that a choice of law does not constitute a choice of court (jurisdiction) and vice versa.

Because this is a highly technical area, we're going to break the issues down into a series of questions.

2. Governing law (Karen Birch)

The first question on our agenda is about why parties choose particular laws to govern their contracts – what factors influence their choice?

The answer is that there are a range of different factors which come into play in the decision-making process for different parties in different circumstances.

For some parties, the decision might be driven by a desire to choose a law that is particularly familiar or convenient (for example it might be the law of their home jurisdiction or the law under which they have previously contracted).

For others, the decision may be driven by an assessment of how commercial or predictable the

relevant law might be – so for example they might want the predictability of knowing that the relevant law permits the immediate acceleration of repayment obligations or the immediate enforcement of security.

A desire to insulate a contract from the application of a potentially unhelpful law may also drive some parties – for example they might want to avoid the law of their counterparty's home jurisdiction.

And of course for many parties a combination of these and other factors might be relevant.

Why has English law historically been a popular choice?

There are a number of reasons why English law has historically been a very attractive choice for commercial parties in the context of international transactions and in particular for creditors. Just running through a few of these:

- The first point goes back to this question of predictability and certainty. English law is one of a number of laws (including New York law) that is generally viewed as being comparatively predictable and comparatively certain. So, for example:
  - Parties can be comfortable that English law will give effect to their contractual bargains. They know that their contracts are interpreted literally in the business context, so the acceleration and security provisions I mentioned earlier are effective. And they know that market disclaimers and non-reliance language will work where sophisticated parties are involved and that there is very limited scope for terms to be implied or for principles of public policy or looser doctrines of good faith or fair dealing to overwrite what has been agreed.
  - There is a strong body of case law that parties can rely on to assess how their agreement will be interpreted and applied.
- Secondly, the flexibility of the English law system is attractive to some parties – the common law system allows the law to develop and grow to deal with innovative deal structures and changes in the commercial environment (although again English law is not alone in this regard).
- Thirdly, English law is familiar to many parties because it is market standard in a wide range of sectors and markets.

Will any of the reasons why parties currently choose English law be affected by Brexit – ie has English law now become a less (or more) attractive choice?

A number of our clients have – quite legitimately – been asking this question over the last few weeks.

Our view is that Brexit should not have an impact on the attractiveness of English law in the vast majority of cases.

Looking first at the question of predictability and certainty.

- Substantive English contract law in the commercial context has in general terms been largely unaffected by European law.
- So the law on almost all key contractual issues including offer, acceptance, consideration, implied terms, exclusion clauses, breach and damages derives from common law. As a result, there is no reason to think that these fundamental common law principles of English law will change on Brexit.
- The same is broadly true in relation to tort law applied in the commercial context, save perhaps in relation to certain statutory torts that have a European law basis.
- So there is no reason why English law in this context should change on Brexit or therefore why the prospect of Brexit should make English law any less predictable or certain.

There is also no reason to think that English law will be any less flexible or familiar on Brexit.

That's not to say that Brexit will have no impact at all. There are some narrow and technical areas where Brexit may make a difference. For example, one of the ECB's collateral eligibility requirements for asset-backed securities is that the acquisition of the underlying cashflow generating assets is governed by the law of a Member State. It remains to be seen whether we will see any change to this requirement post-Brexit. Assuming it remains in place it's conceivable that some market participants might consider moving away from English law as the

governing law of asset purchase and sale arrangements in securitisations if the security would otherwise be eligible and they think that this might make the instruments more marketable.

Outside these very narrow areas, however, we don't think that Brexit will have any real impact on the reasons why parties choose English law.

Will the English courts or the courts of other Member States be less likely to respect a choice of English law post-Brexit?

As things currently stand, the courts of all Member States apply the same set of rules to determine the governing law of both contractual and non-contractual obligations in most commercial contexts – the Rome I and Rome II Regulations.

Both of these Regulations require Member State courts to respect governing law clauses agreed between commercial parties, subject only to certain limited exceptions.

Will this change on Brexit? The answer is that it won't.

Looking first at the position outside the UK, the respect that Member State courts currently give to English governing law clauses will be essentially unchanged on Brexit. Both the Rome I and Rome II regulations require Member State courts to respect governing law clauses irrespective of whether the chosen law is the law of a Member State and irrespective of whether the parties are domiciled within the EU or in a non-Member State.

Within the UK, although Rome I and II may no longer be applied by the English courts following Brexit, in our view it is almost inconceivable that they would change their general approach to respecting a choice of English law:

- Party autonomy in relation to governing law is recognised in virtually all jurisdictions around the globe and the English courts have respected choice of law clauses for contractual obligations since the 19th century. There is no reason why this should change on Brexit.
- The respect given by the English courts to non-contractual governing law clauses is less deep-rooted. But non-contractual governing law clauses have become market standard post-Rome II and the widespread recognition that such clauses increase certainty for commercial parties means that it is highly unlikely in my view that the UK would take a different approach following Brexit.

How easy would it be to amend precedent agreements so that they work under a different governing law?

Much depends on the nature of the contract but in many cases you won't simply be able to cross out the reference to English law in the governing law clause and replace it with a reference to another law.

In practice parties will need to assess whether contractual terms which were drafted on the basis that they would be governed by English law will have the same meaning or effect in practice if the governing law is changed. This wouldn't be an insurmountable hurdle by any means, but it does mean that parties should proceed with caution.

In summary, what is the position on governing law?

Our conclusion on governing law is that in the vast majority of cases Brexit shouldn't require parties to move away from their current approach to negotiating governing law clauses in their contracts.

So the status quo can be retained. If you currently contract under Spanish, French or German law, the prospect of Brexit should not lead you to change your approach, even if you or your counterparties are based in the UK. Similarly, if you currently contract under English law, Brexit is not a reason for you to stop doing so in the commercial context in the vast majority of cases. English law will remain a sensible choice for commercial parties in relation to both contractual and non-contractual obligations. Respect for governing law clauses is a done deal in all developed jurisdictions and there is no reason why parties' expectations in this area will not be met when the UK leaves the EU.

3. Jurisdiction (Sarah Garvey)

What are we talking about here?

We are focused today on the impact of Brexit on jurisdiction clauses. If there is one point I would underline at the outset, it is that the prospect of Brexit reinforces the need for commercial parties (and their lawyers) to be scrupulous about the inclusion (and drafting) of jurisdiction clauses in every contract. The message for the business is a familiar one but worth reinforcing – you must include a jurisdiction clause. This is important because post-Brexit the default or fallback position in the absence of an effective choice is likely to be much less certain than currently.

Terminology – to clarify:

- Brussels Recast Regulation – sets out the rules on jurisdiction and enforcement of judgments in civil and commercial matters. Effective in all 28 Member States including Denmark.
- Lugano Convention – sets out rules on jurisdiction and enforcement of judgments in civil and commercial matters as between EU Member States and Switzerland, Iceland and Norway. Almost identical to the old Brussels Regulation, the predecessor to the Recast.

Jurisdiction clauses in favour of the English courts are ubiquitous in international contracts. They are commonly used in loan agreements, in derivatives contracts and in capital markets documentation, albeit using slightly different formulations.

Will Brexit impact the popularity of such clauses? In short, we do not believe that Brexit should affect the popularity of English jurisdiction clauses. Brexit or the prospect of Brexit does not mean that commercial parties need to switch their English disputes mechanism to select a different forum or fora – I'll come back to explain our reasoning in more detail.

What factors influence a choice of forum?

It is perfectly legitimate, and indeed prudent, to investigate the pros and cons of any particular court system you are proposing to select as the forum in which to resolve your commercial disputes.

Sensible questions to be posed and investigated include: Will the specified courts accept jurisdiction over my dispute in the first place? Do these courts have a good reputation for transparency, with experienced commercial judges? Will my dispute be resolved expeditiously or are there long delays in coming to trial and getting a decision? Is there a right of appeal? Can I seek summary relief? You may want to know if there will be disclosure (also known as discovery) and witness evidence in this legal system? Is there a good pool of local counsel? Is it expensive to litigate in this court system? Will this court order the other side to pay my costs if I win? Are court judgments published? Is there a system of precedent? Importantly, do these courts have market acceptability?

You will also need to consider the governing law of the contract - will the chosen court apply that chosen law in a predictable way? There are inevitably efficiencies in matching governing law to jurisdiction clauses. So if English law is chosen, it makes sense to select English courts.

Another aspect of any forum selection analysis is whether any judgment issued by the court you select will be enforced in other jurisdictions in which the defendant (your counterparty) may have assets.

The potential scope for enforcement of a judgment may be a negotiation point on a transaction. It may be that the prospect of wide enforcement is part of the risk assessment and pricing on a deal. In practice, however, cross-border enforcement of judgments in the commercial context is very rare. Only a limited number of cases ever go to trial and if they do and there's a judgment, workouts or insolvency petitions are more likely than cross-border enforcement actions.

Why have the English courts historically been a popular choice?

The English courts have proved a popular forum for the resolution of international disputes over the years precisely because they score highly in commercial parties' assessment of these factors. For example, the English judiciary has a reputation for independence and experience. The 'loser pays' rule deters many unmeritorious claims. There is extensive disclosure, active case management and a system of precedent. Importantly, English courts have credibility in the financial markets. Brexit will not change these factors.

Will any of the reasons why parties currently choose the English courts be affected by Brexit?

As noted, all the reasons listed above are unaffected by Brexit. Two further factors merit closer attention, however. First – the recognition of English jurisdiction clauses. Second, the enforcement of English judgments. We will now examine both aspects in more detail.

As a preliminary point on enforcement, English judgments are readily recognised and accepted around the world. The UK is also party to various bilateral agreements with commonwealth (largely cricket playing) nations which will be unaffected by Brexit. Of course nothing will change outside the EU context.

However if the UK leaves the EU then it seems likely that the UK will repeal the 1972 European Communities Act, the constitutional statute which provides (amongst other things) that EU Regulations have direct effect in the UK (without the need for specific enactment). This means that unless alternative arrangements are put in place as part of the UK's withdrawal arrangements from the EU, the Brussels Recast will cease to apply on Brexit and the UK would cease to be party to the Lugano Convention (although we recognise that there is a technical debate as to whether the UK may still bound by Lugano or even an early predecessor to the Recast, the Brussels Convention). So, assuming no alternative arrangement is put in place, the streamlined enforcement process under these European regimes would not be available.

Finally, the UK would no longer be part of the Hague Convention on Choice of Court Agreements on Brexit, as the EU acceded to this Convention on behalf of Member States (other than Denmark) on 1 October 2015. I will come back to the Hague Convention shortly.

Will any of the reasons why parties currently choose the English courts be changed by Brexit?

Will English jurisdiction clauses still be respected in Member States on Brexit?

The answer to this question is 'yes', in the vast majority of cases. But to answer this question more precisely, it is necessary to break the question down and consider the position in relation to different types of clause.

- **Will EXCLUSIVE English jurisdiction clauses be respected in another Member State court?**

  The answer is 'yes'.

  - We anticipate that the UK will ratify the Hague Convention as soon as it can upon Brexit. It does not require the consent of other Contracting States to do so. Under the Hague Convention, Member State courts must 'suspend or dismiss' proceedings before them in breach of an exclusive jurisdiction clause in favour of a Contracting State (Art 6). So, where there is an English exclusive jurisdiction clause, this clause will be respected across Member States under the Hague Convention.
  - The Convention contains provisions regarding its entry into force, roughly three months after ratification. With some momentum it is likely that the UK Government could get this regime in place relatively swiftly after Brexit.

- **Will ASYMMETRIC English jurisdiction clauses be respected in other Member State courts?**

  The answer is 'yes', but the analysis is a little more complex.

  - The Hague Convention covers exclusive jurisdiction clauses, not asymmetric clauses or non-exclusive clauses. So for this scenario it is not relevant.
  - If proceedings have already been commenced in England under an asymmetric jurisdiction clause, Member State courts will have discretion to stay proceedings brought before them under Articles 33 and 34 of the Recast Brussels Regulation.
  - If no proceedings have been commenced in England, and the party without the benefit of the asymmetric clause brings proceedings in another Member State court, Articles 33 and 34 would not apply. One approach would be for the Member State court to give Article 25 of the Brussels Recast (which deals with Member State jurisdiction clauses) reflexive effect (ie treat the rules as applying to "third state" – ie non-Member State – parties and

"third state" matters). This was the approach of Mrs Justice Proudman in *Plaza BV v Law Debenture Trust Corp*.

- A further alternative is that Member State courts might apply their national rules and recognise the jurisdiction clause on that basis.
- Another possibility is that the UK may sign up to the Lugano Convention 2007. This would require the agreement of the other contracting states (the EU Member States plus Switzerland Iceland and Norway) and so may not be straightforward. Under this Convention contracting states agree to recognise jurisdiction clauses in favour of other contracting states in essentially the same way as they do under the Recast. So in the above example, Member State courts would recognise an English jurisdiction clause and decline proceedings in favour of the English courts.
- It is recognised that there is an argument that in this scenario a Member State court might take jurisdiction if it considered it had to because the defendant was domiciled in that Member State (as per the ECJ decision in *Owusu*). We're not aware of authority where this approach has been taken, but if neither the Hague Convention nor the Lugano Convention apply, then this possibility cannot be entirely discounted.
- However even if a Member State court did take jurisdiction in this scenario, then the English court might nevertheless proceed with its action (not being bound by EU lis pendens rules to halt its proceedings). It might even issue an anti-suit injunction against the party acting in breach of contract. We will come back to discuss anti-suit injunction in more detail later.
- The same reasoning would apply with a non-exclusive jurisdiction clause.

Will English judgments still be enforced in EU Member States on Brexit?

In short, we believe that they will be.

It is undoubtedly the case that under existing European regimes, English judgments have benefited from a simplified uniform approach of widespread and often automatic enforcement across Member States under the Recast and, in Switzerland, Iceland and Norway under the streamlined process in the Lugano Convention.

Post-Brexit, and assuming the UK signs up to the Hague Convention, Member State courts other than Denmark will still be required to enforce an English judgment given pursuant to an exclusive English jurisdiction clause under the Hague Convention.

But, as discussed, this will not cover judgments pursuant to asymmetric or non-exclusive jurisdiction clauses.

If Lugano is signed up, English judgments would enforceable in a Member State and Switzerland, Iceland and Norway, under this Convention, whether pursuant to exclusive, non-exclusive or asymmetric clauses.

If neither is signed up, and an English judgment was simply a "third state" judgment, then it would generally still be possible to enforce that judgment in a Member State court under applicable national rules. The same approach would be followed with enforcing an English judgment as with a New York or Australian or any other "third state" judgment. There may even be some very old bilateral enforcement treaties in place in some jurisdictions.

In short, it will take more time and cost more money to enforce under national rules, rather than under a Convention. This is, however, an administrative impact. The important point is that in most cases it can be done.

What other questions have clients been asking about jurisdiction clauses?

- **Should I change my asymmetric English jurisdiction clause to an exclusive jurisdiction clause?**

  As discussed earlier, the Hague Convention does not cover asymmetric or non-exclusive jurisdiction clauses and so I anticipate we may see parties over time seeking to update their English jurisdiction clauses to move away from complex clauses towards pure exclusive jurisdiction clauses to take advantage of Hague Convention. There may be other reasons for taking this approach, including the fact that there have been some unhelpful cases in recent years in courts outside England – in

particular in France (Mme X v Rothschild) – which have questioned the enforceability of such clauses.

Post-Brexit, parties to asymmetric jurisdiction clauses may take comfort from English authorities upholding such clauses and worry less about the possibility that the CJEU might follow Rothschild. If the CJEU did decide in the future that such clauses were unenforceable, the English courts would not have to follow such a ruling.

- **What about Art 46 MiFIR**

  Art 46 of MiFIR contains a provision that requires providers of services covered by MiFIR from "third state" jurisdictions to 'offer' to resolve disputes before the courts of, or a tribunal in, a Member State. Once the UK has left the EU and assuming for these purposes (a) the UK is deemed a "third state" and (b) has acquired necessary equivalence approvals for this provision to apply, then it would appear that for certain specific services a UK provider would need to make such an offer which (if accepted) would mean that there would be a move away from English courts in certain contracts. While it is not beyond doubt, the provision talks in terms of an 'offer' to resolve disputes. Presumably this offer can be rejected. Interestingly the provision makes no reference to governing law. The potential application of such a rule is some way off (perhaps only coming into effect towards the end of 2019) but we may see this type of restriction cropping up in other areas of financial regulation. This is an area where we are likely to see an intensification of debate as the Brexit negotiations progress.

- **What about London arbitration clauses?**

  Arbitration is excluded from the Brussels Recast regime. Enforcement of arbitration clauses and awards is governed by the New York Convention 1958, which the UK signed up to individually. Brexit will have no impact on this arrangement.

- **Will we see a revival of the anti-suit injunction?**

  This is an order of the English court against parties (not courts) who act in breach of an exclusive jurisdiction clause (or London arbitration clause) by starting proceedings in a different (non chosen) court. The ECJ has declared that such orders are incompatible with principles of mutual trust between Member State courts. A discretionary measure; the English court still issues such orders where proceedings are brought outside the EU in breach of an exclusive English jurisdiction clause or London arbitration clause. The prospect of such orders can act as a deterrent to breach of contract.

  On Brexit, assuming the UK does not sign up to Lugano or a similar regime, the English courts will no longer have to follow ECJ authority and may feel uninhibited from issuing such orders where parties breach exclusive jurisdiction clauses.

- **Will be see a revival of the 'torpedo' – ie pre-emptive litigation in a non chosen court to delay proceedings in the chosen court**

  Litigation tactics such as the torpedo will no longer be effective if the UK is outside the EU/Lugano jurisdictional regimes. English courts would no longer be bound under these European rules to stay proceedings until another Member State has considered jurisdiction.

  If the UK were to sign up to the Lugano Convention on Brexit, the torpedo may re-emerge as a tactic, in particular because – unlike the Recast – the Lugano Convention has not been updated to fix the torpedo problem. But this is speculative. We understand the Commission has no immediate plans to update Lugano but such an update will presumably follow in due course.

  Moreover, this litigation specific issue is unlikely to be determinative in forum selection.

- **What about ISDA jurisdiction clauses?**

  Certain jurisdiction clauses such as the 1992 and 2002 ISDA Master Agreements are drafted by reference to European legislation. With regard to ISDA contracts, it may be that a market-wide solution via a Protocol would be the most efficient solution to ensure the clarity and effectiveness of these clauses post-Brexit. We anticipate that this is something that ISDA members will want to discuss as the terms on which the UK is exiting the EU become clearer.

- **What about service provisions?**

  Service of process may become more complex on Brexit. Litigants may not be able to take advantage of the provisions in the EU Service Regulation and

may be required more regularly to get permission to serve proceedings out of the jurisdiction.

Any potential practical difficulties could be sidestepped by the inclusion of a process agent clause for non-English parties. Brexit will have very limited impact given these clauses are commonly included in most international commercial contracts.

– **Will the English courts respect a Member state (eg Spanish) jurisdiction clause?**
Yes.

It may do so under the Hague Convention. See above.

Assuming for these purposes that the Hague Convention is not in force, the Lugano Convention is not signed up and no alternative regime is agreed, then such a clause would in any event be respected under English common law rules. Party autonomy is key in this area. The English courts will hold parties to their bargain, unless there are exceptional reasons not to do so.

4. Conclusion (Philip Wood)

It is important to remember that whatever assessment you make about your governing law and disputes clauses, that if you determine you need to amend these clauses don't just strike out the governing law or specified court and substitute them for another governing law or court without proper due diligence. Contract precedents are carefully drafted using specific language which has been tried and tested in the courts. Provisions work in certain legal systems but the very same term may be meaningless or worse unenforceable in another.

If you need assistance reviewing your clauses or drafting your disputes policy over the next few months and years, please do not hesitate to contact Karen, Sarah or me (Philip Wood) or your usual Allen & Overy contacts.

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