Choosing the right law and jurisdiction for IT outsourcing agreements

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All contracts regulating multi-jurisdictional IT outsourcing transactions (ITO Agreements) contain governing law and jurisdiction clauses. Some also provide sophisticated dispute resolution schemes. However, most lawyers that negotiate ITO Agreements would admit that these clauses (with the possible exception of clauses concerning alternative dispute resolution (ADR)) are not given much attention in the negotiating process.

However, they are vital to mitigating the risks associated with potential disputes. If potentially contentious issues are governed by predictable rules and effective dispute resolution mechanisms, there is a far greater possibility of avoiding litigation or arbitration, and achieving reasonable and cost-efficient results.

This chapter considers the following subjects in turn:

- Jurisdiction clauses.
- Arbitration clauses.
- Governing law clauses.
- Dispute resolution schemes.

**JURISDICTION CLAUSES**

This chapter considers the following matters:

- A brief overview of jurisdiction clauses.
- Guidelines for drafting.

**Brief overview of jurisdiction clauses**

Under a jurisdiction clause, the parties agree on the “venue” and the “court” that have subject-matter jurisdiction over a dispute arising out of the ITO Agreement.

In this context, “venue” should mean a specific venue (for example, a certain city or place of domicile). Merely referring to a country may be insufficient. The clause can refer to a specific “court”, depending on that court’s rules of access. The parties must analyse these rules on a case-by-case basis. For example, in the Canton of Zurich in Switzerland the parties can agree that the Commercial Court will have subject-matter jurisdiction over the dispute (to the exclusion of the District Courts in the Canton).

Jurisdiction clauses can be:

- **Exclusive.** In this case, both parties have no choice but to bring their disputes before the agreed court. Any other court, even if that court would have jurisdiction under statutory rules, must deny jurisdiction.

- **Non-exclusive.** In this case, the parties can bring claims against each other either:
  - before the agreed court; or
  - before any other court with jurisdiction (such as the courts of the defendant’s domicile).

Agreeing exclusive or non-exclusive jurisdiction can have considerable repercussions. For a case study of how this can affect the operation of a jurisdiction clause in practice, see box, **Example of a jurisdiction clause in action.**

**Guidelines for drafting jurisdiction clauses**

The following issues should be considered very carefully when drafting jurisdiction clauses.

**The scope of the jurisdiction clause.** ITO Agreements typically consist of:

- A frame agreement between the main parties.
- A number of separate contracts or annexes regulating specific areas, such as:
  - service level agreements (SLAs);
  - development work ordering and change requests;
  - local implementation and relevant form of agreements;
  - termination and transition services.

If there are additional agreements on top of the frame agreement, particularly if those additional agreements are entered into by parties other than the main parties, it must be clarified to which parts of the ITO Agreement the jurisdiction clause in the frame agreement applies, if any. In addition, it may be unclear whether a particular issue that arises (for example, a dispute on transition services agreed to be provided following termination of the ITO Agreement) is to be considered a contractual dispute within the scope of the jurisdiction clause.

To avoid disputes on jurisdiction, it is advisable:

- As a general principle, to refer all disputes to the same venue and court.
- Where, exceptionally, disputes should be referred to separate venues and courts, to include separate jurisdiction clauses with limited scope.
- To draft the jurisdiction clause(s) to catch all disputes arising out of or in connection with the whole or part of the ITO Agreement.
Exclusive or non-exclusive jurisdiction. The exclusivity or non-exclusivity of a jurisdiction clause can have considerable repercussions (see box, Example of a jurisdiction clause in action). In drafting the clause, the parties should consider these points:

- The wording of the clause ought to be very clear as to whether it is:
  - exclusive, in which case the word “exclusive” should be used;
  - non-exclusive, in which case it should be expressly stated that one or more parties can bring its claims before another court.
- Whether the clause should be exclusive or non-exclusive can depend on a variety of factors, for example:
  - the availability of interim relief (see box, Example of a jurisdiction clause in action);
  - whether it is essential to be forced to appear before a particular court, for cost reasons or because of the court’s reputation or consequences for determining the applicable law;
  - whether the parties only want to be heard in a particular venue.

In any case, careful consideration should be given to enforceability and enforcement when determining an agreed venue.

Example jurisdiction clause. The following is an example of a non-exclusive jurisdiction clause, which is intended to have a wide scope:

“Any and all disputes arising out of or in connection with this agreement, including but not limited to disputes on the validity, enforceability and termination of this agreement and the consequences of that termination, shall be submitted to the jurisdiction of the Commercial Court in Zurich, Switzerland, provided, however, that either party can also bring the dispute before any other court of jurisdiction.”

In this clause the term “agreement” must be defined, and include all relevant parts of the ITO Agreement. This usually includes the frame agreement and all separate contracts and annexes (see above, The scope of the jurisdiction clause). If the term agreement does not include separate parts to be executed by different parties, clauses that expressly refer to this term do not cover those separate parts.

**EXAMPLE OF A JURISDICTION CLAUSE IN ACTION**

Two parties (a customer and a supplier) have entered into an ITO Agreement with the following wording:

“The parties agree to submit disputes arising out of or in connection with this agreement to the jurisdiction of the Commercial Court in Zurich, Switzerland.”

The supplier is domiciled in Karlsruhe, Germany and the customer is domiciled in Zurich.

The supplier is about to enter into a cross-border subcontract involving the processing of the customer’s sensitive data without having obtained the customer’s consent, or complied with applicable rules on data protection. The customer wishes to serve an immediate cease and desist order on the supplier by way of without notice (ex parte) proceedings.

Germany, where the order must be enforced, is a member state to the EFTA Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters 1988 (Lugano Convention), as is Switzerland. However, Germany will not enforce an order obtained in another member state unless the defendant has been granted an opportunity to oppose the proceedings (which is not the case in without notice proceedings) (Articles 27 para. 2 and 34 para. 2, Lugano Convention). (Recently, a judge in Zurich dismissed an application for a without notice order on a defendant domiciled in another Lugano Convention state on the basis that the ground could not be enforced in the defendant’s jurisdiction. It is unknown whether this decision will be followed in subsequent cases.)

Therefore, the customer must bring its application before the court in Karlsruhe to ensure enforcement. Unfortunately, this requires the Karlsruhe court to accept jurisdiction. At that stage, whether or not the jurisdiction clause is construed as exclusive or non-exclusive becomes crucial. The clause itself is silent on the matter (see above). There is a risk that the German court will presume that the clause is intended to provide exclusive jurisdiction (Article 17 para. 1, Lugano Convention). In that case, the customer’s application for preliminary relief would be refused.

This example demonstrates the importance of carefully considering the wording of any jurisdiction clause and, in particular, whether it should grant exclusive or non-exclusive jurisdiction.

- Many national institutions, including the Swiss Chambers’ Court of Arbitration and Mediation (see www.sccam.org) or the International Center for Dispute Resolution (ICDR), a division of the American Arbitration Association (AAA).

Each of these provide well-established rules on arbitration and will usually recommend their own arbitration clause, which should be used without unnecessary changes to avoid lengthy and complex disputes.

In large-scale arbitration, the parties usually elect a tribunal consisting of three arbitrators rather than a single arbitrator. The parties can usually appoint their own arbitrator, and the two arbitrators will then appoint the chairperson. Therefore, each party has some say in the composition of the tribunal. This can be

**ARBITRATION AND ARBITRATION CLAUSES**

Parties to an ITO Agreement should always consider whether to have disputes resolved by binding arbitration. They can do so either once the dispute has arisen or (which is usually preferable) refer all disputes under the ITO Agreement to arbitration under a suitable arbitration clause.

The parties can choose arbitration with an arbitration institution, such as:

- The International Chamber of Commerce (ICC).
- The World Intellectual Property Organization (WIPO).
important in the case of complex disputes under ITO Agreements, which may require particular skills and experience.

Institutional arbitration offers other advantages, including the following:

- Disputes can be resolved quickly, if the parties agree to suitable arbitration rules and a suitable institution. For example, under the Swiss Rules of International Arbitration, the average duration of:
  - ordinary proceedings is ten months;
  - expedited proceedings is eight months.

Both of these timelines are considerably faster than arbitrations of other institutions. For instance, the average length for the resolution of a dispute of ordinary complexity under the ICC Rules or under the ICDR Rules is between 16 and 24 months.

- Experienced arbitrators, particularly in international arbitration, tend to take a business and solution-oriented approach when resolving disputes, rather than a legalistic or formalistic one.

- Arbitration is much more flexible in relation to procedural rules and typically allows the parties to structure the process according to their needs (including the rules regarding the taking of evidence).

- The language of arbitration proceedings can be agreed by the parties (it will usually be English in international cases). In contrast, national courts will require the parties to plead in the local official language.

- Cross-border notification, service and enforcement are considerably less difficult in international arbitration than in international litigation. There is usually no need to rely on judicial or diplomatic assistance. The enforcement of arbitral awards is usually very efficient and easy under the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention), which has over 140 signatories. The defences against enforcement are very limited.

Therefore, it is not surprising that an increasing number of ITO Agreements have arbitration clauses. In fact, according to a 2008 study by PricewaterhouseCoopers and the Queen Mary University of London, international arbitration has become the preferred dispute resolution mechanism for cross-border disputes.

**GOVERNING LAW CLAUSES**

This chapter considers the following matters:

- A brief overview of governing law clauses.
- An example governing law clause.

**Brief overview of governing law clauses**

If a party to an ITO Agreement brings a claim on a dispute arising from the agreement before a competent court (or arbitral tribunal), that court must give its decision on the basis of the applicable law. That law will cover all statutes, legal concepts and applicable case law in the relevant jurisdiction, including:

- How disputed contract clauses are to be interpreted.
- The rules that apply where the ITO Agreement is silent.
- Whether and to what extent contractual provisions such as exclusions or limitations of liability are valid and enforceable.
- What rules should prevail if those provisions are void under mandatory statutes of the governing law.

If the ITO Agreement is silent, the conflict of law rules of the jurisdiction in which the action was brought (lex fori) will determine the governing law. In most jurisdictions, multi-jurisdictional agreements are governed by the substantive laws of the jurisdiction where the party performing the contract’s obligations is domiciled. In the case of ITO Agreements, this would be the supplier’s domicile.

Generally, the parties can agree the governing law. In the great majority of ITO Agreements, the parties include an express governing law clause.

Governing law clauses can exclude certain parts of the elected law. The following are often excluded:

- The UN Convention on Contracts for the International Sale of Goods 1980 (Vienna Sales Convention), which provides certain rules that are favourable to the customer on representations and warranties, anticipatory breach of contract, and other matters.
- The conflict of law rules of the elected governing law, which may refer a certain issue of dispute to another governing law (renvoi).

However, it is impossible to avoid certain mandatory rules of the governing law and of the law of other applicable jurisdictions. Therefore, it is important to instruct local lawyers in a multi-jurisdictional outsourcing, even where a governing law clause is agreed (see box, Areas unaffected by a choice of governing law).

When lawyers draft an agreement, they usually do so with a particular substantive law in mind. The necessary level of detail of an ITO Agreement is a direct result of the governing law. ITO Agreements with a common law background will typically require much more detailed provisions than those drafted under continental European laws. For example, Swiss ordinary law already provides reasonable, balanced rules relating to the following matters, even if they have not been regulated in the contract:

- Indemnification for breach of representations and warranties by the supplier.
- Force majeure.
- The consequences of termination of the agreement.

The length of the ITO Agreement has practical consequences: the longer the contract, the more expensive and potentially inconsistent the contract will be. Therefore, the choice of law also has an impact on cost.

**Specimen governing law clause**

The wording of governing law clauses should be clear and straightforward. For example:

“This agreement has been construed under, and shall be governed by, the substantive laws of The Netherlands, excluding the conflict of laws rules and the UN Convention on Contracts for the International Sale of Goods 1980 (Vienna Sales Convention).”

Care should be taken to define “agreement” (see above, Jurisdiction clauses: Example jurisdiction clause).
AREAS UNAFFECTED BY A CHOICE OF GOVERNING LAW

Regardless of a choice of governing law, there may be rules of the governing law that cannot be excluded, or rules of other jurisdictions that will apply on a territorial basis. For example:

- Most, if not all jurisdictions provide rules on exclusion or limitation of liability, particularly in relation to clauses that exclude or limit damages for wilful or grossly negligent breaches of contract. Some laws, such as Swiss law, will uphold those clauses to the extent permitted (for example, a clause excluding claims for compensation for any indirect damage caused by contractual breach will be construed as excluding that damage unless it was caused either intentionally or through gross negligence). Other jurisdictions may treat the entire exclusion or limitation clause as void.

- The ITO Agreement may qualify as a different type of contract in different jurisdictions, triggering different mandatory rules. A contract which qualifies as a work contract under one law can qualify as a purchase or service contract in another. This can have fundamental consequences. For example, Swiss law provides that:
  - a “mandate” contract (an agreement providing for certain consulting on IT matters) can be terminated by each party at any time without:
    - notice period;
    - compensation for the remainder of the contract’s term.
  - a work contact that is terminated without cause can trigger an obligation to compensate the other party for the entire profit that would have been generated if the contract had not been terminated.

- Many jurisdictions provide mandatory data protection rules relating to privacy and data security that apply as soon as there is a territorial link (that is, the affected persons are resident in the jurisdiction, or the data processing takes place there). Complying with the data protection rules of all countries involved plays a key role in multi-jurisdictional ITO Agreements and needs careful contract drafting. Data protection standards have become a more important cost issue for multi-jurisdictional outsourcing, as they can require suppliers and customers to take particular measures to comply with the different data rules which in some cases, such as Germany, can be particularly burdensome and subject to fines in the case of non-compliance.

- Jurisdictions may have mandatory rules on local employment law. For example, if IT departments or important parts of those departments are transferred to the supplier, this can trigger the automatic transfer of all the customer’s employment contracts with its IT department staff.

- Jurisdictions may have mandatory rules on the licensing and assignment of IP rights. In some jurisdictions a party can assign any IP rights it has in the whole or part of an IT system. In other jurisdictions this may not be possible, or may require the approval of the original right holder. This can lead to the same contractual provision in an ITO Agreement having different effect in different countries. This issue is often underestimated in negotiations of ITO Agreements.

- The competition or anti-trust laws of all affected jurisdictions apply, including:
  - local merger control laws that require notification or applications for approval if the affected ITO volume meets the local thresholds;
  - tight restrictions on provisions in technology transfer and other contracts that may limit competition, such as:
    - exclusivity provisions;
    - restrictions beyond the termination of an agreement.

Breach of these laws may lead to heavy penalties.

DISPUTE RESOLUTION SCHEMES

If an ITO Agreement provides properly drafted jurisdiction or arbitration clauses, and governing law clauses, it will be clear which court or arbitral tribunal will hear the claim and which substantive law will apply.

However, other ways to avoid or resolve disputes can be chosen, which may be particularly useful in commercial contracts, such as ITO Agreements. These schemes can include:

- **Two-tier dispute resolution mechanisms.** In the event of a dispute, these provide for:
  - a structured negotiating process, which often allows the dispute to be escalated to the top management or board level of the parties, with the aim of solving the dispute amicably; and
  - an option to refer the dispute to the courts or arbitration where there has been a failure to reach an out-of-court settlement after good faith efforts to do so.

There are different types of two-tier dispute resolution schemes, the details of which must be carefully drafted. In addition, there is the issue of available remedies where a party does not follow the two-tier process and directly starts litigation or arbitration. Most laws are silent on this issue and it appears that global standards have not developed on this matter. However, it appears that:

- a two-tier dispute resolution scheme cannot deprive a party from going to court whenever the matter is or becomes urgent;
- filing a court action or starting arbitration proceedings triggers notice of those proceedings to interested parties (*lis pendence*).

In practice it often helps to refer the dispute to persons or levels within the parties’ organisations that have no day-to-day involvement in the actual ITO project and will assess the dispute on a more strategic level.

- **Mediation.** Most arbitration institutions also provide a specific framework for mediation, including procedural rules. Those institutions assist the parties in finding suitable mediators in the field of technology at issue on request. A well-known example for IT-related disputes is the WIPO Arbitration and Mediation Center (www.arbiter.wipo.int). While it is widely known
for its domain name dispute resolution procedures, its main focus is providing assistance in the resolution of commercial technology and IP disputes, including by mediation. The Center maintains a considerable database of neutral experts for ADR.

Mediation can bring disputes to an early settlement, and result in a fair settlement given the merits of the dispute. It is dependent on the personality and skills of the mediator. Mediation can either be agreed in the ITO Agreement as an initial step, or subsequently if structured negotiations between the parties fail (see above, Two-tier dispute resolution mechanisms). Mediation can also be agreed after a dispute has arisen.

- **Expert determination.** Some disputes in connection with ITO Agreements can be resolved by referring the dispute to an expert. This is because many ITO disputes (at least initially) concern technical facts rather than issues of contract interpretation. For example, if service levels are not met and there is a dispute as to whether this arises from the actions of the customer or supplier, it may be efficient and save costs and time if the parties involve a neutral expert and agree to follow his or her findings. In other areas of ITO Agreements, such as benchmarking clauses, it is customary to rely on expert determination. To avoid disputes, the rules governing the process of selecting and, in particular, instructing the expert must be carefully drafted. The result of an expert determination is usually not considered directly enforceable, unlike an arbitration award. However, enforcement is usually not an issue.

- **Careful contract drafting.** Careful drafting of the ITO Agreement is a very efficient way of avoiding disputes and making dispute resolution, if necessary, predictable and more cost efficient. Particular care should be applied in the drafting of:
  - all SLAs, including penalties and other remedies where there is failure to meet service levels; and
  - the rules governing the termination of the ITO Agreement and the provision of transition services to allow a smooth insourcing to the customer or outsourcing to a third party supplier.

**SUMMARY**

The following points arise from this chapter:

- ITO Agreements usually contain jurisdiction or arbitration clauses, and clauses on the governing law. However, those clauses deserve more consideration than they usually receive. These clauses can be a very efficient way to mitigate the risks of disputes.

- The parties to ITO Agreements should consider whether arbitration, instead of litigation, would be the appropriate method of binding and final dispute resolution. An ADR scheme, such as a two-tier dispute resolution scheme under which the dispute is escalated to the top management or board level of the parties and to people not involved in the day-to-day management of the project before starting litigation or arbitration, is recommended.

- Mediation and expert determination should be considered as an alternative by the parties when disputes arise.

This chapter does not assess the advantages or disadvantages of the different national laws and arbitration rules. However, as an example, Swiss law provides rules capable of governing disputes under an ITO Agreement at reasonable cost, and arbitration under the Swiss Rules has been shown to be successful.

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