“Midnight” Clauses

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Introduction:
Every now and then, two business parties realize that they are short on time to reach an agreement, so they resort to their lawyers to draft a sophisticated cross-border commercial transaction in an aggressively short time-span. The parties usually would have already agreed on all the main terms and conditions; they just need their lawyers to translate their agreement into a formal contract. In this situation, the transactional lawyers will usually borrow “boilerplate clauses” from their respective libraries of standardized agreements. Unfortunately, transactional lawyers might start drafting the choice of law and choice of forum clauses only when it’s after midnight; that’s why these clauses are called the “midnight clauses.”

Choice of Law Clause:
The most critical “boilerplate clause,” is the choice of law clause. If the parties - as often the case is - belong to two different jurisdictions, the outcome will be either: a) One party has the upper hand, and so he is able to get his way with this clause and so he usually chooses his own jurisdiction as the applicable law. b) Both parties reach a middle ground which is usually the law of a third country; typically, a law that is sophisticated and suited enough for this type of transaction (i.e. English law for maritime and shipping transactions, New York law for financial transactions). Regardless of the law chosen by the parties, transactional lawyers should be aware that the chosen law will have considerable effects on the entire agreement between the parties, in particular, the interpretation and enforceability of such an agreement would largely depend on the provisions of the applicable law.

Interaction with other Boilerplate Clauses:
To show the effects of the applicable law on boilerplate clauses, imagine this hypothetical; the transactional lawyers agree that the contract “shall constitute the entire agreementbetween the parties.” The question is whether such a clause will be sufficient to deem the contract as a self-sufficient system that operates into the vacuum without any input from the applicable law. The literal interpretation of this clause suggests that the parties have intended that they will be governed by their agreement only. The parties might argue that party autonomy is a principle enshrined in mostly all civilized jurisdictions. Despite that, almost all national jurisdictions provide for limitations to the principle of party autonomy. Therefore, the law governing the transaction may provide for mandatory rules providing for the principle of good faith or the principle preventing abuse of rights. For instance, German law will provide the parties with the ability to evidence that they have agreed upon obligations that are different from those contained in the contract. This means that transactional lawyers should be fully aware of the effects of the chosen law on their boilerplate clauses and whether such choice should be maintained or changed. In other words, a German or French law might not be beneficial for a German or a French party in light of the facts of the transaction. It should be noted that the chosen law might include international conventions such as the Vienna Convention on the Sale of Goods (“CISG”). Therefore, transactional lawyers should seek advice whether the CISG would be beneficial to their client or not based on the given factual pattern.

Choice of Forum Clause and International Arbitration:
More importantly, the choice of law clause operates in tandem with the choice of forum or arbitration clause. In other words, it does not matter only which law is applicable but also who is in charge of applying such a law. In this regard, there is a principal choice between litigation and arbitration. In light of the recent survey by Queen Mary University, 90% of the respondents prefer arbitration to litigation. However, transactional lawyers should be aware that there is not a fit-for-all solution. In the case of choosing international arbitration, the transactional lawyers should first and foremost choose a seat of arbitration which is party to the New York Convention

and is an arbitration-friendly regime. Further, transactional lawyers should pay extra care to the following practical issues:

1. **Arbitrability:** Transactional lawyers should be aware that the scope of the arbitration agreement might be considered non-arbitrable under the law of the seat of arbitration. Usually the law applicable to arbitrability is the law of the seat of arbitration, however, the arbitral tribunal might also consider the law of the potential place of enforcement as well as part of its duty to render an enforceable award. Therefore, transactional lawyers should try to pin down the places where the award might be enforced and analyze if there are any issues with arbitrability in such jurisdictions, in addition of course to the seat of arbitration. This would offer their clients more legal certainty right from the start.

2. **Scope of the Arbitration Agreement:** the tribunal might consider that the wording of the arbitration clause reaches only the contractual disputes between the parties and that they should litigate tortious claims which could lead to parallel proceedings. This could lead to conflicting judgments across jurisdictions which might further complicate the issues. Therefore, transactional lawyers should ensure that the wording of the arbitration agreement is decisive in its reference to the arbitration of all disputes "arising out of or in relation tothe agreement."

3. **Confidentiality:** Transactional lawyers might be under the false impression that arbitration is confidential by default, however, this is entirely a myth. Therefore, as a safeguard, transactional lawyers should provide for the confidentiality of their dispute under the main agreement and agree on a seat of arbitration that conforms with this view.

4. **Challenge of Arbitrators:** Transactional lawyers might be shocked to know that the principle of "nemo judex" is not enshrined in the UNCITRAL Model Law of arbitration which is adopted by more than 70 jurisdictions around the world. This means that the challenged arbitrator will normally be part of the tribunal which decides upon the challenge of such an arbitrator, unless the parties agree otherwise. It should be noted that the IBA Guidelines on Conflict of Interest are considered the leading guide to international arbitral tribunals when deciding on this issue. This issue could be contracted away by the parties; therefore, it might come handy if the transactional lawyers adjust this rule either explicitly or implicitly by choosing a jurisdiction as the seat of arbitration which does not allow for this ruling.

5. **Interim Measures:** Arbitrators might not have the same power as national courts when it comes to interim measures. In fact, some jurisdictions prevent arbitrators from rendering such measures. Even if the arbitrators have the power to render interim measures, such measures are not self-enforcing, the awarded party needs to apply for the recognition and enforcement of this interim measure before the competent court. Therefore, transactional lawyers should seek a jurisdiction which allow for the application of ex parteinterim measures directly before the national courts even in the event of pending arbitration proceedings. This could be crucial in some cases.

6. **Multi-Contract Disputes:** Arbitrators will usually not have the power to consolidate different claims concerning the same parties unless agreed otherwise by the parties. The parties might agree on this issue at any point of time. The transactional lawyers must weigh in advance whether the counterparty might refrain from agreeing on such an issue when it is presented in the dispute, therefore, it might be beneficial to agree on this issue in advance to avoid any future dilemmas. This could be solved also by choosing arbitral institutional rules that put such power explicitly in the hands of the arbitral tribunal.

7. **Multi-Party Disputes:** Multi-party disputes can become very tricky, especially, when forming the arbitral tribunal. For instance, the norm in arbitration is for each party to choose an arbitrator and then both arbitrators choose the chair of the tribunal. In a multi-party dispute,

it might take a considerable amount of time to have parties agree on the tribunal especially if the arbitration is ad hoc with no assistance from an arbitral institution.

8. **Third Parties:** This can be indeed messy; as arbitrators might not be able to bind third parties or force them to join the case or present certain evidence or appear as witnesses without support from the national courts which might not be available in some jurisdictions. Therefore, in cases where the transactional lawyers anticipate the involvement of third parties, the choice of court which could force the involvement of such third parties might be way more beneficial.

9. **Evidence and Discovery:** Evidence and discovery in international arbitration is usually entirely up to the arbitral tribunal. This might come as a shock to parties from both civil-law and common-law countries, as the tribunal might fashion its own procedures which could be at stark with the rules governing evidence and discovery in both counterparties' jurisdictions. The practice of arbitral tribunals is following the IBA Rules on Taking of Evidence which can be considered as a middle ground between common-law and civil-law practice, however, some practitioners and scholars consider that the IBA Rules are more tilted towards the practice of common-law jurisdictions. This could be because the IBA Rules might not allow for US fishing expeditions but in the same time allow for the discovery of internal documents if the latter are relevant and material to the outcome.

10. **Costs and Fees:** the tribunal will usually have the discretion to allocate the fees and costs of arbitration (which could be enormous!!) as it sees fit, unless agreed otherwise by the parties. In this regard, the tribunal will have the freedom to choose between allocating the legal fees of the parties in accordance with the American rule whereby every party incurs its own legal fees, or in accordance with the civil-law rule whereby the loser pays the legal fees.