Feature

KEY POINTS

- The choice of governing law can lead to potentially difficult negotiations among the JV parties.
- One objective in choice of governing law may be to identify a jurisdiction that recognises a particular form of entity or particular rights or duties in respect of that entity.
- The various arbitration rules may need to be supplemented or modified by stipulations in the JVA.

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Joint venture agreements: part 18 – planning for disputes

This is the 18th and final article in a series examining project development and finance joint ventures (JVs) based on the International Trade Centre incorporated joint venture model agreement (JVA) among three or more parties[1]. This instalment focuses on JVA Arts 30 and 31[2], which provide the mechanism for resolving disputes between or among two or more of the JV parties and/or the joint venture company (JVCo).

Article 30 specifies the governing law for the JVA and Art 31 provides an escalating series of dispute resolution mechanisms beginning with attempts at amicable settlement through direct negotiations, progressing to mediation and culminating with the option of binding arbitration or litigation.

Drafting the governing law clause appears relatively simple. Article 30 simply states that "[t]his Agreement is governed by the laws of . . . [specify country]." However, as the experienced practitioner will know, there is more to choice of law than first meets the eye, and the decision involves a variety of practical and legal considerations and may lead to potentially difficult negotiations among the JV parties.

There are three primary elements of governing law to consider. The first is substantive law. It will govern the interpretation of the JVA, the existence and scope of the express and implied legal duties it creates and the availability and measure of damages and other forms of relief for breach of the JVA. A dispute may also involve other causes of action than those arising under the JVA, such as those arising under statute or the common law of property or tort. Though the model JVA does not, the JV parties may want to clarify in Art 30 that the choice-of-law provision governs the existence and extent of such other duties and rights as well as those arising under the JVA.

The second is procedural law. If the JV parties agree in Art 31 to litigate disputes, then the procedural law will ordinarily be that of the courts in which they agree to litigate. These courts are often, but not always, in the same jurisdiction whose substantive law the JV parties agree to apply.

On the other hand, if the parties agree to binding arbitration, the procedural law is supplied by a combination of the arbitration rules adopted by the parties (usually by reference to the rules of an arbitral institution such as the ICC or UNCITRAL), the procedural rules for arbitrations under the laws of the jurisdiction that serves as the "seat" of the arbitration, and any supplements thereto or derogations therefrom agreed to by the parties (in the JVA or at the time an arbitration proceeding is commenced).

The lawyers for the JV parties should be aware that some defences to substantive legal rights straddle the dichotomy between substantive and procedural law. For example, a statute of limitations defence could be considered either as a matter of substantive law or procedural law. The length of the limitation period may be determined under the chosen substantive law, under the law of the seat of the arbitration or under both (such as where the shorter limitation period will control). The answer to this question varies from jurisdiction to jurisdiction. Some attempt should be made to consider such matters in selecting the governing substantive and procedural law.

The third element of choice of law addresses conflict of laws. Although the model JVA does not do so, one often encounters choice-of-law provisions that designate a particular jurisdiction's law as governing, but disclaim that the choice of such jurisdiction's law is "without reference to its conflict-of-laws principles". Practitioners have engaged in a long-standing debate about whether this disclaimer is necessary or not. The argument in favour is that the provision clarifies that the parties intend to apply the substantive law of the designated jurisdiction even if its conflict-of-laws principles would otherwise have applied the law of another jurisdiction (for example, if the transaction or dispute had a stronger nexus with another jurisdiction). The argument against is that this is implicit in the statement that the designated jurisdiction's law will govern and the disclaimer is therefore superfluous. The author is not aware of any precedent where conflict-of-laws principles were applied to frustrate the choice of substantive law by parties to a dispute.

Let us now consider choice of substantive law. In the context of an incorporated JV, the ownership and governance of the JVCo, and hence the rights and responsibilities of the parties to each other, will to a degree be governed by the law of the jurisdiction in which it is incorporated even if the JV parties specify another legal system as the governing law. For example, the boundaries of the privileges and obligations that may be associated with share ownership may be prescribed under the relevant companies act or corporate law. Although the JV parties may attempt in the JVA to establish privileges and obligations outside those boundaries, their attempt may be unenforceable under the laws of the jurisdiction in which the JVCo is incorporated and, for the same reason, may not be recognised as valid by an arbitral tribunal or the courts of another jurisdiction selected by the parties as a dispute resolution forum. Hence, choice of law is not a blank cheque to ignore the law of the jurisdiction

in which the JVCo is incorporated. If that law presents insurmountable hurdles to the structure the JV parties want to adopt, one solution may be to form a special purpose project entity in the host jurisdiction as a wholly owned subsidiary of a parent JVCo incorporated in a jurisdiction that will recognise the structure desired by the JV parties. As mentioned in an earlier instalment, there may be tax, regulatory or other business reasons for adopting such a structure in any event.

Subject to the above caveat, some of the primary objectives in choice of substantive law in international project development and finance transactions include selection of a legal system that is well-developed, predictable and stable. Where the project is in a developing country, whose own laws may be underdeveloped and interpretive precedent may be scant or non-existent, English and New York law have long been favourites for these very reasons. Neither legal system is perfect. For example, English law does not imply a duty of good faith and fair dealing, while New York law does. English and New York law also differ widely in the creation, perfection and process for enforcing "charges" (under English law) or "security interests" (under New York law) over personal property collateral pledged by a borrower to secure repayment of a loan. (Incidentally, this is also an area where the law of the jurisdiction in which the collateral is located may override or at least modify the parties' choice of law.)

Another objective in choice of substantive law for an incorporated joint venture may be to identify a jurisdiction that recognises a particular form of entity or particular rights or duties in respect of that entity. Choice of where to incorporate the JVCo is thus an important and central facet of the choice of governing law for the JVA. Likewise, it invokes choice of entity, a decision that often goes hand in hand with tax planning considerations, so the choice of jurisdiction and entity type, and indeed the entire holding company structure for the JV, must be carefully mapped out in light of the tax position and home jurisdiction tax laws of the JV parties (which often differ), the anticipated cash flows and earnings and losses of the JVCo over time, the tax laws of the host country, and the availability of intermediate countries with favourable tax laws and/or tax treaties with the host country of the JV business and home countries of the JV parties. The lawyers for the JV parties must be diligent in considering these interrelated factors.

We turn now to the dispute resolution provisions of Art 31. Article 31.1 requires the parties to attempt to resolve all disputes amicably. Where these efforts are not working, Art 31.2 allows a party to escalate the negotiation process to the highest-level decision-makers in each party. Where these efforts are still not working, Art 31.3 also contemplates the possibility of a party requesting mediation (where the other parties must give the request "constructive consideration" but are not required to accede to it). Finally, if these efforts fail, under Art 31.4, a party may notify the others that it may commence proceedings. Article 31.4 also allows the JV parties, in preparing the JVA, to choose between binding arbitration and litigation as the exclusive means of resolving disputes.

> "There are no time limits or other procedural parameters for these mandatory attempts at amicable dispute resolution."

In the model JVA, the preliminary steps in Arts 31.1 and 31.2 appear to be mandatory, particularly in view of the language in Art 31.3. There are no time limits or other procedural parameters for these mandatory attempts at amicable dispute resolution. The threshold for initiating arbitration or litigation under Art 31.4 is that "a Party has come to the conclusion that the attempts at amicable resolution are to no avail."

Similar provisions to those in the model JVA are commonly encountered. In the author's experience, they are unnecessary, as few investors will voluntarily embrace the cost and disruption of arbitration or litigation without first making considerable effort to resolve matters amicably. Adding such steps as mandatory contractual prerequisites to initiating arbitral or judicial proceedings creates uncertainty as to whether one has done what is contractually required to commence proceedings and affords one's adversary with a ready defence, which is likely to be raised in every instance to seek dismissal on jurisdictional or other similar grounds. The author therefore recommends removing Arts 31.1 through 31.3 from the model JVA.

Nevertheless, if the JV parties are intent on including such provisions, then they should be modified to clarify the minimum waiting period required, the number and manner of attempts at amicable resolution required, and any conditions under which no preliminary steps are required (such as when the respondent voluntarily seeks protection from creditors under any insolvency or bankruptcy law).

Article 31.4 offers the JV parties the option (which must be selected in drafting the JVA) of either binding arbitration or litigation. Neither arbitration nor litigation is an ideal dispute resolution mechanism, with each offering positives and negatives. Arbitration requires the parties, rather than the taxpayers of the forum, to absorb the full costs of the arbitrators, arbitral institution and arbitration facilities, as well as their own legal costs. The arbitrators lack the supervisory and enforcement powers of a court over litigants and their counsel, and have virtually no authority over third-party witnesses, third-party litigants or property. The arbitrators will also comprise an *ad hoc* panel that must ascertain and familiarise itself with the substantive and procedural rules adopted by the parties who have consented to the arbitration, whereas a court will have established procedural rules (with which the judge is already familiar) and, assuming the court is in the jurisdiction whose law will govern, are also familiar with the governing substantive law. An arbitral award is not self-enforcing and must be lodged in an appropriate court to become an enforceable judgment.

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Biog box

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On the other hand, arbitration affords the parties the ability to choose a neutral seat for the conduct of the arbitration and to select neutral arbitrators who are not only expert in the procedures of international arbitration but also familiar with the chosen governing law and possibly the subject matter of the dispute. Unless all or most of the JV parties are from the same home country, unless the host country is an acceptable forum or unless one JV party has considerably more bargaining power than the others, it may be difficult for the JV parties to agree on any court that should have exclusive jurisdiction to hear disputes under the JVA. In contrast, it should be easier to find a mutually acceptable arbitration seat and set of arbitration rules.

In drafting an arbitration agreement, the lawyers for the JV parties should consider, and try to accommodate, those circumstances in which arbitration may be unavailable or inappropriate. These may include insolvency or winding up proceedings, which may be governed by the law of the jurisdiction in which the entity being wound up or liquidated is located and may require judicial oversight or other specified statutory trustee or practitioner. They may also include situations involving third parties who did not consent to arbitration. In order to avoid wasted time and costs and potentially inconsistent outcomes from unnecessary or duplicative proceedings, care should be taken to try to carve out these and other such circumstances from the exclusivity of the arbitration clause

Article 31.5 specifies the applicable arbitration institution or arbitration rules, the seat of the arbitration and the language of the arbitration. A detailed comparison and analysis of the pros and cons of the various arbitration rules and institutions from which the JV parties may choose is beyond the scope of this article. In any event, those rules may need to be supplemented or modified by stipulations in the JVA (either because the rules expressly contemplate that such matters must or may be stipulated in an arbitration agreement or because they are not addressed in the rules). For example, many arbitral institutions do not supply procedural rules for the taking of evidence. However, the International Bar Association has developed a useful set of evidence rules for international arbitrations that the parties may adopt by reference in the JVA.

As discussed, the seat of the arbitration has significant implications for the choice of procedural law. The seat also governs the availability of judicial aid to the arbitration, such as enforcement of provisional measures, determining certain unsettled questions of law, and similar items. To the lay management of the JV parties, the venue of the arbitration (which is often, but not necessarily, the same as the seat) has symbolic and logistical importance. It should not be a place that is too difficult or costly for any party to reach or navigate once there (on a principle of mutual minimisation and equal sharing of difficulty and costs). It should not be a place that appears to indicate that one party has to come to another to get relief or that otherwise evinces bias. From the lawyers' perspective, it is also helpful if the selected venue has available arbitration facilities, particularly those associated with the chosen arbitral institution. Moreover, the lawyers will need to determine whether to treat the venue as the seat, and therefore to bring in the accoutrements that come with a seat and that seat in particular – or whether to specify an alternative seat or no seat for the arbitration. The decision will depend on a variety of considerations, including some mentioned above and others beyond the scope of this article.

Finally, Art 31.6 supplies some additional substantive guidance for the arbitral tribunal in interpreting the JVA. It directs the arbitrators to give effect to both the letter and the spirit of the JVA. Most interestingly, its final sentence states that, in case of conflict between the JVA and applicable law, the arbitrators will act as "amiable compositeurs" and, "subject to public policy," give effect to the JVA and the "reasonable intentions" of the JV parties. One can readily see that these directions, containing both a rule and a counter rule, are ripe for dispute if any such conflict between the JVA and applicable law does arise. The preferred option, therefore, is to use all diligence to ensure that there is no such conflict.

Because the jurisdiction of an arbitral tribunal is defined by the consent of the parties to the arbitration, the lawyers negotiating the JVA should exercise care in drafting the arbitration clause. If the JV parties agree, it should include within the scope of consent not only disputes arising under the JVA, but also disputes under ancillary or related agreements as well as those that may arise under statute or common law. Even still, the scope of consent will ordinarily not extend to third parties, including affiliates of the JV parties. Nor will it cover counterclaims or setoffs arising under unrelated agreements and transactions unless the scope of consent is quite broad. Some of these matters may be addressed in the applicable arbitration rules, but others will need to be addressed in the JVA.

> "The lawyers for the JV parties should consider, and try to accommodate, those circumstances in which arbitration may not be available or inappropriate."

In conclusion, transaction and corporate lawyers are well advised to consult an experienced international arbitration lawyer in drafting the choice-of-law and arbitration clauses for the JVA. Drafting mistakes and oversights discovered years later, when a dispute arises, are likely to add significant cost, complexity and uncertainty to the "agreed" dispute resolution process and it will then be too late to add, remove or modify even a single sentence, phrase or word that could otherwise have avoided these consequences. ■

1 The model JVA discussed may be found at www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf.

2 Article 31.7 was discussed in part 14 of this series and will not be discussed in this instalment.