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THE PERILS OF BAD CONTRACT DRAFTING: THE IRONY OF DISPUTE-RESOLVING PROVISIONS BECOMING THE CAUSE OF DISPUTE

Litigating or arbitrating contractual disputes can be a stressful experience for all parties involved, but the process can be considerably smoother if the parties' dispute is dealt with expeditiously, cost-effectively, and judiciously. Achieving this objective will depend primarily on the efficiency and experience of the court or arbitral tribunal dealing with the dispute, the effectiveness of the procedures to be adopted to manage the case, and the certainty of the laws to be applied when the judge or arbitrator discharges his or her decision-making power.

During the drafting and negotiation of contracts, parties will have the opportunity to determine how subsequent disputes are to be resolved. For example, the parties may prefer to submit to the exclusive jurisdiction of the courts of a particular country, state, or region because those courts are known to be efficient and fair. Alternatively, they may wish to refer their disputes to arbitration rather than initiating litigation, by including an arbitration agreement in their contract. On the other hand, the parties may agree in their contract to adopt alternative methods of dispute resolution, such as mediation, expert determination, or conciliation, before embarking on litigation or arbitration. The parties might also choose the laws of a particular jurisdiction rather than those of the jurisdiction more closely related to their contractual arrangement because the former laws are perceived to be more certain (*e.g.,* foreign companies involved in a transaction in China may prefer that their contract be governed by the laws of Hong Kong instead of the Mainland).

The recent decision of *Beyond the Network Limited v Vectone Limited* (High Court of Hong Kong, December 13, 2005) is illustrative of the importance of drafting such contractual clauses with care and clarity. This *Commentary* will review the case in detail and highlight the perils of poorly drafting these clauses, in particular the detrimental impact on the efficient and cost-effective resolution of the parties' substantive differences. Specifically, the ensuing fight between the parties in this case regarding the proper interpretation of clauses associated with the resolution of disputes effectively

hijacked the court proceedings and put the resolution of the primary claim on hold. In fact, more than a year passed between the filing of the writ and the serving of a defense to the claim.

THE ROOT OF THE PROBLEM

The case involved a dispute over alleged billing discrepancies in invoices issued by Beyond the Network ("Beyond") to Vectone for the provision of international telephone services. The dispute led Beyond to commence proceedings in December 2004 against Vectone to recover US$718,999.26 said to be due on the disputed invoices. After obtaining several extensions of time for the filing of its defense, Vectone applied to stay the proceedings to arbitration on the basis that the agreement with Beyond included an arbitration agreement. (By way of explanation, under the laws of Hong Kong, as in many other jurisdictions, court proceedings can be stayed in certain circumstances if the parties had previously agreed that they would resolve their disputes through arbitration rather than litigation.)

But whether or not the parties were subject to an arbitration agreement was far from clear. The confusion arose out of the following clauses of the contract:

> 4. SETTLEMENT AND PAYMENT
>
> 4.3 Each party will be responsible for payment of all undisputed charges as reflected on any billing statement. . . . Neither party shall have an obligation to pay any amount which has been disputed in good faith until such time that the dispute is satisfactorily resolved by the Parties. . . . In the event the Parties are unable to resolve the dispute amicably with[in] a reasonable period of time and havin[g] exchanged their respective call detail records, not to exceed 14 days, then, the parties will submit the difference to the Hong Kong Courts.
>
> 5. REGULATIONS. This Agreement is made expressly subject to all present and future valid orders, regulations of any regulatory body having jurisdiction over the subject matter of this Agreement, and to the laws of the Hong Kong, SAR. The Parties hereby submit to the exclusive jurisdiction of the courts of Hong Kong, SAR.
>
> 11. GENERAL PROVISIONS
>
> . . . .
>
> 11.2 GOVERNING LAW. This Agreement will be interpreted in accordance with the laws of the State of New York, USA, notwithstanding the principles of conflicts of laws thereof, and any dispute shall be submitted to the courts in the State of New York. The Parties agree that the United Nations Convention on Contracts for the International Sale of Goods will not apply to this Agreement.
>
> 11.3 ARBITRATION. Either Party may require that any dispute arising hereunder be settled by binding arbitration in accordance with the commercial arbitration rules of the American Arbitration Association provided that alleged breaches of Section 7 (Confidentiality) may be settled by injunctive relief in a court as provided in Section 11.2. The arbitral tribunal shall be composed of a sole arbitrator. The English language shall be used throughout the arbitral proceeding. The arbitration shall take place in New York, NY, USA. The cost of the arbitration, including the fees and expenses of the arbitrator(s), shall be shared equally by the Parties unless that award provides otherwise.

As a result of the apparent contradictions between these clauses, the court had to deal with the following issues:

1. Was the proper law of the contract the laws of Hong Kong (clause 5) or the state of New York (clause 11.2)?
2. Given the reference to two different laws (clause 5 and 11.2), could the laws of Hong Kong apply to some aspects of the agreement while the laws of the state of New York applied to others?
3. Were the parties required to use arbitration to resolve their disputes (clause 11.3) or could they resort to litigation (clauses 4.3 and 5 or clause 11.2)?
4. If the parties could opt for litigation, were the disputes to be resolved by the courts of Hong Kong (clauses 4.3 and 5) or the courts in the state of New York (clause 11.2)?

The main argument for Vectone (the party applying for the stay of the existing court proceedings) was that the true and proper meaning of clauses 4.3, 5, and 11.2 was irrelevant on the basis that clause 11.3 contained an arbitration agreement. Consequently, the court proceedings should be stayed in favor of arbitration, and the court could avoid having to undertake the complicated task of interpreting the meaning of clauses 4.3, 5, and 11.2. In particular, Vectone argued that the court need not concern itself with unraveling the apparent contradiction within the contract, which on the one hand required the parties to deal with their disputes by way of court proceedings (and determine whether the jurisdiction would be Hong Kong or New York) and on the other hand referred disputes to arbitration in New York.

MAKING SENSE OF THE PARTIES' WORDS

The court acknowledged that the contract was, as the judge put it, "badly drafted." Nevertheless, the court was not to be deterred by the difficulties arising out of the confusing and contradictory language of the contract. Instead, the court attempted to give meaning to the parties' words by determining the objective intention behind each of the problematic clauses. In short, the court held that there was no arbitration agreement; instead, the parties had agreed to submit their disputes to the exclusive jurisdiction of the courts of Hong Kong. The court came to this conclusion on the following bases:

Clauses 4.3 and 5. By virtue of clauses 4.3 and 5, the parties had unequivocally agreed to submit all differences on billings to the exclusive jurisdiction of the courts of Hong Kong. As far as the court was concerned, the parties had made this "crystal clear" by including the word "exclusive" in clause 5. Although the judge did not say so expressly, he seems to have concluded that by virtue of clause 5, the laws of Hong Kong would also be the governing or proper law of the contract (except for issues surrounding the interpretation of the contract, which would be subject to the laws of the state of New York, as discussed later in this *Commentary*).

It is interesting to note that Vectone argued that because of the heading "Regulations" in clause 5, the exclusive jurisdiction of the courts of Hong Kong related only to "regulatory matters" and therefore clause 11.3 could still give rise to an arbitration agreement that would deal with all disputes other than those of a regulatory nature. The court rejected this argument because by "reading clause 5 as a whole, one sees that the word 'Regulations' is used as a general term which at least encompasses orders, regulations and the entire laws of Hong Kong SAR (whether statutory or common law)."

New York Laws to Govern Contract Interpretation. Notwithstanding that the governing or proper law of the contract was Hong Kong law and the courts of Hong Kong were to have exclusive jurisdiction, clause 11.2 stipulated that the laws of the state of New York would be the governing law with respect to issues surrounding the interpretation of the contract. The court did not see this as contradicting clauses 4.3 and 5 on the basis that "[u]nder Hong Kong conflicts of law principles, the courts will normally give effect to such a choice of law provision. Thus, applying Hong Kong law in the sense of private international law rules, a Hong Kong court would be prepared to apply New York law canons of construing contracts here." In other words, the Hong Kong courts would apply the laws of the state of New York to issues surrounding the interpretation of the contract (which is presumably what the court was doing to determine the meaning of these problematic clauses), whereas the laws of Hong Kong would be applied to all other issues, disputes, and differences in connection with the contract.

Issues Related to Clause 11.2. The more difficult issue arising out of clause 11.2 was the inclusion of the apparently mandatory requirement that ". . . any dispute *shall* be submitted to the courts in the State of New York" *(emphasis added)*. Not surprisingly, Vectone argued that if the Hong Kong courts did in fact have exclusive jurisdiction, any requirement to submit disputes to the New York courts was pointless and should therefore be ignored. However, due to the overriding requirement that the court should "make sense of the contract as a whole," it could not simply ignore the express words of the parties. Consequently, because clauses 5 (exclusive jurisdiction of the Hong Kong courts) and 11.2 (submission of disputes to the courts in the state of New York) would give rise to an insurmountable contradiction, Vectone argued that the true intent of the parties could only be that they would refer their disputes to arbitration pursuant to clause 11.3.

However, the court held that there was no contradiction because the word "shall" in clause 11.2 was intended to be permissive and not mandatory. In the words of the court: "... to read 'shall' in clause 11.2 in some other way, as (say) incorporating some mandatory flavour, would be inconsistent with the plain and obvious meaning of the expression 'exclusive jurisdiction' in clause 5." That being the case, the parties could agree to submit their disputes to the courts of the state of New York. If they did not agree, the Hong Kong courts would maintain their exclusive jurisdiction.

The court also considered the possibility that New York courts would deal only with legal issues involving the interpretation of the contract, which, according to clause 11.2, would be governed by the laws of the state of New York. However, the court did not accept that the parties could have intended such a split approach to jurisdiction. In particular, this could potentially have resulted in parts of a dispute going before the courts of Hong Kong and the remainder being dealt with by New York courts. This would obviously be confusing, impractical, and costly to the parties. The court went on to say that if the parties had intended jurisdiction to be split, they should have used clear language to that effect.

Clause 11.3. What then was the effect of clause 11.3, which stipulated arbitration in New York? The court dealt with clause 11.3 in the following two ways (neither being helpful to Vectone):

Clause 11.3 was permissive only and the parties could refer their disputes to arbitration if they agreed. In such an event, the agreement of the parties would become an arbitration agreement and override clause 5. However, because Beyond did not agree to arbitration, clause 5 remained in effect.

Alternatively, the court was of the view that pursuant to clause 4.3, an attempt by the parties to "resolve the dispute amicably with[in] a reasonable period of time" included referring the dispute to arbitration under clause 11.3. Whatever a reasonable period of time for invoking arbitration may be (14 days as argued by Beyond or something else), Vectone did not give notice of its intention to refer the differences over billings to arbitration until five months after the invoices were first disputed. According to the court, this was an unreasonable amount of time "by any objective yardstick." Consequently, the court held that Vectone waived any right under clause 11.3 to arbitrate.

OBSERVATIONS CONCERNING THE JUDGMENT

The court in this case appeared to find no contradictions between clauses 4.3, 5, 11.2, and 11.3, despite those clauses appearing at face value to contradict one another. As a result, some might argue that the court effectively ignored the fact that the clauses in question were so poorly drafted that they were incapable of reflecting the true intention of the parties on any objective assessment.

For example, if the parties had truly intended to submit to the exclusive jurisdiction of the courts of Hong Kong, why did they also include a permissive provision to refer disputes to the New York courts? The fact is that the parties could subsequently have chosen to do this without such a provision in the original contract. The same might also be said regarding the permissive stipulation for arbitration in clause 11.3. In relation to clause 4.3, did the parties really intend arbitration to be a form of amicable dispute resolution? After all, arbitrations are very often as adversarial as litigation. This being the case, could Vectone have waived its right to arbitrate because it had not referred the disputes to arbitration within a reasonable period of time?

Despite these ambiguities, the court had a duty under the law to make sense of the parties' words and give their agreement meaning. In the end, whether or not the court's conclusions represented the objective intention of the parties at the time of entering into the contract, the judgment had the practical and desired effect of ending arguments over the proper mode of dispute resolution and allowed the parties to get on with resolving the substantive differences between them. The alternative would have been for the court to find that there was an arbitration agreement, but this would have involved ignoring three other express clauses in the agreement and would have been contrary to the laws of contract interpretation in both Hong Kong and New York.

CONCLUSION

Beyond v Vectone is a striking example of what can go wrong if parties to commercial agreements pay little attention to the clauses associated with the resolution of disputes. While parties are not always mindful of the risk of disputes when negotiating and drafting their contracts, the failure to think ahead and deal with these possibilities with precise clauses could expose the parties to complex procedural arguments when disputes subsequently arise. Parties should avoid wasting time and money arguing over the true meaning of these clauses instead of resolving the primary disputes that have arisen between them. Such an outcome can be easily avoided if the time is taken to get these clauses right in the first place. They are, after all, important parts of a contract that can assist greatly in the efficient and cost-effective resolution of disputes—and as such should not become the cause of dispute themselves.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Phillip Georgiou
852.3189.7312
pgeorgiou@jonesday.com

Iain Seow
852.3189.7292
iseow@jonesday.com

Ashley Howlett
86.10.5866.1113
ahowlett@jonesday.com