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Don't repeat UBS's mistake

The world is gearing up for international securitized debt litigation. Make sure you check the jurisdiction clauses, contract by contract

A transatlantic battle over jurisdiction in one of the first structured finance cases brought in the US has already offered a valuable lesson for practitioners and institutions pursuing suits in this rapidly-developing area of the law. Recent decisions in litigation between HSH Nordbank and UBS AG and UBS Securities LLC (collectively UBS) reveal that apparently minor wording differences in jurisdictional clauses underlying complex structured finance can have enormous implications on where and how these cases will be litigated.

In negotiations conducted in 2001 and 2002, HSH agreed to purchase from UBS a $500 million interest in a CDO called North Street 4 managed by UBS. The transaction was set out in several complex and intertwined contracts with distinct provisions regarding choice of law and jurisdiction.

The parties first entered into a letter agreement that confirmed the purchase and sale of the North Street notes, described mutual expectations for the deal, and called for the creation of a final offering memorandum setting out details of the deal. The letter agreement was silent as to which court would have jurisdiction over any dispute, but stated that it was governed under New York law.

Two months later, in March of 2002, the parties agreed to a final offering memorandum, described as an offering circular. The offering circular explained that the profits HSH could make from its investment in the North Street CDO would turn on a credit swap entered into with UBS. The offering circular was governed by New York law and contained a New York jurisdiction clause.

The terms of the credit swap

Under the credit swap, HSH's profits from its North Street investment would be linked to performance of collateral in a reference pool. UBS, on the other hand, would profit if the value of the collateral in the reference pool declined. The terms of the credit swap were spelled out in a credit swap agreement that was governed by English law and that contained a jurisdiction clause favouring English courts.

UBS had a potential advantage in the credit swap arrangement, because it was permitted to select the collateral for the reference pool, and to make substitutions to the collateral held in the reference pool. Accordingly, the parties entered into a reference-pool side agreement (RPSA) that contained provisions aimed at protecting HSH's interest in the selection of appropriate collateral. This RPSA was subject to New York law and contained a non-exclusive New York jurisdiction clause.

Paragraph 9.08 of the RPSA read: "All judicial proceedings brought against the swap counterparty or [HSH] arising out of or relating to this agreement may be brought in any state or federal court in the borough of Manhattan in the City of New York and any appellate Court from any such Court, and by its execution and delivery of this agreement, each of the swap counterparty and [HSH] accepts for itself and in connection with its properties, generally and unconditionally, the nonexclusive jurisdiction of the aforesaid courts and waives any defence of forum non conveniens and irrevocably agrees to be bound by any judgment rendered thereby in connection with this agreement."

HSH's payment to UBS for its interest in the CDO was made in the form of puttable medium term notes (MTNs). The details of these notes were the subject of a pricing agreement signed by HSH and a dealer's confirmation signed by UBS, each governed by English law and subject to an exclusive English jurisdiction clause. The last contract in the transaction was a letter-agreement term sheet setting out the sale of the North Street Shares in exchange for the MTNs. It contained no express agreement regarding jurisdiction or choice of law.

After UBS created the reference pool, it made repeated substitutions to the collateral in the pool. By UBS's own estimation, the value of HSH's investment in the CDO had declined by at least $200 million by July of 2007, when UBS informed HSH that it would not provide any further valuations. When attempts to resolve the dispute reached an impasse, the parties raced to court on opposite sides of the Atlantic.

Proceedings brought

HSH brought suit on February 25 2008 in New York, alleging, among other things, that UBS had deceived HSH and violated its agreement with HSH by deliberately putting poorly-performing collateral in the reference pool. On the same day, UBS brought proceedings in the High Court in London seeking negative declaratory relief against HSH.

In both suits the first order of business was deciding which of the seemingly contradictory choice of law and jurisdiction clauses applied. UBS filed a

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motion to dismiss in the New York court, asking that the court dismiss the suit or stay it in light of the English case. While UBS acknowledged that the RPSA, the MTNs, and the indenture in the offering circular were governed by New York choice of law and non-exclusive New York choice of forum clauses, it argued that English jurisdiction and law were called for by the credit default swap, the MTN information memorandum, and the dealer's confirmation. UBS argued that English jurisdiction and law was appropriate because the allegations of the complaint are largely based on the credit default swap and alleged discussions between the parties outside the agreements.

HSH filed a parallel application in the English case for an order that the English court had no jurisdiction to try UBS's claim in light of the forum selection and choice of law clauses in the RPSA, and the notes and indenture.

Both parties had a great deal at stake in resolving the question of jurisdiction. If UBS prevailed in the UK suit, HSH would bear the costs of potentially protracted litigation, providing UBS with powerful leverage to negotiate an early settlement. If HSH lost in the US however, it could walk away bearing only its own expenses. Moreover, because damages in the US are higher than in the UK, HSH could expect greater returns on litigating its case in New York.

English court goes first

The English court was the first to rule on the thorny question of jurisdiction. In a July 4 2008 Decision, the High Court explained that, because HSH was domiciled in Germany, and because UBS was not domiciled in England, the question of jurisdiction was governed under Article 23 of Council Regulation (EC) 44/2001, which provides that: "23(1) If the parties, one or more of whom is domiciled in a member state, have agreed that a court or the Courts of a member state are to have jurisdiction to settle any disputes which have arisen or may arise in connection with a legal relationship, that court or those courts shall have jurisdiction. Such jurisdiction shall be exclusive unless the parties have agreed otherwise." Subsection (a) of Article 23 provides that such an agreement shall be "in writing or evidenced in writing."

The problem for the High Court was determining which of the many conflicting writings should control. In resolving this issue, the court looked both to the specific language in the jurisdiction clauses underlying the CDO purchase contracts and to the nature of the dispute. First, the court observed that the fundamental question before it "was the contractual meaning of the English jurisdiction clauses," and observed that the plaintiff must satisfy the court that "a good arguable case" existed for the English court's jurisdiction.

The problem for UBS, held the court, was that the series of contracts between the parties made it impossible to consider the clauses calling for exclusive English jurisdiction in a vacuum. Rather, they had to be seen against the backdrop of the contrary provisions in the related contracts. The court observed that, given the multiple jurisdiction clauses in the contracts underlying the transaction, "a person . . .would at once see that there was scope for the clauses to clash."

In particular, the court seized on the contrast between the language of the RPSA and the clauses calling for English jurisdiction. While forum selection clauses are generally intended to fix an exclusive forum, the RPSA clause stated that that dispute arising under the agreement "may be brought" in New York, and that such jurisdiction was "nonexclusive". This stood in stark contrast to the provisions in the contracts designating England as possessing exclusive jurisdiction over disputes relating to their subject matter. The court held that "[i]t is manifestly incompatible with a non-New York jurisdiction clause for matter falling within it to also be the subject of an exclusive English jurisdiction clause."

The only way to resolve this conflict, held the court, was to read each forum selection clause as relating to the subject matter of the contract in which it is found. Because the focus of the transaction lay not with the MTNs but with the RPSA, offering circular, and letter agreement, the court concluded that New York was the appropriate forum, and ordered that HSH would succeed in its application.

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In entering into the agreements underlying the North Street transaction, UBS may have taken comfort in the fact that some key agreements in the deal provided for the exclusive jurisdiction of UK courts. What it did not contemplate was that the existence of non-exclusive forum selection clauses in other agreements relating to the same deal would defeat British jurisdiction.

Identical exclusive jurisdiction

Accordingly, when a structured finance arrangement involves multiple contracts, a party would be well advised to ensure that each of the agreements calls for identical exclusive jurisdiction, or risk that a court might parse each contract's jurisdiction provisions individually.

The consequences for UBS's lack of attention to this point were immense. Although UBS quickly moved to dismiss HSH's suit in New York Superior Court, on October 29 2008 the court denied much of the motion and permitted HSH to proceed on its claims of breach of contract. HSH could also prosecute its suit secure in the knowledge that, whatever the result, it would not bear UBS's costs of litigation.

It is possible that, even if the High Court had found that jurisdiction lay in the UK, the parties could nevertheless have resolved the case in the US under NASD Rule 12000 adopted by the Financial Industry Regulatory Authority (FINRA), a body that oversees disputes involving members of the NYSE and the NASD; UBS would have had to agree to arbitration of HSH's claims upon the demand of HSH.

As plaintiffs on both sides of the Atlantic attempt to recover staggering losses left in the wake of the collapse of the structured finance market, they may find UBS's hard learned lesson is the key to their own success.

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