

Governing Law: Correctly agreeing the applicable choice of law in supply and goods documents

Governing Law refers to the choice of law agreed in the contract, i.e. the determination of which national law applies to the contractual relationship in the event of a dispute. For technical buyers and suppliers, this clause is a central building block of framework supply agreements, terms and conditions of purchase and international supply contracts. Anyone who does not actively shape it leaves the application of law to chance or to the other party. The following glossary article explains the definition, negotiation practice, risks and current developments relating to the choice of law in industrial procurement.

Key facts

- Governing Law bindingly determines which national law applies to a contract.
- In international contracts, the choice of law is frequently combined with an agreement on jurisdiction or an arbitration clause.
- Without an effective choice of law, a connection to the place of performance or of the court may arise depending on the individual case, creating planning uncertainty.
- The choice of law does not automatically affect the admissibility of courts, but only the applicable substantive law.
- In the DACH region, German or Austrian law is typically chosen; for cross-border transactions, English or Swiss law is also used.
- Commercial standards such as the Incoterms are interpreted differently in practice depending on the choice of law and should be specified in the contract.

Definition: Governing Law

Governing Law is the contractual provision that determines the substantive law applicable to the contract. It is one of the core components of any contract clause documentation and is also referred to in procurement jargon as the choice-of-law or applying-law clause.

Distinction from jurisdiction and arbitration

The choice of law determines which substantive law is applied to the contract, whereas jurisdiction and arbitration clauses determine before which body a dispute is fought out. In practice, both aspects are frequently linked, but they are legally independent. For example, a contract may stipulate German law as the Governing Law while agreeing the jurisdiction of an arbitral tribunal seated in a third country. Buyers should consider both clauses together and not assume that the choice of law automatically governs dispute resolution. A separate assessment in each individual case is standard practice.

Choice of law in an international context

Cross-border contracts within the European Union are subject to the principle of party autonomy: the parties can in principle agree on the law of a state of their choice, even if there is no connection to that country. Restrictions apply above all to mandatory protective provisions or to certain consumer transactions, which are rarely relevant in B2B industrial procurement. Important for buyers: unless expressly agreed otherwise, the choice of law typically does not cover the chosen state's private international law and procedural law. In addition, mandatory provisions of the state where performance is rendered may nevertheless remain applicable.

Governing Law versus forum law

The choice of law must not be confused with the concept of forum law, i.e. the law of the state in which a court or arbitral tribunal is seated. Forum law primarily governs procedural matters, whereas the governing-law clause regulates substantive issues such as warranty, default or liability. If the two are not clearly separated, avoidable interpretative disputes arise in practice.

Methods and approach: anchoring the choice of law in the procurement process

The choice of law should not be a detail at the end of the negotiation phase, but an integral part of the contract strategy. The following shows how buyers can systematically integrate the clause into their processes.

Define policy-compliant standard clauses

Best practice is a company-wide clause library in which pre-formulated governing-law clauses are stored for typical business cases – framework supply agreement, supply of works contract, development contract, NDA. These are coordinated with the legal department and updated regularly. A good procurement guideline establishes the rule that deviations from the standard clause may only be accepted with approval from the legal department. This prevents individual buyers from conducting renegotiations under time pressure to the supplier's advantage. Within electronic tendering, the intended choice of law can already be communicated as binding in the tender documents.

Align choice of law with contract strategy and supplier risk

Depending on the criticality of the supply relationship, a different approach is advisable: for strategic components with a high volume commitment, the choice of law should be addressed early on during the supplier creditworthiness check and contract negotiation. For standard catalogue parts of low value, a reference to one's own terms and conditions of purchase is often sufficient. In dual-source management, care must be taken to ensure that parallel contracts with different suppliers do not contain opposing choices of law, which would create different scopes for action in a crisis.

Ensure consistency across the contract text

The governing-law clause must not be viewed in isolation: references to standards such as the Incoterms, to contract templates or to separate side agreements must be compatible with the chosen legal system. In particular, different interpretations may arise depending on the chosen law, especially regarding transfer of risk under the Incoterms and provisions on warranty. A consistent contract draft therefore reviews all cross-referenced clauses in conjunction.

Key KPIs and assessment dimensions

The quality of contractual protection can be measured – even if Governing Law itself is not a classic KPI. The following indicators help to monitor the robustness of contractual protection in procurement.

Share of negotiated contracts with an agreed choice of law

Typically, almost all written contracts above a defined order value should contain an express choice of law. As a rule of thumb, practice shows a rate of well over 95 per cent for contracts above a certain material group threshold. If the rate is lower, this indicates inadequate enforcement of the terms and conditions of purchase or legacy contracts requiring data cleansing.

Deviation rate for standard clauses

How often do concluded contracts deviate from the company's prescribed standard clause? A low deviation rate indicates effective negotiation guidelines and clear escalation routes. In well-organised procurement organisations, this rate typically lies in the single-digit percentage range. Rising values are an early warning indicator of negotiating weaknesses or a lack of legal coordination.

Link disputes with schedule variance analysis

Disputes arising from the interpretation of contract clauses should be systematically recorded. Linking this with the schedule variance analysis is revealing: if delivery delays accumulate on contracts with weak contractual protection, this may indicate a structural contract problem. The backorder rate in crisis situations also shows how well contractual rights can actually be enforced.

Risks and controls: pitfalls in the choice of law

Incorrectly agreed or missing choice-of-law clauses create measurable risks – from unpredictable litigation costs to the de facto impossibility of enforcing claims. The key pitfalls and control mechanisms at a glance.

Typical pitfalls in contract practice

Common mistakes include: duplicate and contradictory clauses in the buyer's and the supplier's standard terms and conditions, references to Incoterms without specifying the applicable law, silent renewal of framework agreements with an outdated choice of law, and failure to adapt after the supplier has relocated its registered office. The question of whether a neutral law is chosen that is close to neither party – for example English law in German–Italian transactions – can also have strategic advantages and disadvantages and should be decided deliberately.

Control mechanisms and internal audits

Effective controls focus on two points: firstly, the approval practice for deviating clauses and, secondly, regular reviews of the contract portfolio. A structured supplier audit programme should also review contractual protection – for example, whether valid choice-of-law and dispute resolution clauses exist for key suppliers within the supplier network. In a risk heatmap, contracts with an unclear legal position can be prioritised by order value and supply criticality.

Crisis preparedness and enforceability

In a crisis – for example the insolvency of a supplier or export control restrictions – clause quality determines the scope for action. Buyers should check whether the chosen law provides the necessary

instruments such as contractual rights of withdrawal, contractual penalties or rights of substitution, and whether these are enforceable. The enforceability of a judgement in the supplier's country is an often-overlooked point which, in the worst case, renders a legal victory worthless. The supplier creditworthiness check often already provides indications of this, as it can also take account of the legal position at the supplier's location.

Governing Law in interplay with procurement and the supply chain

The choice of law does not operate in isolation but is interwoven with operational processes such as demand planning, tendering and delivery management. Those who understand these interfaces negotiate more effectively and avoid later friction losses.

Interface with planning and execution

Clauses on delivery dates, part deliveries or rights of withdrawal only take effect in operational execution. Contracts stipulating German law, for example, should include provisions optimised for delivery schedule calls and requiring an Advance Shipping Notice (ASN), so that the contractual sanctions basis harmonises with the operational reporting processes. The Master Production Schedule (MPS) and Material Requirements Planning (MRP) also generate data that can serve as evidence in a dispute – the choice of law determines how such data is assessed.

Interface with tendering and supplier selection

The intended choice of law should be communicated transparently as early as the competitive dialogue or the quotation phase. Anyone who introduces the clause only after price negotiations risks negotiating losses or the other party requesting additional documentation. International sourcing strategies such as onshoring or nearshoring also change the question of applicable law: anyone relocating production back can often revert to their own national law, thereby simplifying the contract architecture.

Interface with budget and strategy

Contractual penalties, warranty periods and liability caps – all dependent on the chosen law – have a direct financial impact. These effects should be taken into account at least qualitatively in the procurement business plan and in the savings forecast. Likewise, negotiating strength in framework agreements with large volumes can be strengthened by a clear, consistent legal strategy, which in the long term is reflected in measurable synergy effects.

Current developments: digitalisation, geopolitics and standardisation

The practice of choice of law is in motion. Digitalised contract management processes, geopolitical upheaval and new supplier structures are changing the requirements for clause design.

Digital contract and data management

Modern contract management systems and electronic signature processes make it possible to check and version-control choice-of-law and jurisdiction clauses automatically. This requires thorough data cleansing of the contract portfolio, particularly after M&A activity or system changes. In electronic tendering, too, prescribed clauses can be mapped directly in tendering platforms, which reduces renegotiations.

Geopolitical influences on the choice of law

Export controls, sanctions regimes and supply chain requirements have raised the importance of the choice of law. Buyers are increasingly aware that the chosen law influences the handling of sanctions clauses, force majeure provisions and long-term volume commitments. When sourcing from countries with contested legal certainty, a neutral legal system combined with an international arbitration clause is frequently chosen to improve enforceability.

Sustainability and compliance requirements

Supply chain laws and sustainability requirements also operate at contractual level. Buyers integrate compliance and sustainability clauses into their framework agreements, whose effectiveness depends on the chosen law. The combination of choice of law, supplier audit programme and defined audit rights forms a closed control system here. Detailed questions on this should always be legally assessed on a case-by-case basis.

Typical metrics

Share of contracts with express choice of law: > 95 %

typical benchmark for written contracts above a defined order value

Deviation rate from standard clauses: < 10 %

low values indicate effective negotiation guidelines and clear approval processes

Clause-related disputes per year: 0–2

benchmark for well-protected procurement organisations; an accumulation indicates structural contract deficiencies

Practical example

A medium-sized mechanical engineering company with around 400 employees sourced critical castings from a supplier in South-East Europe. The framework supply agreement contained no express choice of law; the supplier's terms and conditions referred to its home-country law. When the supplier, in the vicinity of insolvency, missed several deadlines, it was unclear what rights the engineering company had and before which forum it could enforce them. Following this incident, the company revised its contract strategy:

- Introduction of a company-wide binding standard clause with German law and a defined place of jurisdiction, with deviations requiring approval by the legal department
- Linking the clause library to the electronic tendering process, so that the choice of law is already binding in the tender documents
- Data cleansing and review of the entire contract portfolio along a risk heatmap by order value and supply criticality
- Extension of the supplier audit programme to include a review of contractual protection for key suppliers within the supplier network

Conclusion

Governing Law is a seemingly technical clause with considerable strategic significance. It determines which rights buyers actually have in a dispute and how enforceable those rights are. Anyone who systematically manages the choice of law through clause libraries, approval processes and audits noticeably reduces negotiating losses and crisis risks. Consistent alignment with jurisdiction, Incoterms

and operational supply processes is essential. Legal questions of detail – particularly in cross-border contracts – should always be examined on a case-by-case basis with the legal department or external advisers.

Frequently asked questions

What does Governing Law mean in a contract?

Governing Law refers to the contractually agreed choice of law, i.e. the determination of which national law applies to the contractual relationship in the event of a dispute. The clause governs substantive matters such as warranty, liability or default. It is not identical to the agreement on jurisdiction or arbitration, but in practice it is frequently combined with these.

Which law should be chosen in international supply contracts?

The law of one's own country is often chosen because the in-house legal department is familiar with it and internal processes are aligned with it. In transactions with partners in countries with weaker legal certainty, a neutral legal system such as English or Swiss law is typically agreed in combination with an international arbitration clause. The best solution depends on supply criticality, contract value and enforceability and should be assessed on a case-by-case basis.

Is Governing Law the same as jurisdiction?

No. Governing Law determines which substantive law applies to the contract, whereas jurisdiction determines before which court a dispute is heard. Both clauses can be chosen independently of one another, but should be coordinated. For example, a contract may stipulate German law while simultaneously providing for arbitration proceedings seated abroad.

What happens if no choice of law is agreed in the contract?

No. Without an effective choice of law, the applicable law is determined by the conflict-of-law rules of the respective forum state, often by reference to the place of characteristic performance. This creates planning uncertainty, because the very question of the applicable law is prone to dispute. Buyers should therefore ensure that every written agreement above a defined order value contains an express choice of law.

How does the choice of law affect Incoterms?

The Incoterms themselves are standardised trade terms, but their interpretation can vary depending on the applicable law, particularly on questions of transfer of risk and allocation of costs. In practice, it is advisable to name the Incoterms in the contract and at the same time specify the Governing Law. Unclear interactions between the two clauses should be clarified before the contract is concluded.

Can the supplier simply reject my choice-of-law clause?

Yes, every clause is negotiable. Whether the supplier accepts a different choice of law depends on its negotiating position. Buyers should therefore define internal escalation routes: for critical material groups and high contract values, hard-fought negotiation is worthwhile, whereas for low-coverage parts a pragmatic solution is often more economical. Deviations should be documented and assessed legally.