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Commentary

Determining The Law Applicable To Arbitration Agreements: The Common Law Approach

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[Editor's Note: Alan Tsang is an associate with Sidley Austin, Hong Kong. Mr. Tsang's practice focuses on complex commercial litigation, international arbitration, investigation and contentious financial services regulatory matters. The author thanks Charles Allen, Partner, Sidley Austin, Hong Kong for his comments on the earlier drafts of this article. The views expressed herein are solely the author's, and do not represent those of the firm, Mealey's Publications or any other entity or individual. This article has been prepared for educational purposes only. It should not be construed or relied on as legal advice or to create a lawyer-client relationship. Copyright © 2014 by Alan Tsang. Responses are welcome.]

Introduction

International commercial arbitrations resolve disputes with international elements. Given the diversity of parties to international commercial transactions, the disparate disputes to which they give rise, and the practical inevitability of a seat in a jurisdiction which is foreign to at least one of the parties, it is far from surprising that more than one system of law is frequently relevant to the conduct of an international commercial arbitration.

At least three systems of law are recognized as being relevant to an international commercial arbitration, namely:

- (a) the law governing the substantive contract (sometimes referred to as the *lex causae*);
- (b) the law governing the arbitration proceedings (the *lex fori*, the *lex arbitri* or the curial law); and
- (c) the law governing the agreement to arbitrate.

Most agreements contain an express governing law clause providing for the *lex causae*, to which effect is almost invariably given by the arbitral tribunal. In common law jurisdictions at least, where there is no express choice, the substantive law will be ascertained by applying appropriate conflict of laws principles.

The *lex arbitri* will generally be the law of the jurisdiction in which the arbitration is seated: the choice of the seat of arbitration is usually expressed in unequivocal terms. The *lex arbitri* controls, among other things, the conduct of the arbitration and the role of the supervising court at the seat.

The law governing the arbitration agreement itself is however very rarely specified in commercial contracts. While an agreement to arbitrate will often be an element of the broader commercial contract, the principle of separability provides that the arbitration agreement is separate and distinct from the substantive contract. A consequence of this is that the validity of the substantive contract will have no bearing on the validity and enforceability of the arbitration agreement.¹

Matters to be determined in respect of the terms and effect of the substantive contract are governed by the applicable substantive law; on the other hand, issues like the validity, scope and interpretation of the arbitration agreement are governed by the law applicable to the arbitration agreement.

These systems of law will not necessarily be the same however. Thus, where the jurisdiction of the arbitral tribunal is in issue, the law governing the arbitration

agreement will need to be ascertained, and this may not be a particularly straight-forward exercise given the interplay between the multiple systems of law relevant to the task.

This article discusses a trilogy of recent English decisions on determining the governing law of the arbitration agreement which, from a common law perspective, provide guidance on formulating a principled approach to resolving this issue.

Sulamérica v. Enesa² (“Sulamérica”)

The dispute concerned an insurance policy governed by Brazilian law which contained both an exclusive jurisdiction clause in favor of the courts of Brazil, and a London arbitration clause. After the insurer (Sulamérica) gave notice of a London arbitration to the insured (Enesa), the insured commenced proceedings in the courts of Brazil and successfully obtained an injunction preventing the insurer from continuing with the arbitration. In response, the insurer applied to the English High Court for an anti-suit injunction to prevent the insured from pursuing the proceedings in Brazil. The English Commercial Court granted an injunction in favor of the insurer, and the English Court of Appeal dismissed the insured's appeal, allowing the injunction to stand.

There was no express choice of the law to govern the arbitration agreement. The main ground relied upon by the insured in the Court of Appeal, in its efforts to discharge the injunction, was that the law governing the arbitration agreement was Brazilian law, which provided that the arbitration agreement could not be invoked by the insurer without the insured's consent. The insured argued that the parties had impliedly chosen Brazilian law to govern the arbitration agreement, and relied heavily on the express choice of Brazilian law as the governing substantive law.

In response, the insurer placed emphasis on the principle of separability, contending that English law was the law of the arbitration agreement given the express choice of London as the seat of the arbitration.

Two lines of somewhat conflicting English authorities were examined by the Court of Appeal. On the one hand, there was a list of cases consistent with Lord Mustill's conclusion in *Channel Tunnel Group Ltd v. Balfour Beatty Construction Ltd*³ that the proper law of

the arbitration agreement would normally be the body of law expressly chosen to govern the substantive contract.⁴ On the other hand, there was a line of cases suggesting that the arbitration agreement would normally have a close connection with the seat of the arbitration and therefore the law of the arbitration agreement should be that of the seat.⁵

Moore-Bick LJ., giving the judgment of the Court of Appeal, held that the proper law of the arbitration agreement was to be determined by undertaking a three-stage enquiry, namely (i) whether there is an express choice, (ii) whether any choice can be implied, and (iii) which system of law has the closest and most real connection. He stated that the three stages should be embarked on separately but nonetheless in that order.⁶ Applying the three-stage test to the facts, it was decided that the parties' express choice of Brazilian law as the governing law of the substantive contract was not sufficient evidence of an implied choice of Brazilian law to be applicable to the arbitration agreement. This was because the application of Brazilian law would have had the effect of undermining the arbitration agreement. On the basis that there was no express or implied choice of law governing the arbitration agreement, the Court of Appeal considered that the arbitration agreement “*has its closest and most real connection with the law of the place where the arbitration is to be held and which will exercise the supporting and supervisory jurisdiction necessary to ensure that the procedure is effective.*”⁷ Given that London was the seat of the arbitration, it was held that the governing law of the arbitration agreement was English law.

Arsanovia v. Cruz City⁸ (“Arsanovia”)

This dispute was between a group of developers (Arsanovia) on the one hand, and Cruz City on the other, over the development of slum areas in Mumbai, India. For this purpose, a joint venture company (Kerrush) was formed, with Arsanovia and Cruz City as its shareholders, and the three parties also entered into a Shareholders' Agreement (SHA). Separately, two companies associated with Arsanovia (Unitech and Burley) entered into a Keepwell Agreement with Cruz City in respect of the funding of the project.

Both the SHA and the Keepwell Agreement contained Indian governing law clauses, and both provided for LCIA arbitration in London.

Three separate LCIA arbitrations were commenced before the same arbitral tribunal resulting in an award in each. In one of the arbitrations brought by Cruz City under the SHA, Arsanovia and Burley were both joined as parties. This was even though Burley, albeit that it had acceded to certain terms of the SHA, was not a party to the SHA. The arbitral tribunal having decided that it did have jurisdiction over Burley, Arsanovia and Burley applied to the English High Court under section 67 of the Arbitration Act 1996 challenging the award on the ground that the arbitral tribunal did not have substantive jurisdiction.

Consistent with *Sulamérica*, Smith J. applied English conflict of laws rules to determine what was the governing law of the arbitration agreement.⁹ Having accepted that the *Sulamérica* case was concerned with a situation where the parties had made no choice at all on the governing law of the arbitration agreement,¹⁰ the judge held that where there *was* an express or implied choice, that choice would usually be upheld.

On the facts of the case, apart from the fact that the governing law of the substantive contract was Indian law, the arbitration clause itself also included express reference to provisions in the Indian Arbitration and Conciliation Act 1996. Smith J. considered that “[t]he governing law clause is, at least, a strong pointer to [the parties’] intention about the law governing the arbitration agreement and there is no contrary indication other than choice of a London seat for arbitrations.”¹¹ It was in these circumstances that the judge held that the parties had evinced an intention that the arbitration agreement was to be governed by Indian law, even though the seat of the arbitration was London.¹²

Habas v. VSC¹³ (“Habas”)

The dispute concerned a sale and purchase contract between a Turkish company (Habas) and a Hong Kong company (VSC) providing for the delivery of steel from Turkey to Hong Kong. After an elaborate negotiation by way of email exchanges, the final form of the contract contained a London ICC arbitration clause. It did not however contain a clause identifying the *lex causae*. No delivery of steel was made by Habas and an arbitration was commenced by VSC in London, resulting in an award in its favour. Habas challenged the award, *inter alia*, on the ground that the arbitral tribunal erred in finding that there was a binding arbitration agreement.¹⁴

The striking aspect of this case was the lack of an express choice of law in respect of the substantive contract. The consequence was that there was no basis upon which to imply such a choice of law to also govern the arbitration agreement.

Hamblen J. proceeded on the assumption (but without deciding) that Turkish law had the closest and most real connection with the dispute, and that it was therefore the law governing the substantive contract. The judge considered both *Sulamérica* and *Arsanovia* and concluded that, given the lack of an express choice of substantive law, the law applicable to the arbitration agreement would be the law of the seat, i.e. English law, which had the closest and most real connection with the arbitration agreement.¹⁵

Summarizing the principles applicable when determining the governing law of the arbitration agreement, Hamblen J. provided the following guidance:¹⁶

- (a) *Even if an arbitration agreement forms part of the substantive contract (as is commonly the case), its proper law may not be the same as that of the substantive contract.*
- (b) *The proper law is to be determined by undertaking a three-stage enquiry into (i) express choice, (ii) implied choice and (iii) the system of law with which the arbitration agreement has the closest and most real connection.*
- (c) *Where the substantive contract does not contain an express governing law clause, the significance of the choice of seat of the arbitration is likely to be “overwhelming.” That is because the system of law of the country of the seat will usually be that with which the arbitration agreement has its closest and most real connection.*
- (d) *Where the substantive contract contains an express choice of law, this is a strong indication or pointer in relation to the parties’ intention as to the governing law of the agreement to arbitrate, in the absence of any indication to the contrary.*
- (e) *The choice of a different country for the seat of the arbitration is a factor pointing the other way. However, it may not in itself be sufficient to*

displace the indication of choice implicit in the express choice of law to govern the substantive contract.

- (f) *Where there are sufficient factors pointing the other way to negate the implied choice derived from the express choice of law in the substantive contract, the arbitration agreement will be governed by the law with which it has the closest and most real connection. That is likely to be the law of the country of the seat, being the place where the arbitration is to be held and which will exercise the supporting and supervisory jurisdiction necessary to ensure that the procedure is effective.*

Conclusion

The New York Convention expressly recognizes the principle of party autonomy in respect of the governing law of the arbitration agreement.¹⁷ Nonetheless, there is no international consensus about how to determine the law governing the arbitration agreement.¹⁸ The *Habas* guidance, however, broadly illustrates the approach that is likely to be adopted by common law courts and arbitrators in resolving this issue.¹⁹

Even though the standard arbitration clauses recommended by the major arbitration institutions do not include specific provisions on the law governing the arbitration agreement, it is the author's view that parties would benefit from a well-drafted arbitration clause in which this is specified. Otherwise, parties are potentially submitting the issue to interpretation and arguments, the results of which may not easily be predictable. A well-considered choice at the time of drafting the contract would save the parties the need to resolve the governing law of the arbitration agreement in the event that the jurisdiction of an arbitral tribunal ever becomes an issue in proceedings, and thereby avoid unnecessary expense and delay.

Endnotes

1. This internationally recognized principle is stated in Article 16(1) of the UNCITRAL Model Law on International Commercial Arbitration (2006): *"The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity*

of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause." For a modern statement of this principle under English law, see *Fiona Trust & Holding Corp v. Privalov* [2007] UKHL 40, [2008] 1 Lloyd's Rep 254.

2. *Sulamérica Cia. Nacional de Seguros S.A. & Ors v. Enesa Engenharia S.A. & Ors* [2012] EWCA Civ 638 (16 May 2012), [2012] 1 Lloyd's Rep 671.
3. [1993] AC 334, at pp. 357-358: *"It is now firmly established that more than one national system of law may bear upon an international arbitration. Thus, there is the proper law which regulates the substantive rights and duties of the parties to the contract from which the dispute has arisen. Exceptionally, this may differ from the national law governing the interpretation of the agreement to submit the dispute to arbitration. Less exceptionally it may also differ from the national law which the parties have expressly or by implication selected to govern the relationship between themselves and the arbitrator in the conduct of the arbitration: the "curial law" of the arbitration, as it is often called."*
4. *Sonatrach Petroleum Corp v. Ferrell International Ltd* [2002] 1 All ER (Comm) 627; *Sumitomo Heavy Industries Ltd v. Oil & Natural Gas Commission* [1994] 1 Lloyd's Rep 45; *Leibinger v. Stryker Trauma GmbH* [2006] EWHC 690 (Comm).
5. *Black Clawson International Ltd v. Papierwerke Waldhof-Aschaffenburg AG* [1982] 2 Lloyd's Rep. 446; *XL Insurance Ltd v Owens Corning* [2001] 1 All ER (Comm) 530; *C v D* [2008] 1 Lloyd's Rep 239.
6. See paragraph 25, *Sulamérica*; See also Dicey, Morris & Collins, *The Conflict of Laws (15th Ed)*, paragraphs 16-016 and 32-006.
7. Paragraph 32, *Sulamérica*.
8. *Arsanovia Ltd & Ors v. Cruz City 1 Mauritius Holdings* [2012] EWHC 3702 (Comm) (20 December 2012), [2013] 2 All ER 1.
9. While not expressing it as a three-stage test, it was held that the court will first consider whether the parties

- have expressly or impliedly chosen a law applicable to the arbitration agreement, if not, then the court will determine the system of law with which the arbitration has its closest and most real connection: see paragraph 8, *Arsanovia*.
10. Paragraph 19, *Arsanovia* provides: *"If he intended to submit that the choice of an English seat means that the parties are to be taken to have impliedly chosen English as the law applicable to the arbitration, I cannot agree: in [Sulamérica] Moore-Bick LJ did not hold that the parties had impliedly chosen English law to govern the arbitration agreement, but that the parties had made no choice, whether express or implied."*
 11. Paragraph 21, *Arsanovia*.
 12. It is noted that having decided that Indian law was applicable to the arbitration agreement by way of an implied choice, the judge went to the state the following at paragraph 24: *"Had I had to decide which system of law has the closest and most real connection with the arbitration agreement, I would have concluded that it is English law for the reasons that Longmore LJ concluded that the English law had the closest and most real connection with the arbitration agreement [in C v D] and that Moore-Bick LJ similarly decided in [Sulamérica]. But in view of my decision about the parties' choice of an applicable law, that question does not arise."*
 13. *Habas Sinai Ve Tibbi Gazlar Istihsal Endustrisi AS v. VSC Steel Company Ltd* [2013] EWHC 4071 (Comm) (19 December 2013).
 14. Under section 67 of the English Arbitration Act 1996.
 15. Paragraph 103, *Habas*.
 16. Paragraph 101, *Habas*.
 17. In the context of enforcement of an arbitration award, Article V(1)(a) of the New York Convention specifically provides that it is a ground to refuse enforcement of an award if the arbitration agreement *"is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made"*; see also Article 34(2)(a)(i), Model Law in relation to the setting aside of an arbitration award.
 18. See Lew, Mistelis & Kröll, *Comparative International Commercial Arbitration*, paragraphs 6-25 to 6-74.
 19. While the guidance provided in *Habas* are helpful in determining the governing law of the arbitration agreement under certain commonly found scenarios, they are by no means exhaustive: see Graeme Johnston, *The Conflict of Laws in Hong Kong (2nd Ed)*, paragraph 10.007 for the position of Hong Kong common law on determining the governing law of the arbitration agreement under a wider range of scenarios; see also David Joseph, *Jurisdiction and Arbitration Agreements and their Enforcement (2nd Ed)*, paragraphs 6.27 to 6.43 for the analysis of the English common law position prior to the three cases discussed in this article. ■

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