

The governing law of the arbitration agreement Q&A

Sherina Petit and Marion Edge



One way to reduce the cost of arbitration proceedings is through careful drafting. Disputes around the interpretation of an arbitration agreement arise surprisingly often and resolving them – through negotiation or interlocutory hearings – is an expensive business. In the last issue, Deborah Ruff and Charles Golsong provided guidance on negotiating an ICC arbitration agreement involving a state or state entity. Our Q&A looks at the governing law of the arbitration agreement.

Standard arbitration agreements rarely make provision for the governing law of the arbitration agreement. But problems can arise when this is not dealt with in the agreement – making provision for this is good practice.

1 | Which law applies?

In international arbitration it is not unusual for the laws of more than one state to apply. You need to consider:

- the law governing the substantive contract
- the law governing the arbitration procedure or legal seat
- the law governing the arbitration agreement
- the law of the state(s) where the award will be enforced.

2 | Is the law governing the arbitration agreement the same as the law of the contract?

Not necessarily. Usually, the agreement to arbitrate takes the form of a clause within a broader contract. The arbitration agreement is a contract in its own right and separable from the substantive contract in which it sits. This reflects the parties' presumed intention that their agreed procedure for resolving disputes should remain effective even if the substantive contract is found ineffective. The doctrine of separability means that it is possible for an arbitration agreement to be governed by a different law than the governing law of the substantive contract. To avoid uncertainty it is best to specify the law of the arbitration agreement.

3 | What law governs the arbitration agreement if it is not specified in the arbitration agreement?

This is a difficult question and will depend upon the circumstances of the case and the approach taken by the arbitral tribunal or national court considering the issue. This lack of clarity can lead to expensive satellite proceedings which would be unnecessary if the law governing the arbitration agreement were specified in the arbitration agreement.

4 | How do the English courts determine the law governing the arbitration agreement if it is not specified?

The Court of Appeal laid down guidelines on this in the case

of *Sulamérica v Enesa*. Following the English common law rules around the determination of governing law generally, the governing law of an arbitration agreement is to be determined by undertaking a three-stage enquiry into express choice; implied choice; and closest and most real connection.

5 | How do the English courts apply this test in practice?

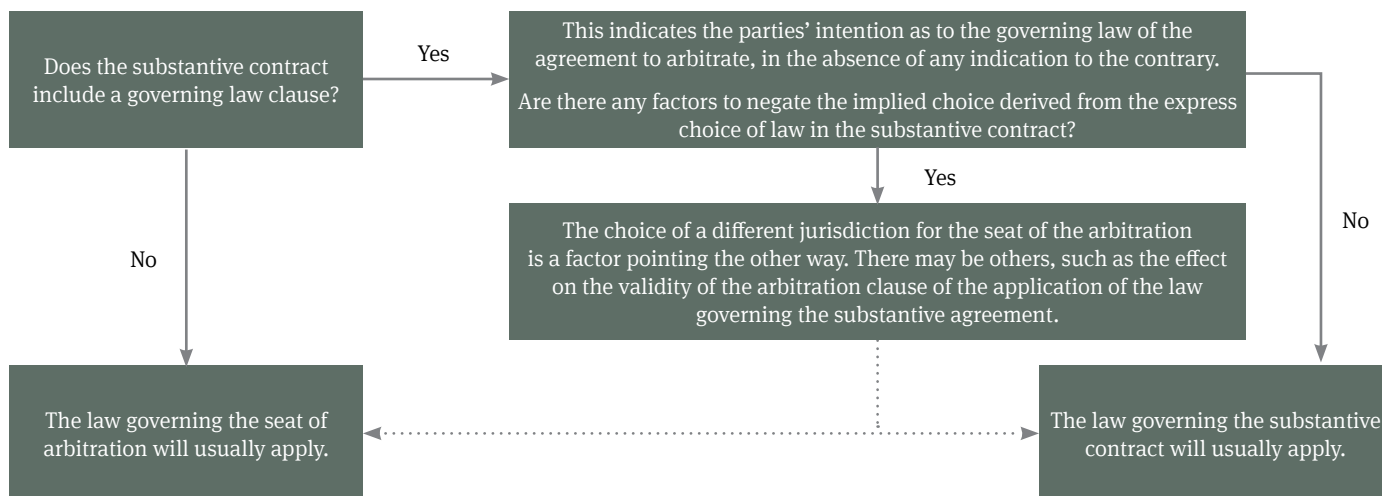
In *Sulamérica*, a dispute had arisen under insurance contracts relating to a hydroelectric generating plant in Brazil. The English court had to determine whether Brazilian or English law applied as the governing law of the arbitration agreement. In the absence of an express agreement, the court considered first whether a governing law could be implied.

The policies contained a Brazilian governing law clause and an arbitration clause with a London seat. An express choice of law governing the substantive contract is a strong indication of the parties' intention concerning the agreement to arbitrate, unless there are other factors present which point to a different conclusion. These may include the terms of the arbitration agreement itself or the consequences for its effectiveness of choosing the proper law of the substantive contract. Although there were powerful factors in favour of an implied choice of Brazilian law as the governing law of the arbitration agreement, two important factors pointed the other way.

The first was the choice of an English seat. The choice of another jurisdiction as the seat of the arbitration suggests an acceptance that the law of that country relating to the conduct and supervision of arbitrations will apply to the proceedings. This suggests that the parties intended English law to govern all aspects of the arbitration agreement, including matters touching on the formal validity of the agreement and the jurisdiction of the arbitrators.

The second factor was the consequences of the choice of the law of Brazil as the law governing the arbitration agreement; i.e. that it could not be enforced without both parties' consent. It was asserted that if Brazilian law applied to the arbitration agreement, then it was only enforceable with the consent of both parties, and the judge noted that there was 'at least a serious risk that a choice of Brazilian law would significantly undermine that agreement'. There was nothing to indicate that the parties intended to enter into a one-sided arrangement of that kind. On that basis, Brazilian governing law could not be implied and the question then turned to the law with the

Law governing an arbitration agreement in the absence of an express choice



‘closest and most real connection’.

Lord Justice Moore-Bick noted that an agreement to arbitrate in London does not have a close juridical connection with the system of law governing the policy of insurance, whose purpose is unrelated to that of dispute resolution. Instead, it 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. In this case, the arbitration agreement had its closest and most real connection with English law, so English law governed the arbitration agreement.

6 | What law governs the arbitration agreement if the terms of the arbitration clause are agreed by an agent without the principal’s authority?

In a recent English Commercial Court case, *Habas Sinai*, an agent (in contravention of the principal’s instructions) agreed a contract with no governing law provision and an arbitration clause providing for ICC arbitration in London. In the absence of any express governing law provision in the substantive contract, the governing law of the arbitration agreement would normally be the law of the seat, i.e. English law. It was argued that in this

case the seat should be ignored because it was agreed without actual authority. The governing law would then be that with the closest connection to the substantive contract, which would be Turkish law (which was the intention of the principal).

This argument was rejected on numerous grounds. There was no logical link between the question of agent’s authority and the question of the law with which the contract was most closely connected. Such a finding would give special treatment to actual authority for conflicts of law purposes and could affect the validity of many contracts which would otherwise be binding because the agent had ostensible authority. The judgment deals with some complex principles in relation to agency and conflicts of law.

7 | How do you draft a provision designating the governing law of an arbitration clause?

Simple wording such as ‘the governing law of this arbitration agreement shall be the law of [England]’ is effective.

Care should also be taken to consider the wider implications of the choice of law and advice sought where necessary.

Sherina Petit is a partner and Marion Edge is a senior knowledge lawyer in the London office of Norton Rose Fulbright.

References

Sulamérica CIA Nacional de Seguros SA and others v Enesa Engenharia SA and others [2012] EWCA Civ 638
Habas Sinai Ve Tibbi Gazlar Istihsal Endustrisi AS v VSC Steel Company Ltd [2013] EWHC 4071