INTERNATIONAL ARBITRATION - THE LAW APPLICABLE TO ARBITRATION AGREEMENT

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ABSTRACT

Arbitration is a consensual method of resolving dispute between the parties and it shall be conducted according to the procedure determined by the parties to the dispute. In this regard, an international commercial contract is expected to provide the details of seat of arbitration, language of arbitration, law applicable to the main contract (substantive law), arbitration rules (procedural law) and law applicable to the arbitration clause. In order to determine the validity of arbitration agreement, it is important to know the applicable law or rules to the arbitration agreement. Where the parties have made no choice of law for arbitration clause the controversy before the various forums was which law governs the parties’ arbitration agreement. The study concludes that the courts have applied substantive law of the contract and the law of the seat of arbitration, basing on parties’ express choice, implied choice and the system of law with which the arbitration agreement has the closest and most real connection. It is recommended that every arbitration agreement must be accompanied by a choice-of-law clause, specifying the substantive law applicable to the parties’ underlying contract, related disputes and arbitration agreement.

Keywords: Arbitral Tribunal, Substantive Law, Doctrine of Separability, UNCITRAL Model Law, New York Convention.

INTRODUCTION

Arbitration has several advantages such as confidentiality of dispute resolution, speedy disposal of dispute, freedom to choose arbitral procedure and enforcement of arbitral agreement and award internationally. According to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (hereinafter referred as the New York Convention) the Contracting State shall recognize the written arbitration agreement of the parties to submit the dispute to arbitration, which is capable of settlement by arbitration (Article II) and such non-domestic awards are enforceable internationally in Contracting States (Article I (1)).

Like a contract, arbitration does not exist in a legal vacuum (Alan Redfern, 2004). The substantive law selected by the parties governs the main contract and the procedural law governs the tribunal’s arbitration procedure. The procedural law regulates the matters including grant of interim relief, assistance of national courts, composition of the arbitral tribunal and procedure of conducting arbitration. Whereas, the law governing arbitration agreement deals with matters such as, validity of arbitration agreement, scope of arbitration, legality of the contract, interpretation of arbitration agreement and enforceability of the arbitration agreement. Therefore, it is pertinent for the parties to the arbitration agreement to specify the law applicable to, the
contract, arbitration procedure and for the arbitration agreement. An arbitration clause need not be lengthy or complicated, but if it is to be effective it must be clear (Bond, 1989).

In respect of arbitration procedure, the UNCITRAL Model Law provides that the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings. Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence (Article 19 (1) & (2)).

In respect of substantive law, some arbitration rules provide the guidance for which law shall be applied in absence of parties’ choice of law. According to the English Arbitration Act 1996 the arbitral tribunal shall decide the dispute in accordance with the law chosen by the parties as applicable to the substance of the dispute, or if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal (Section 46 (1)). The London Court of International Arbitration (LCIA) Rules, 2014 state that the Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute (Article 22.3). The similar kind of rules are found in the Singapore International Arbitration Centre (SIAC) Rules 2016 (Rule 31.1), the International Chamber of Commerce (ICC) Arbitration Rules 2017 (Article 21) and the Hong Kong International Arbitration Centre Rules, 2018 (Article 36).

It is certainly desirable for the parties to the arbitration agreement to agree upon the applicable law in the arbitration clause (Bond, 1989). However, when parties failed to choose the applicable law, raises the question before the different forums which law should be applied to the arbitration clause. The parties to the arbitration agreement must explicitly specify the law that governs the arbitration agreement in the arbitration agreement itself, even though the parties intend for the arbitration agreement to be governed by the same law that governs the main contract (Primrose, 2017).

In international arbitration it is possible that a different law may apply to the arbitration agreement (as distinguished from the parties’ underlying contract) (Born, 2014). Although the applicable law of the arbitration agreement is crucial for the valid arbitration, parties often failed to mention in their contract the law applicable to arbitration agreement. In many cases parties assume that the choice of law clause stated in main contract applies to the arbitration agreement. Hence, there is always question before the courts and tribunals that whether the arbitration agreement is governed by the law of the main contract or the law of the seat.

**METHODOLOGY**

The courts in different jurisdictions followed different approaches, such as seat and host theory, autonomous theory, validation theory, express choice, implied choice, closest and real connection test for the purpose of determination of which law or rules shall be applied to the arbitration agreement. The present research followed the qualitative method, for which analyzed the decisions of the various adjudicating forums and referred to related literature.
DISCUSSION

What Law Governs the Arbitration Agreement to Arbitrate

The arbitration agreement is the written record of the parties’ consent to arbitrate. An arbitration agreement may be in the form of an arbitration clause in contract or in the form of a separate agreement, it gives the arbitral tribunal its jurisdiction. Therefore, the law that governs the arbitration agreement is crucial to determining the existence and scope of the tribunal's jurisdiction (Primrose, 2017).

The applicability of law depends upon nature of issue raised before the forum and relief sought. The multiple approaches are used to determine the law of the arbitration agreement when parties have not made an express choice of law for arbitration agreement (Diana, 2020). The New York Convention (Article V (1)(a) and the UNCITRAL Model Law (Article 36(1)(a)(iv)) indirectly refers to, in absence of choice of law for arbitration, application of substantive law of the contract and the law of the seat.

The New York Convention, in respect of validity of arbitration agreement provides that the agreement under which the award is made must be valid under (a) the law to which the parties have subjected it or (b) under the law of the country where the award was made (Article V (1)(a) of NYC). Accordingly, in the absence of parties’ choice of law applicable to arbitration clause could be the law that governs the main arbitration agreement or the law of seat of arbitration.

For the purpose of determination of law applicable to arbitration agreement, there are only two real possibilities, the application of the law of the host contract, or it is the law of the seat (Ashford, 2019). The possibilities that are considered by different courts are: (a) the law that governs the main agreement; (b) the law that contained in arbitration clause; or (c) the law of the place or country where arbitration is taking place; (d) law of the judicial enforcement forum; (e) law of the State with which the main contract has closest relationship.

In the absence of any consensus with respect to law applicable to arbitration agreement has often produced uncertainty about the choice of the law governing international arbitration agreements (Born, 2021). The theories and approaches followed by the courts have been presented in below paragraphs.

The Seat and Host Theories

According to the “seat” theory the governing law follows the geographical location of the place of the arbitration and the “host” theory that states that the governing law of the agreement to arbitrate is the same as the substantive law of the contract in which, the agreement to arbitrate is a clause (Ashford, 2019). In a case where the contract contains an arbitration agreement but does not contain an express choice-of-law clause either for the main agreement or for the arbitration agreement, it is generally agreed that the arbitration agreement is governed by the law of the place of arbitration (Glick & Venkatesan, 2014). Accordingly, in following cases the courts from various jurisdictions applied the law of the seat for the arbitration agreement.

The application of the law of the seat, in default of the parties’ agreement would be consistent with Article V (1)(a) of the New York Convention (Jhangiani, 2015). In ICC Case No 6149 (2015), the tribunal held in an interim award that the law of the seat would “seem appropriate” to apply to the parties' arbitration agreement as this conclusion would be supported by article V (1)(a) of the New York Convention. Similarly, in C vs. D case (2007), it was held that it would be “rare” for the law of the arbitration agreement to be different from the law of the seat.
In Matermaco SA *vs.* PPM Cranes Inc, Legris Industries SA (2000), the Tribunal de Commerce in Brussels held that questions of arbitrability were to be decided under the law of the seat of arbitration (Belgium), rather than the law of the host contract (Wisconsin law) (Ashford, 2019).

In BNA *vs.* BNB & BNC (2019), the choice of law for the substantive contract is Peoples Republic of China (PRC) law and the seat of arbitration is Singapore. The question before the court was what is the proper law of the parties’ arbitration agreement, law of Singapore or PRC. If the choice of law is Singapore, the arbitration will be valid, but if the choice of law is PRC, the dispute be considered as domestic dispute, to be decided by court in PRC and the arbitration will be invalid. The defendant (BNB) contended that the parties’ implied choice of law for the arbitration agreement is Singapore and not PRC. The plaintiff contended that the law of the seat will be the parties’ implied choice as the proper law of their arbitration agreement only if the parties have failed to make express provision as to the proper law of their substantive contract. The Singapore High Court considered the parties’ intention at the time of commencement of arbitration proceedings and not at the time of signing arbitration agreement, accordingly, the agreement has its closest and real connection with Singapore being seat of arbitration, therefore, the court followed the Sulamérica case (2013) and held that Singapore law (law of seat) is the proper law of the parties’ arbitration agreement *i.e.* law of the seat.

In Abuja International Hotels Ltd *vs.* Meridien SAS (2012), the main contract was governed by Nigerian law but the seat of arbitration is London, therefore, the court held that the curial law (law of seat) applicable to the arbitration is English Law. Similarly, in AES Ust-Kamenogorsk *vs.* Ust-Kamenogorsk JSC (2013), the main agreement is governed by Kazakh Law and the arbitration agreement only stated that the arbitration shall be conducted according to International Chamber of Commerce (ICC) rules in London. On this basis the court held that arbitration agreement is subject to English Law.

In Enka Insaat Ve Sanayi A.S. *vs.* OOO ‘Insurance Company Chubb’ & others (2020), the main contract was governed by Russian Law and the seat of arbitration was London. The Chubb Russia (Respondent) brought claims before the Russian court; Enka (Plaintiff) resisted the claims stating that English Law is the proper law for the arbitration agreement. The question before the Court of Appeal of England and Wales was whether the applicable law for arbitration agreement is English law or Russian Law. The court referred to Habas Sinai Ve Tibbi Gazlar Istihsal Endustrisi AS *vs.* VSC Steel Co Ltd (2014) in which Hamblen J, summarized that even if an arbitration agreement forms part of a matrix contract (as is commonly the case), its proper law may not be the same as that of the matrix contract. 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. Accordingly, in this case even though governing law of the contract is Russian law but that is not by express choice, therefore, the choice of seat is by its very nature a submission to the curial jurisdiction (law of seat). The decision followed the Sulamérica case (2013) in which the court applied the law of seat of the arbitration agreement.

**Validation Theory**

According to the validation theory the court should eschew the conventional choice-of-law method in favour of simply applying the law of the jurisdiction which would validate rather than invalidate the arbitration agreement. In Hamlyn & Co *vs.* Talisker Distillery (1894), seat of arbitration was London but the contract to be performed in Scotland, the House of Lords held
that curial law (law of seat) is the law of arbitration agreement because the arbitration agreement would be invalid if the court applies the law of Scotland.

In Sulamérica case (2013), the dispute resolution clauses in two insurance policies contained London as seat of arbitration, but the underlying contract contained Brazilian law as proper choice of law. The law with which agreement to arbitrate had its closest and most real connection was England, and under Brazilian law the arbitration agreement was at risk of being ineffective or invalid. Therefore, the court applied the “closest connection” test and held that notwithstanding the Brazilian law clause in the policy, the arbitration agreement was a separate contract and was subject to its own law.

In Klöckner Pentaplast GmbH vs. Advance Technology (HK) Company Limited (2011), the law applicable to the main contract was German law; the seat of arbitration was Shanghai, China and the arbitration to be conducted according to the ICC Arbitration Rules. The choice of substantive law clause provided that “all of the obligations herein shall be governed in its entirety by the laws of the Federal Republic of Germany.” The Hong Kong Court of First Instance concluded that the arbitration agreement would be invalid under PRC law, but it will valid under German Law, therefore, held that the arbitration agreement was governed by German law.

**Autonomous Theory**

The general rule is that arbitration clause is governed by the law which is applicable to the main agreement i.e. substantive law of contract. However, it is also arguable that arbitration clause is autonomous and to be separable from other clauses in the agreement. In this context there is a possibility that arbitration clause may be governed by the different law from that which governs the main contract (Blackaby et al., 2004).

In the international context, arbitration clauses are generally deemed to be presumptively “separable” or “severable” from the underlying contract within which they are found (Born, 2001). If the arbitration clause is deemed separate from the rest of the contract, the inference becomes available that the clause is not necessarily governed by the same law applicable to the rest of the contract (Landolt, 2013). Accordingly, the arbitration clause may be governed by different law than the one applicable to their main contract.

In Black Cawson International Ltd vs. Papierwerke Waldorf-Aschaffenburg AG (1981), the Queen’s Bench Division (Commercial Court) held that similar to substantive law for contract may be different from lex fori, the law governing arbitration agreement may also be different from lex fori. Similarly, in Compagnie Tunisienne de Navigation SA vs. Compagnie d’Armement Maritime SA., (1970), the House of Lords recognized that parties may choose one system of law for the main contract and another law for the arbitration agreement.

**The Substantive Law Applied to the Arbitration Agreement**

There is a very strong presumption that law applicable to the main contract to be extended the arbitration clause, the reason is that when the parties have expressly chosen a particular law to govern the main contract than where is the requirement to apply some other law to the arbitration agreement (Blackaby et al., 2004). This approach was followed by the various courts in following cases.

English courts have applied an English conflict of laws analysis to determine the law of the arbitration agreement (Jhangiani, 2015). The English Arbitration Act 1996 provides that the arbitral tribunal shall decide the dispute in accordance with the law chosen by the parties as
applicable to the substance of the dispute, or if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal (Sec. 46(1)).

In Tzortzis vs. Monark Line A/B (1968), the Queen’s Bench Division (Commercial Court) held that when the main contract contains an arbitration clause, it shows the parties intention to apply the same law for the arbitration clause, unless contrary is proved. Similarly, in Union of India vs. McDonell Douglas Corporation (1993), the Queen’s Bench Division (Commercial Court) held that arbitration clause is a sub-agreement inside the main agreement, the choice of law (India) agreed by the parties is not only applicable to the main contract but also applicable to agreement to arbitrate. It further held that the same law which governs rights and obligations arising out of their commercial dispute applies to rights and obligations arising out of their agreement to arbitrate.

In Star Shipping AS vs. China National Foreign Trade Transportation Corp (The Star Texas) (1993), there was no governing law for arbitration clause but it provides that the dispute may be referred to arbitration in Beijing or London with defendant’s option. The English Court of Appeal held that where there is a single place selected for arbitration, it provides a strong presumption that parties intended application of proper law of the contract to the arbitration clause, however, in absence of no place of arbitration (floating seat of arbitration), such presumption cannot operate.

In Sonatrach Petroleum Corporation (BVI) vs. Ferrell International Ltd., (2002), the main contract was governed by Japanese law and sub contract was governed by English law, the Sonatrach commenced proceedings in England, Ferrell contended that the claims involved were subject to binding arbitration agreement and governed by Japanese law. The court held that the choice of law stated in main contract (Japanese law) applicable to arbitration agreement, therefore, stayed the proceedings under English law. The court also held that “where the main contract contains an express choice of law, but the agreement to arbitrate contains no separate express choice of law, the agreement to arbitrate will normally be governed by the body of law expressly agreed by the parties to govern the substantive contract”.

The Indian court followed the approach of English Courts in National Thermal Power Corp. vs. Singer Co., (1993). In this case the choice of law for the underlying contract is the Indian law and seat of arbitration is London. The respondent contended that since London was chosen to be the seat of arbitration, English law was the proper law of arbitration. The Supreme Court of India rejected this argument and held that where there is a proper law of the contract is expressly chosen by the parties, in absence of contrary, such law governs the arbitration agreement, accordingly Indian law is the proper law for arbitration agreement and arbitral award.

In FirstLink Investments Corp Ltd vs. GT Payment Pte Ltd., (2014), the Singapore High Court followed the C vs. D case (2007) English Court decision and held that the substantive law of the contract will generally be the law of the agreement to arbitrate, rather than the law of the seat. But after two years in BCY vs. BCZ (2016), the Singapore High Court reaffirmed the three-stage inquiry laid down in Sulamérica case (2013) for the purpose of determination of proper law for arbitration agreement, instead of substantive law applied the law of seat to the arbitration agreement.

In Kabab-Ji S.A.L. (Kuwait) vs. Kout Food Group (Lebanon) (2020) the English Court deviated the rule laid down in Sulamérica case (2013) and extended the law of main contract to the arbitration agreement. In this case the substantive law of Franchise Development Agreement (FDA) (main agreement) was English law, seat of arbitration was Paris, France, arbitration to be conducted under International Chamber of Commerce (ICC) rules and there was no choice of law for arbitration clause. The question before the court was which law governs the arbitration agreement to examine its validity for the enforcement of the arbitral award. The Court of Appeal
upheld the High Court decision and held that the governing law clause in Kabab-Ji should be properly construed as an *express* choice of English law for *all* provisions of the contract including the arbitration clause. Accordingly, applying English law, the English Court of Appeal refused the enforcement of the arbitral award in question on the basis that the non-signatory respondent was not a proper party to the arbitration agreement (Darius, 2020).

The international arbitration may be governed by more than one national system of law (Channel case, 1993). In Sumitomo Heavy Industries Ltd *vs.* Oil & Natural Gas Commission (1994), the Queen’s Bench Division (Commercial Court) summarized the following possibilities as applicable law to the arbitration agreement. The applicable law could be (a) the law of the main agreement; (b) the law of the arbitration agreement; (c) the law of the individual “agreement to refer”; and (d) the curial law, *i.e.* the law of the seat, governing the procedure of the reference (Ashford, 2019).

If a dispute arises about which law governs the arbitration agreement, the English courts will conduct a three-stage inquiry in which they will consider: (i) the parties’ express choice, if any; (ii) the parties’ implied choice, if any; and, if no governing law has been determined, (iii) the law with the closest and most real connection to the parties’ arbitration agreement. The three-stage inquiry principle was confirmed by the English court in Sulamérica case (2013). In Habas Sinai *vs.* Tibbi Gazlar Istihsal Endustrisi AS *vs.* VSC Steel Co Ltd., (2014), the English Court summarized the proper law for arbitration agreement 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.

The international arbitration institution rules are suggesting model clauses for the parties to draft the arbitration clause which includes the details of seat of arbitration, language of arbitration, substantive law, procedural law and law applicable to the arbitration agreement. In order to promote harmony and certainty in international arbitration, the arbitration practitioners must encourage the parties to specify the law of the arbitration agreement in their dispute resolution clauses (Jhangiani, 2015).

**CONCLUSION**

The reference made to above case law concludes that if the parties failed to choose the applicable law to the arbitration clause it will lead to further litigation and thereby increases the time and cost of an arbitration. In this context it is important for the parties to choose the substantive law, procedural law and more importantly, the law applicable to the arbitration agreement itself. It is well settled that the law applicable to main contract is not necessarily be the law for arbitration agreement; it may be law of the place of arbitration. In absence of choice of law applicable to the arbitration agreement, it is for the adjudicating forum to determine basing on parties’ express choice, implied choice and the system of law with which the arbitration agreement has the closest and most real connection. The English courts in majority of referred cases applied either substantive law or law of the seat, whichever closer to the arbitration agreement.

**RECOMMENDATIONS**

In order to avoid any controversy and litigation in future, the parties to the arbitration must include the information in arbitration agreement such as, seat of arbitration, applicable arbitration rules, matters referred for arbitration, selection of the arbitral institution, language of arbitration, effects of arbitral award (waiving of right to appeal and agree that it is final and
binding), and more importantly applicable law to the arbitration agreement itself. For this purpose, the parties may choose one of the model arbitration clauses prepared by leading arbitral institutions, in order to avoid ambiguities, inconsistencies and defects. In case of dispute with regard to law of applicable to arbitration agreement, the adjudicating forums should take into consideration the parties’ express choice, implied choice, and the system of law with which the arbitration agreement has the closest and real connection.

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