Rules of the road

Philippa Charles and Al Trent consider the vexed question of which law governs an arbitration agreement

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'The House of Lords made clear in *Fiona Trust v Privalov* [2007], an arbitration agreement is separable from its parent contract. It must be considered – in effect – as a separate contract.'

Arbitration practitioners will be aware that the law governing an arbitration agreement can differ from the law governing its parent contract. For those not so familiar with the intricacies of the arbitration world, that proposition may seem counter-intuitive. Surely where a contract specifies a system of law by which it is to be construed, that stipulation will apply across the board, including to any dispute resolution provisions?

Not so. Under s7 of the Arbitration Act 1996 and, as the House of Lords made clear in *Fiona Trust v Privalov* [2007], an arbitration agreement is separable from its parent contract. It must be considered – in effect – as a separate contract. The law governing the arbitration agreement must therefore be determined by the applicable choice of law rules.

It follows that the governing law of the parent contract may be a factor in that equation. And in practice, as explained below, a discrepancy between the governing law of the parent contract and that of the arbitration agreement is only likely to arise where two things occur simultaneously. One, where there is no express agreement as to the law governing the arbitration agreement; and two, where the seat of the arbitration is in a different jurisdiction from the governing law of the parent contract.

Determining the law applicable to the arbitration agreement

The principle in *C v D*

The case which first brought this issue into stark relief was *C v D* [2007]. The Court of Appeal's task in that case was to apply the English common law choice of law rules to an agreement to arbitrate (as the Rome 1 Regulation (EC) 593/2008 is not applicable to 'arbitration agreements' pursuant to Article 1(2)(e)). In Longmore LJ's much-quoted judgment (at para 26):

> ... an agreement to arbitrate will normally have a closer and more real connection with the place where the parties have chosen to arbitrate than with the place of the law of the underlying contract in cases where the parties have deliberately chosen to arbitrate in one place disputes which have arisen under a contract governed by the law of another place.

Following *C v D*, therefore, the seat of the arbitration seemed determinative of the question of governing law.

Determining the seat

Of course, parties do not always even specify a seat of the arbitration. The arbitral seat has always been a key issue in terms of the supervision of the arbitral process, and Longmore LJ's emphasis on its importance on this context is a further reminder to parties that they should take care not only to select a seat, but to be aware of the consequences and implications of that choice.

In some cases, the uncertainty created by the parties' failure to specify the seat may be avoided by their choice of institutional or other rules to govern the arbitration (as in the LCIA, SIAC, HKIAC, LMAA, ARIAS and CIETAC rules, which provide for a specific seat in default of express agreement). In other cases, however, the applicable rules provide no certainty, leaving the decision open to the tribunal or even to the institution itself (as in the SCC, AAA-ICDR and UNCITRAL rules).

The unforeseen 'fallout' of *C v D*

In the aftermath of *C v D*, three reported English cases have turned on this issue, with some interesting (and perhaps unexpected) results.

***Abuja International Hotels Ltd v Meridien SAS* [2012]**

The first case arose out of the breach of a Nigerian law-governed hotel management agreement (the management agreement) between Abuja International Hotels Ltd (AIHL) and Meridien, pursuant to which Meridien had agreed to manage a hotel in Abuja owned by AIHL. In 2007, AIHL unilaterally took over the management of the hotel (formerly Le Meridien Abuja and now the Nicon Luxury), and Meridien commenced arbitration proceedings against AIHL in November 2009 pursuant to a London-seated ICC arbitration clause in the management agreement. The tribunal upheld Meridien's claims in respect of AIHL's breaches of the management agreement.

The case of *Abuja International Hotels Ltd v Meridien SAS* [2012] concerned AIHL's challenge to the tribunal's award, including under s67 of the Arbitration Act 1996. Specifically, AIHL alleged that the tribunal lacked substantive jurisdiction on the basis that the arbitration agreement was invalid under Nigerian law.

Hamblen J's reasoning was simple. He applied *C v D*, holding that England had the closest and most real connection with England because the seat of the arbitration was in London, and noting that the parties had agreed in the signed terms of reference that 'the curial law applicable to the arbitration is English law'.

His decision avoided the need for expert evidence as to Nigerian law, and left the determination of the governing law of the arbitration agreement still apparently very simple. The seat of the arbitration remained the key.

***Sulamérica Cia Nacional de Seguros SA v Enesa Engenharia SA* [2012]**

The second decision – this time taken to the Court of Appeal – was rather more nuanced.

In March 2011, workers rioted at the construction site of the Jirau Dam hydro-electric facility in Brazil, burning down more than 30 structures, looting stores and causing widespread destruction. The project companies (together 'Enesa') claimed against the insurers (together 'Sulamérica') under two all-risk insurance policies (together 'the policy') in respect of the physical damage and their consequential losses.

The policy was governed by Brazilian law and contained not only an ARIAS arbitration clause specifying a London seat, but also an exclusive jurisdiction clause in favour of the Brazilian courts.

On 29 November 2011, Sulamérica commenced arbitration proceedings in London pursuant to the arbitration clause in the policy, seeking relief including a declaration of non-liability. In response, Enesa commenced Brazilian court proceedings pursuant to the exclusive jurisdiction clause.

Sulamérica Cia Nacional de Seguros SA v Enesa Engenharia SA *turned on whether the governing law of the arbitration agreement was Brazilian or English law.*

Sulamérica then obtained an interim anti-suit injunction in the English courts restraining Enesa from pursuing its Brazilian proceedings (the ruling of the ECJ in *West Tankers* being inapplicable to restraint of non-EU proceedings).

The case of *Sulamérica Cia Nacional de Seguros SA v Enesa Engenharia SA* [2013] concerned Sulamérica's application for continuation of its anti-suit injunction.

The case turned on whether the governing law of the arbitration agreement was Brazilian or English law. If Brazilian law applied, Enesa's position was that it could not be forced to arbitrate without its further consent at the outset of proceedings. If English law applied, there would be no such bar to arbitration, and the scope of the arbitration clause and the effect (if any) of the parallel exclusive jurisdiction clause would have to be considered.

In defending the injunction proceedings, Enesa argued that the arbitration agreement was governed by Brazilian law on the bases that the parties were Brazilian, the insured project and the events leading to the claim under the policy were all located in Brazil, and that the policy itself was governed by Brazilian law Sulamérica argued that English law, as the law of the seat of the arbitration, should also govern the arbitration agreement.

The Court of Appeal (upholding Cooke J's first instance decision) found for Sulamérica and continued the injunction on the basis that English law governed the arbitration agreement. In doing so, however, the court made it clear that the principle established in *C v D* was not to be considered 'a rule of law that the proper law of the arbitration agreement is determined by the law of the place of the seat' (at para 24). Instead, it found that the authorities established the following proposition (para 25):

> [T]hat the proper law [of the arbitration agreement] is to be determined by undertaking a three-stage inquiry into
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> (i) express choice,
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> (ii) implied choice and
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> (iii) closest and most real connection. As a matter of principle, those three stages ought to be embarked on separately and in that order.

Recognising that the second and third stages may often merge into one another (see Dicey, Morris & Collins, *The Conflict of Laws*, 15th ed (2012), 32-007), the court found on application of its three-stage test that the parties had impliedly chosen English law to govern the arbitration agreement. Moore-Bick LJ held that, although there were 'powerful factors in favour of an implied choice of Brazilian law', two important factors pointed the other way. The first of these factors was the choice of another country as the seat of the arbitration – an acceptance of the application of that country's law to the conduct and supervision of the arbitration – which he held 'suggests that the parties intended English law to govern all aspects of the arbitration agreement'. The second factor was the 'possible existence of a rule of Brazilian law' preventing either party invoking the arbitration clause, which he found (arguably obiter, given the lack of evidence as to Brazilian law before the court) 'tends to suggest that the parties did not intend the arbitration agreement to be governed by that system of law'.

Although the injunction in support of the arbitration proceedings was ultimately upheld, this hard-fought case would have been entirely unnecessary had the parties made express provision for the governing law of the agreement to arbitrate.

Despite the choice of a London seat in Arsanovia Ltd & ors v Cruz City 1 Mauritius Holdings, *Andrew Smith J held that Indian law governed the arbitration agreement.*

***Arsanovia Ltd & others v Cruz City 1 Mauritius Holdings* [2012]**

The most recent case on this subject is perhaps the most surprising.

Arsanovia Ltd (Arsanovia) and Cruz City 1 Mauritius Holdings (Cruz City) were the shareholders of Kerrush Investment Ltd (Kerrush), a joint venture company incorporated to redevelop certain slum areas of Mumbai, India. The relationship between Arsanovia, Cruz City and Kerrush was set out in a shareholders' agreement dated 6 June 2008 (the SHA). The SHA was governed by Indian law, and contained an LCIA arbitration agreement specifying a London seat and expressly excluding the application of Part 1 of the Indian Arbitration and Conciliation Act 1996 (the ACA), including with respect to seeking interim relief in India.

The clearance of the slums was delayed and, on 14 July 2010, Arsanovia served notices on Cruz City under the SHA, among other things requiring Cruz City to sell its interest in Kerrush to Arsanovia at a rate favourable to Arsanovia. On 13 September 2010, Cruz City purported to exercise a put option, also under the SHA and also requiring Arsanovia to buy Cruz City's interest in Kerrush, but at a rate favourable to Cruz City.

Three separate arbitrations (the precise details of each of which are immaterial) were commenced and heard concurrently by the same tribunal. The essential question at the hearing was whether Arsanovia's notices were valid: if they were, Cruz City was not entitled to exercise the put option. The tribunal held in two separate awards ('Award 1' and 'Award 2' respectively, the second being brought under a related agreement and involving different

Abuja International Hotels Ltd v Meridien SAS
[2012] EWHC 87 (Comm)
Arsanovia Ltd & ors v Cruz City 1 Mauritius Holdings
[2012] EWHC 3702 (Comm)
Bharat Aluminium Co v Kaiser Aluminium Technical Service Inc
(Civil Appeal No. 7019 of 2005)
Bhatia International Ltd v Bulk Trading SA
[2002] 4 SCC 105
C v D
[2007] EWCA Civ 1282
Fiona Trust & Holding Corp & ors v Privalov & ors
[2007] UKHL 40
Sulamérica Cia Nacional de Seguros SA & ors v Enesa Engenharia SA & ors
[2012] 1 Lloyd's Rep. 275 (first instance); [2012] EWCA Civ 638

but related parties) that Arsanovia's notices were invalid and that Cruz City had validly exercised the put option. The award in the third arbitration dismissed all claims and counterclaims brought in that arbitration, and is therefore irrelevant to the subsequent litigation.

The case of *Arsanovia Ltd & ors v Cruz City 1 Mauritius Holdings* [2012] concerned section 67 challenges by Arsanovia to Awards 1 and 2. Despite the choice of London seat, Andrew Smith J held that Indian law governed the arbitration agreement. Having made that determination, he upheld Arsanovia's challenge in respect of Award 1 only, on the basis of extensive expert evidence as to the relevant principles of Indian law applicable in respect of each Award.

The court's decision as to the governing law of the arbitration agreement involved a strict application of the Sulamérica decision. In applying that test, Andrew Smith J focused on the fact that the parties had expressly excluded the application of Part 1 of the ACA. The purpose of this exclusion (as canvassed with Arsanovia's Indian law expert at trial) was to avoid the effect of the controversial Indian Supreme Court decision in *Bhatia International Ltd v Bulk Trading SA* [2002], which held that Part 1 of the ACA (which includes very generous grounds for challenging awards in India) applies not only to domestic awards but also to arbitration proceedings seated outside India (despite s2(2) of Part 1 of the ACA, which states that 'this Part shall apply where the place of arbitration is India). Bhatia was overruled prospectively only in *Bharat Aluminium Co v Kaiser Aluminium Technical Service Inc* [2005] on 6 September 2012.

Rightly or wrongly, given the undisputed purpose of the exclusion, Andrew Smith J considered (at para 20) that 'where parties have expressly excluded specific statutory provisions of a law, the natural inference is that they understood and intended that otherwise that law would apply', and therefore held that Indian law governed the arbitration agreement.

While perhaps a surprising result, this case demonstrates the need expressly to agree the governing law of the arbitration agreement to avoid such satellite proceedings.

Conclusion

The law is now left in a difficult position. The outcome of the apparently simple Sulamérica test is demonstrably uncertain, and the stakes are high: the potential detriment caused by satellite injunctive litigation and challenges to awards is huge – not least in wasted time and costs.

Those who get it wrong fall into two camps: those who do not even consider these issues at the drafting stage, and those who relied on Longmore LJ's simple analysis in *C v D* by simply selecting the seat and thinking no more about it. The former are taking a number of considerable risks in any event. The latter, however, thought they were protected. Following Sulamérica and Arsanovia, however, parties cannot simply rely on their selection of a seat (whether express or via institutional rules) to avoid protracted injunctive or post-award litigation.

The solution is a simple one. An express statement of the governing law of the arbitration agreement will avoid all of these issues. Not that this governing law can be chosen lightly, of course – making the right choice may be all-important. It is noticeable that very few standard arbitration clauses from the major arbitral institutions deal with the question of governing law of the agreement to arbitrate. As these cases demonstrate, the choice is not a minor matter and deserves specific attention.

Parties cannot simply rely on their selection of a seat (whether express or via institutional rules) to avoid protracted injunctive or post-award litigation.

As unpalatable as it may be to negotiate dispute resolution clauses in detail at the very outset of the parties' relationship, at least until a sea-change in the law arrives – whether moving further away from Longmore LJ's reliance on the seat or simply clarifying the application of the Sulamérica test – parties would be well-advised to stipulate expressly which law they wish to govern their arbitration clauses.

A little more time and money spent up-front may reap huge benefits when it really matters. ■

Summary

Where a contract is governed by the laws of one jurisdiction but contains an arbitration agreement with its seat in another, the law governing the arbitration agreement may differ from the law governing the remainder of the contract.

- The English courts (following *Sulamérica v Enesa* [2012]) will apply a three-stage test to determine the law governing an arbitration agreement, looking:
  - first, to the parties' express choice;
  - secondly, to the parties' implied choice; and
  - finally, to the place with the closest and most real connection to the agreement to arbitrate.
- Applying this test, the law governing the arbitration agreement will often be the law of the seat of the arbitration. However, other factors can override that determination, as was the case in *Arsanovia Ltd v Cruz City 1 Mauritius Holdings* [2012].

In order to avoid jurisdictional arguments and challenges to awards, it is essential when negotiating an arbitration agreement to agree not only the seat of the arbitration, but also the law governing the arbitration agreement itself.