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Hold on to your seats! A settled test for the proper law of arbitration clauses?

Jacqueline Chaplin (Linklaters) · Friday, March 23rd, 2012

The High Court of England & Wales has confirmed the nature of the test that will be applied when determining the proper law of an arbitration agreement in the absence of the parties' express or implied choice. In two recent cases, *Sulamérica CIA. Nacional De Seguros S.A. and Anors v Enesa Engenharia S.A. – ENESA and Anors* [2012] EWHC 42 (Comm) and *Abuja International Hotels Limited v Meridien SAS* [2012] EWHC 87 (Comm), the court heard argument in two very different contexts on the law governing the parties' agreement to arbitrate, but delivered judgments affirming the same principle.

The distinct identity afforded to arbitration agreements under the doctrine of separability means that, when called upon to ascertain the proper law of an agreement to arbitrate, national courts will undertake a conflicts analysis which is separate from that undertaken in respect of the parent contract. National courts within the European Union will not, in this regard, have recourse to Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I), as arbitration agreements fall outside the scope of the Regulation (See, Article 1(2)(e) of Rome 1). A national court seised of such a dispute must therefore apply its own conflicts of law rules to determine the governing law of the arbitration clause. In England, that analysis will lead the court to enquire into the law with which the arbitration agreement has its closest and most real connection.

Two recent cases have highlighted the process the English court will go through when seised of a dispute regarding the proper law of an arbitration clause. *Sulamérica CIA. Nacional De Seguros S.A. and Anors v Enesa Engenharia S.A. – ENESA and Anors* concerned a dispute as to liability under two all risk insurance policies following incidents at a hydro electric construction site in Brazil. The defendant insureds made a claim under the policies against the claimant insurers and the latter denied liability. An issue subsequently arose as to the validity of the arbitration agreement contained in the policies; the claimants approached the High Court seeking the continuation of an interim anti-suit injunction restraining the defendant from pursuing proceedings instituted in Brazil. In the English anti-suit proceedings before Mr Justice Cooke, the defendant argued that the arbitration agreement was invalid because it was governed by Brazilian law and did not comport with that system of law in a number of key respects. The claimant argued to the contrary. As the seat of the arbitration was London, it was said, English law governed the agreement to arbitrate and as a matter of English law that agreement was valid.

At first blush, all the indicators pointed to the arbitration agreement being governed by Brazilian

law: the proper law of the policies was expressly that of Brazil, the signatories to those policies were Brazilian, the subject matter of those policies was situated in Brazil and the incidents leading to the claim thereunder occurred in Brazil (*See* paragraph [2] of the judgment). However, an examination of previous authority where the court was called up on to determine the proper law of the arbitration clause, where it was said to differ from the proper law of the parent contract, produced a different result.

Mr Justice Cooke in particular considered the Court of Appeal's decision in *C v D* [2007] EWCA Civ 1282 and found it to be persuasive. In *C v D* it was said that it would be rare for the law of the separable arbitration agreement to be different from the law of the seat of the arbitration chosen by the parties. The reason was that "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" (*See* paragraph [26] of the judgment). In these circumstances Mr Justice Cooke had no hesitation in concluding that the law with which the arbitration agreement contained in the *Sulamérica* policies was most closely connected was the law of the seat of the arbitration, namely English law. It followed that the arbitration agreement was binding on the parties, as it was valid under English law.

The findings made by Mr Justice Cooke in the *Sulamérica* case were echoed by Mr Justice Hamblen in *Abuja International Hotels Limited v Meridien SAS*. In *Abuja*, an ICC arbitration was commenced following Abuja's alleged breach of a management agreement. The Terms of Reference signed by the parties confirmed that the governing law of the management agreement was the law of Nigeria and the curial law applicable to the arbitration was English law. In the event, the Tribunal upheld the claim against Abuja and dismissed Abuja's counterclaim. Abuja then challenged the substantive jurisdiction of the Tribunal on the ground that the arbitration agreement was invalid under Nigerian law.

Mr Justice Hamblen summarised the relevant issue of substantive jurisdiction in the following terms. The sole enquiry was whether a valid arbitration agreement existed, which enquiry was to be undertaken in accordance with English law as the law governing the arbitration agreement. Mr Justice Hamblen had no difficulty in reaching the conclusion that English law governed the agreement to arbitrate, as, on the authority of *C v D*, the law with which the arbitration agreement had its closest and most real connection was England because the seat of the arbitration was there. The parties had recognised and acknowledged the fact that the seat of the arbitration was in England when they signed the Terms of Reference. It followed as a matter of English law that the arbitration agreement was valid.

It is clear from the line of English cases which has been continued by *Sulamérica* and *Abuja* that when called upon to determine the proper law of arbitration agreements, the English Court will look to the law with which that agreement is most closely connected. It is also clear that, in circumstances where the parties have agreed that the seat of the arbitration is England, the Court will not hesitate to find that the law with which the agreement is most closely connected, is English law. The test, so far as it goes, seems settled.

However, if the Court has adopted a "closeness" test which is contingent upon the parties choosing England as the seat of the arbitration, in the absence of such a choice by the parties, by which law do we construe the substantive effect of the agreement to arbitrate? There are a myriad of

circumstances in which parties may be required to arbitrate their dispute in England when they have not have chosen to do so. They may find that their silence on the matter leads to the imposition of an English seat under the LCIA Rules, (Article 16.1 LCIA Rules) or, perhaps less commonly, under the ICC Rules. (Article 18 ICC Rules (in force as from 1 January 2012) and Article 14 ICC Rules (in force as from 1 January 1998)). Their arbitrator or Tribunal may choose an English seat on their behalf, should they fail to reach agreement on the matter. In numerous ways, the parties may come to have England as the place where they are to arbitrate, despite the fact that the same did not form part of the bargain they struck. In those circumstances, can the "closest and real connection" test, which hitherto dictated that the law governing the arbitration agreement be that of the curial law, be justified?

Each case will turn on its facts, however, it may be that in such cases the Court will be persuaded to look to the law of the underlying contract instead of the curial law. Recall for a moment that in *C v D* it was said an agreement to arbitrate will normally have a closer connection with the place where the parties have deliberately chosen to arbitrate than with the place of the law of the parent contract. On that basis it is arguable that in cases where the parties have deliberately chosen the governing law of their contract but not the seat of the arbitration, the agreement to arbitrate will be more closely connected with the law of the contract chosen by the parties.

English arbitration law has developed in a subtle but distinct way since issues relating to governing law were first considered. The difference lies in what is now said to indicate the closest system of law to the arbitration agreement. The authors of a seminal text on English arbitration law (Mustill & Boyd, *Commercial Arbitration* (1989)) described the common law position over two decades ago, when they stated (at page 63) that "if there is no express or implied choice of law, the arbitration agreement will be governed by the law with which the agreement has its closest and most real connection". Indeed, that precise language forms the backbone of the current legal test. However, the prevailing view at the time was that, as a general rule, the law with the closest connection to the arbitration agreement was the law governing the contract, since the arbitration agreement was considered "part of the substance of the underlying contract."

English law now dictates that the law with which the arbitration agreement is most closely connected is the law of the seat of the arbitration. The necessary caveat to this otherwise settled position is that, to date, the principle has not been tested in a case where the seat of the arbitration has not been chosen by but, rather, imposed on the parties. Absent the parties' agreement to arbitrate in a particular place, whether by express agreement or by signing Terms of Reference, it cannot be said that the parties have "chosen" a place to arbitrate their dispute – a crucial element of the test. A case with just such a difficult factual matrix may be the exception that proves the rule, in the true sense of testing its robustness.

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