Kluwer Arbitration Blog

Back to Basics: The Law Applicable to an Arbitration Agreement under Swedish Law

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In a recent judgement in the proceedings for setting aside an arbitral award, the Swedish Court of Appeal addressed issues concerning the law applicable to an arbitration agreement, the validity of an arbitration agreement, the due process standard applicable in cross-examination, and the procedural error of rendering an award without considering all the arguments raised by a party. The court declined to set aside the award, and this blog post will deal with the arguments and decision made concerning the jurisdiction of the arbitral tribunal.

International Stances Regarding the Applicable Law to an Arbitration Agreement

The question of the law governing the arbitration agreement, even though it is so often invoked and discussed in practice and scholarly work, does not seem to lose on its importance and it is often scrutinized over and over again by national courts. Interestingly, both the UNCITRAL Model Law on International Commercial Arbitration ("UNCITRAL Model Law") and the New York Convention ("NYC") resolve this question in the same manner by referring to the law to which the parties have subjected the arbitration agreement or, failing any indication thereon, to the law of the seat of arbitration (Article 34 2a(i) of the UNCITRAL Model Law and Article V1(a) of the NYC). This, however, is not a uniformly accepted stance in all jurisdictions that are signatories to the NYC and jurisdictions adopting the UNCITRAL Model Law.

The parties' agreement as a connector when determining the law governing the arbitration agreement is generally accepted as the starting point in Model Law and non-Model Law – as well as in civil law and common law – jurisdictions (this probably being the least disputed matter!). Still, the discussion continues at several different levels.

Firstly, there is no uniform international stance as to which connector is to be applied if there is no (either implicit or explicit) parties' agreement. In those cases, national approaches are divided based on whether one is to rely on the choice of law provisions contained in the NYC and the UNCITRAL Model Law (if such a provision is adopted in the respective jurisdiction) or to apply a test independent from those provisions. The widely recognized test on this matter was set in the *Sulamerica* case, which provided for a three-pronged test under which in the absence of an explicit and implicit choice of law governing the arbitration agreement, the law that has the closest and most real connection to the arbitration agreement is the governing law. The *Sulamerica* case

became the leading case on the issue of applicable law to the arbitration agreement in common law countries for years to come (until very recently, as discussed in a previous blog post).

This, however, does not mean that national courts will not conclude that the law of the seat is the law applicable to the arbitration agreement, but that they will follow a different connector when making such a decision; and that is precisely the second issue that is widely discussed – should courts follow the NYC connector which directly assigns the law of the seat as the law applicable to the arbitration agreement, or should they use the prescribed test and determine the law with the closest connection (an interesting discussion on these and other issues can be found here, here, and here). Civil law jurisdictions are not immune to a similar discussion, even if they are not applying the *Sulamerica* test. National courts in both legal families will have to deal with the importance of the choice of law clause for the underlying agreement when considering an *implicit* choice of law governing the arbitration agreement and, in general, the applicability of the validation principle (e.g., see here, here and here).

This post delivers the Swedish perspective on the matter presented in a recent Court of Appeal judgement and highlights the importance of opting for an *explicit* agreement of the parties on the law which they wish to govern their arbitration agreement.

The Issue of the Law Applicable to the Arbitration Agreement under Swedish Law

The dispute arose between a Cypriot company Coraline Limited ("Coraline Ltd.") and Walter Höft concerning the repayment of a loan under the Loan Agreement concluded between the parties ("Loan Agreement"). The arbitral award was rendered on 13 June 2017 and mandated Coraline Ltd. to pay EUR9.2 million to Walter Höft. Coraline Ltd. challenged the award on several grounds, one of them being a claim that the arbitral tribunal did not have jurisdiction. The Court of Appeal rendered the judgement on 19 December 2019 in which it rejected the challenge on all grounds (Judgment in the Svea Court of Appeal, 19 December 2019. Case No. T 7929-17; hereinafter: "Judgement"). As a consequence of oversight in drafting, as concluded by the Court of Appeal, the Loan Agreement contained two inconsistent dispute resolution clauses:

- Article 6 of the Loan Agreement subjected all disputes and differences which are not amicably settled between the parties to the "international arbitration court in Stockholm", whereas
- Article 9 of the Loan Agreement provided for the jurisdiction of a competent court in Nicosia, Cyprus (Judgement, p. 3).

Coraline Ltd. objected to the validity of the arbitration agreement arguing that the inconsistency of the two mentioned dispute resolution clauses shows that there was no will to unequivocally contractually remove the right to a court proceeding, i.e. that the parties have not ousted the courts of their jurisdiction. Coraline Ltd. based its arguments on Cypriot law, which was prescribed by Article 9 as the law governing the (*underlying*) agreement. Article 6 provided for no explicit choice of the law applicable to the arbitration agreement, and Coraline Ltd. argued that there is no strong connection with Sweden that would warrant the application of Swedish law, but in case the court decided the opposite, it claimed that the application of Swedish law would lead to the same finding regarding the validity of the arbitration agreement. Coraline Ltd. emphasized also that the fact that neither of the parties was Swedish in the case at hand presents the *international connections* and speaks in favour of the application of Cypriot law to the arbitration agreement.

Walter Höft, on the other hand, argued for the application of the Swedish choice of law rules for determination of the applicable law and Swedish law as the law applicable to the arbitration agreement, under which the agreement to arbitrate would stand the test of validity as it shows the joint will of the parties to resolve the dispute through arbitration.

The Court of Appeal called for the application of Swedish law to the arbitration agreement under Section 48 of the Swedish Arbitration Act ("SAA") which states that

> "Where an arbitration agreement has an international connection, the agreement shall be governed by the law agreed upon by the parties. Where the parties have not reached such an agreement, the arbitration agreement shall be governed by ***the law of the country in which, by virtue of the agreement, the proceedings have taken place or shall take place***." (emphasis added)

The Court of Appeal ascertained that under this provision the agreement on the applicable law needs to be *explicitly* stated in the agreement, and that "[a] *regulation on applicable law for the main agreement accordingly does not concern the arbitration agreement*" (Judgement, p. 38). Interestingly, the court was not concerned with the existence of an *implicit* agreement on this matter. This approach sheds some light on what is expected from the parties to exercise their right to choose under Swedish law and eliminates legal uncertainty and possible argumentation beyond those requirements. This is a welcomed, although comparably strict, approach.

The only identification of applicable law was present in Article 9 of the Loan Agreement, which provided that the "*agreement shall be governed by and interpreted in accordance with the laws of Cyprus*" and that the disputes are to be brought to a Cypriot court (Judgement, p. 3). The Court of Appeal concluded that the "*the formulation of the provision appears to most closely regulate a choice of law for the main agreement*" (Judgement, p. 38), meaning that there is no specific and explicit choice of law provision that would indicate the law governing the arbitration agreement. The Court of Appeal finally found Swedish law, as the law of the arbitration forum, to be the law applicable to the arbitration agreement.

The drafting of dispute resolution clauses, in this case, was far from perfect. Not only that the parties oversaw that they have eventually included both an arbitration clause and the choice of court clause in the agreement, but the wording of the arbitration clause was also unclear to an extent. Namely, the arbitration clause in its relevant part read as follows:

> "*Should the parties fail to reach an agreement a case shall be submitted, without recourse to courts of law, to the International arbitration court in Stockholm in accordance with the rules for procedure of the said court.*" (Judgement, p. 3)

Whereas the Court of Appeal easily (perhaps too easily) discerned that the parties meant to submit their dispute to the SCC and that the seat was Stockholm, it used the principle of reading the contract as a whole and giving effect to all of its clauses when it was deciding on the relation of the inconsistent clauses in Article 6 (arbitration) and Article 9 (choice of court). Having in mind that the arbitration clause was introduced per specific request of one of the parties and that the parties testified that the choice of court clause remained due to an oversight, the Court of Appeal

concluded that there was a joint party intention that the disputes would be resolved through arbitration. Consequently, the court found no reason to set the arbitral award aside on this ground.

What is the Lesson to be Learnt?

It is a never-ending tradition to treat dispute resolution clauses as “midnight” clause, i.e. clauses that are negotiated and drafted last or, even if they are drafted earlier in the negotiation process, they do not enjoy the same amount of due diligence. It seems that this tradition costs the parties later in time more than they would expect. Legal issues such as the lack of the determination of applicable law and/or seat of arbitration, as well as the lack of the use of a model clause provided by the designated arbitral institution probably seems to be easy to circumvent, however, the case commented in this post showcases a different reality. These were not the only grounds invoked by the party challenging the award, but they were the ones that could have been resolved at the drafting and negotiating stage. Hence, reminding ourselves of the basics in drafting can be rather rewarding in the future when a dispute arises.

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