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Governing Law of Arbitration Agreements Arising From Standing Offers to Arbitrate in Treaties and Foreign Legislation: The Exception to the Default Rule Under the English Arbitration Bill

Aaron McDonald (Herbert Smith Freehills LLP) · Friday, October 11th, 2024 · Herbert Smith Freehills

The English Arbitration Bill, introduced to UK Parliament in November 2023, aimed to ensure that the Arbitration Act 1996 remained fit for purpose and maintained England's status as a leading destination for commercial arbitration. However, the bill was lost when the 2024 UK general election was called.

In July 2024 the new government reintroduced the Arbitration Bill with an important change.

The previous bill had introduced a new default rule which provided that the governing law of an arbitration agreement would be the law of the seat, unless the parties expressly agreed that a different law would apply ("Default Rule"). For these purposes, an express agreement that a particular law would govern the main contract (within which the arbitration agreement was contained) was not an agreement that this law should also apply to the arbitration agreement itself.

The re-introduced Arbitration Bill now contains a carve-out to the Default Rule. It provides that the Default Rule does not apply to an arbitration agreement "derived from a standing offer to submit disputes to arbitration where the offer is contained in … a treaty, or … legislation of a country or territory outside the United Kingdom" (see clause 1(2) of the Arbitration Bill, inserting section 6A(3) into the Arbitration Act 1996).

This note briefly outlines the background to the Default Rule, and the reasons for carving out investments under treaties and foreign legislation from the default regime.

Governing Law of Arbitration Agreement and Principle of Separability

The Default Rule is premised on the principle that arbitration agreements are separate from the main (or "matrix") contract, preserving their validity even if the main contract is disputed. For example, if the matrix contract is said to have been induced by misrepresentation – and so can be avoided – the arbitration agreement is treated as a separate contract which will nevertheless stand and disputes will still be referred to arbitration.

A consequence of this principle is that the arbitration agreement may have a different governing law from the matrix contract. While the governing law of the matrix contract will govern the parties' substantive rights and obligations under the matrix contract, the governing law of the arbitration agreement will govern the scope and validity of the parties' agreement to refer disputes to arbitration.

In commercial contracts, the ideal governing law for the main contract's obligations may not suit the arbitration agreement, particularly if it's not 'pro-arbitration' or limits the agreement's scope. Hence, parties often select different laws for the main contract and the arbitration agreement to ensure efficient and fair dispute resolution through arbitration.

Rationale for the Default Rule

The Default Rule in the Arbitration Bill was a response to the UK Supreme Court's 2020 *Enka v Chubb* decision, which addressed the governing law for arbitration agreements without an explicit choice (see here). The Court established that the arbitration agreement's governing law would be the same as that of the matrix contract unless it would render the arbitration agreement invalid, or, in the absence of any choice in the main contract, to the law with the closest connection, typically the law of the seat. This was controversial as parties often expect the seat's pro-arbitration legal principles to apply, not the potentially restrictive law of the matrix contract. The Default Rule amends these principles from *Enka* by applying the seat's law to the arbitration agreement unless explicitly stated otherwise, aligning with commercial expectations for a pro-arbitration legal framework.

However, this approach encounters complications when dealing with arbitrations arising from investment treaties and foreign legislation.

Arbitration Agreements Arising from Investment Treaties and Foreign Investment Legislation

Investment treaty arbitrations differ from arbitrations arising out of commercial contracts, as they originate from arbitration agreements within treaties. These treaties typically extend a standing offer to investors to arbitrate disputes, which is accepted when the investor initiates arbitration, provided that certain jurisdictional requirements are met. The offer may allow choices between various arbitration forms, such as ICSID, *ad hoc* or institutional, with the seat often determined post-commencement for non-ICSID options (ICSID lacks a national seat).

So, what is the governing law of the arbitration agreement created by the investor's acceptance of the host State's standing offer to arbitrate?

English courts have generally taken the view that the arbitration agreement is governed by international law (see for example *Ecuador v Occidental Exploration and Production* [2005] EWCA Civ 1116).

Similarly, foreign investment legislation may afford investment protections to investors in the host State, either by reference to domestic law standards of the host State or by reference to

international law standards. It may also contain a standing offer to arbitrate which is accepted by the investor commencing arbitration.

Although there is less authority on the topic, the starting point under English law is likely to be that the arbitration agreement is governed by that foreign law (see *Kyrgyz Republic v Stans Energy Corporation* [2017] EWHC 2539 (Comm)).

However, if the Default Rule in the Arbitration Bill were to apply to *ad hoc* and institutional arbitrations under investment treaties and foreign investment legislation, then the arbitration agreement would be governed by the law of the seat absent an express choice otherwise. (ICSID arbitrations do not have a domestic seat and are excluded from the scope of the Arbitration Bill and the Arbitration Act 1996).

Would this have been the right outcome?

Arguments in Favour of the Default Rule for Arbitrations under Investment Treaties and Foreign Investment Legislation

There are potential benefits in the Default Rule applying to arbitration agreements arising under the standing offer in investment treaties and foreign investment legislation:

- It provides certainty and is (in theory) easy to apply.
- Where such arbitrations are seated in England, it gives the benefit of pro-arbitration English law principles about the scope and validity of arbitration agreements.
- It creates a consistent position on the governing law of arbitration agreements as between commercial arbitration, investment treaty arbitration and arbitration under foreign investment legislation.
- It aligns with the New York Convention, which allows an incoming award to be challenged on the basis that the arbitration agreement was invalid under the law to which the parties subjected it or, failing such indication, the law of the seat (Article V(1)(a)).

These benefits, however, are modest compared with the drawbacks of the Default Rule.

Arguments Against the Default Rule for Arbitrations under Investment Treaties and Foreign Investment Legislation

The Default Rule presents serious problems when applied to arbitrations under investment treaties and foreign investment legislation:

- The approach would be contrary to the agreement of States who enter investment treaties. The standing offer to arbitrate in an investment treaty – like the other provisions of the treaty – should be interpreted in accordance with international law (in particular, the Vienna Convention on the Law of Treaties). States would not expect that, in the case of English-seated arbitration, English law will displace international law when interpreting the offer to arbitrate in the treaty.
- Similarly, States which promulgate investment protection legislation would not expect the offer to arbitrate in their domestic legislation to be interpreted under English law in the case of

English-seated arbitration. The expectation would be that its domestic legislation will be interpreted in accordance with its own laws.

- There is uncertainty about how English law would be applied to the interpretation of arbitration agreements arising under investment treaties and foreign investment legislation. Would English law principles of interpretation incorporate principles of public international law (and, perhaps through renvoi, foreign law?) Would considerations of comity come into play? Or would the Default Rule require a solely 'domestic' approach when applying English law? Tribunals would need to grapple with these difficult issues because they are generally the first to decide issues of jurisdiction under the arbitration agreement.
- There is a risk of inconsistent decisions on the interpretation of the offer to arbitrate in investment treaties and foreign investment legislation, depending on the law which is applied to the interpretation exercise. English law might give a different answer from the answer given by international law (in the case of treaties) or foreign law (in the case of legislation or a different seat of arbitration).
- There is a significant risk of enforcement of the award being refused in the host State, on the basis that the tribunal has incorrectly applied English law to the interpretation of the arbitration agreement.

These problems likely outweigh any benefits provided under the Default Rule.

Comment

The introduction of the carve-out to the Default Rule reflects the considerations outlined above.

It means that the interpretation of arbitration agreements arising under investment treaties and foreign investment legislation will not necessarily benefit from pro-arbitration English law principles.

However, the carve-out gives effect to States' intentions when entering investment treaties or promulgating investment legislation – just as the Default Rule is intended to give effect to the intention of parties who choose England as their seat for commercial arbitration. The carve-out also reduces uncertainty about how standing offers should be interpreted in practice and whether the resulting awards will be enforced.

The carve-out to the Default Rule thus serves to maintain England's position as a desirable seat of arbitration and promote the pro-arbitration aims of the Arbitration Bill.

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