What law governs your arbitration clause? You decide.

November 5, 2020

It's midnight and you're in the final stages of negotiation in a complex international transaction. It's probably a safe bet that the one thing that is not keeping you awake is a concern over what law governs the arbitration clauses within those contracts. After all, why does the governing law of an arbitration clause matter? Won't it be the same law as the law governing the underlying contract?

It will probably surprise you to hear that this is an issue that has vexed the courts and commentators, in England and internationally, for many years. On the one hand are authorities that say the law chosen to govern the main contract should also govern the arbitration clause. On the other hand are authorities that say is should be the law of the chosen seat of arbitration.

The English Supreme Court has recently considered the issue in Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb [2020] UKSC 38. This blog post considers why the law governing an arbitration clause matters, looks at the English common law rules for determining the governing law of an arbitration clause and suggests some simple practical steps to avoid problems in practice.

The governing law of an arbitration clause – why it matters

The governing law of an arbitration clause is important because it is law that is applied to determine any disputes over the validity, scope or interpretation of the agreement to arbitrate. For example, if there is a dispute as to whether a particular claim falls within the scope of an arbitration clause, that dispute will be resolved by applying the law governing the arbitration agreement.
Isn’t the governing law of an arbitration clause the same as the governing law of the contract that contains it?

Sometimes, but not always.

Where parties to an international transaction have agreed to arbitrate, the legal framework for resolving disputes may result in the application of a number of different laws. Those laws include: (1) the law governing the substantive rights and obligations of the parties – usually expressly chosen and set out in a governing law clause; and (2) the law governing the conduct of the arbitration proceedings (also known as the curial law) – which is determined by the choice of a seat or legal place of arbitration.

In international contracts, it is not unusual for the governing law of a contract to differ from the system of law of the place chosen as the seat of arbitration. A common example of this is where parties to an international contract governed by English law have chosen to resolve disputes by ICC arbitration seated in Paris.

What parties may not appreciated is that, in this scenario, a failure to specify the governing law of the arbitration clause may give rise to a dispute as to which law (English law or French law) should apply to any issues relating to the validity, scope or interpretation of the arbitration clause.

How is that conflict resolved?

There is no internationally accepted approach to determining what the governing law should be in cases where the governing law of the underlying contract differs from the system of law at the seat of arbitration.

The courts in some jurisdictions have held that, in the absence of an agreement to the contrary, the law of the seat of the arbitration will also apply as the governing law of the arbitration clause (the “seat approach”). Courts in other jurisdictions have held that the governing law of the arbitration clause should be the same as the governing law of the underlying contract (the “main contract approach”).

It’s an issue that that doesn't arise if the parties choose a system of law specifically to govern the arbitration clause. But, and it’s a big but, parties seldom, if ever, make a separate express choice of the law governing an arbitration clause. This can result in costly litigation, which may delay the resolution of the substantive issues in dispute or give rise to grounds for challenging an award.

How do the English courts resolve the conflict?
The English courts have recognised the need for clarity on this question. As Lord Justice Popplewell stated in the Court of Appeal judgment in Enka v Chubb [2020] EWCA Civ 574.

“In my view the time has come to seek to impose some order and clarity on this area of the law .... The current state of the authorities does no credit to English commercial law which seeks to serve the business community by providing certainty.”

The Court of Appeal sought to impose order and clarity by opting for a general rule that the law of the seat of arbitration should prevail as a matter of implied choice subject only to any particular features of the case demonstrating powerful reasons to the contrary.

On appeal, the Supreme Court decided that the Court of Appeal got this wrong and set down the following principles for determining the governing law of an arbitration clause.

1. If the law governing the arbitration clause is not specified, an express or implied choice of governing law for the main contract will generally apply to an arbitration clause forming part of that contract.

2. That presumption may be rebutted if applying the law of the main contract would invalidate or significantly undermine the arbitration agreement (the “Validation Principle”).

3. If there is no express or implied choice of governing law for the main contract, the system of law with the closest connection to the arbitration clause will apply and that is the law of the seat.

So is this an end to the “main contract” v “seat” debate? Do we now have a clear and definitive statement of the English common law on the proper law of an arbitration agreement that is principled, straightforward, clear and easy to apply?

A clue to the answer to this question may lie in the fact that the Supreme Court decision runs to 115 pages, is a majority decision and includes two dissenting judgments.

There are two significant issues on which the Supreme Court is divided.

The first is on the question of which system of law has the closest connection with an arbitration clause. The majority favoured the law of the seat. The minority favoured the law of the main contract, taking the view that the application of the same presumption at each stage would promote certainty and align the rule with the likely result the parties would have wished to achieve.
The second is on the scope of the Validation Principle. The minority would have limited the application of the Validation Principle to cases where the application of the main contract law would invalidate the arbitration clause. The majority view extends the principle to apply in cases where the application of the main contract law would “significantly undermine” the arbitration clause – for example in cases where the application of the law of the main contract would limit the construction of the arbitration clause.

The upshot of all this is the UK Supreme Court has provided a clear statement of the common law principles that are to be applied to determine the governing law of an arbitration clause, but whether it will be straightforward, clear and easy to apply those principles in practice remains to be seen.

In the meantime, here are three simple checks you can make to avoid potentially costly uncertainty.

1. Check that your contract includes a governing law clause.

2. Check whether the governing law of the main contract is the same as the law of the chosen seat of the arbitration. If it is, then there is no potential conflict. If it’s not –

3. Make an express choice of the law you want to govern the arbitration clause and state it clearly in the arbitration clause and/or the governing law clause.

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