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Governing law of arbitration clauses.
Court of Appeal decision in Sulamerica prompts revised drafting approach.

In Sulamerica CIA Nacional de Seguros SA and others v Enesa Engenharia SA and others [2012] EWCA Civ 638, the Court of Appeal considered the question of how the law governing an arbitration clause in a contract is to be assessed. Although a robust, pro-arbitration, ruling it has also drawn attention to the issue of whether to make a separate, express, choice of law in respect of the arbitration clause itself.

As this note considers, whilst no action would be required where an arbitration clause names England as seat and the main contract is governed by English law, there are advantages in doing so where the seat is in England and the main contract is governed by a foreign law. Similarly, where the seat of arbitration is not in England and the governing law of the main contract is different from the law of the seat (e.g. seat in France with an English law contract or a German law contract), it is a point to put to local lawyers.

Contents

The facts

The case concerned a dispute as to liability under insurance contracts relating to the construction of a Hydro-Electric power plant in Brazil. Both insured and insurers were Brazilian. The policies were expressly governed by Brazilian law and contained provisions for disputes to be settled by arbitration in London.

Certain incidents occurred which caused the insured to claim on the policies. When the insurers disputed liability the insurers commenced an arbitration in London. In response, the insured commenced court proceedings in Brazil. In the English courts the insurers then applied for an anti-suit injunction against those Brazilian proceedings to support the English arbitration.

In that application the insured argued that Brazilian law governed the arbitration clause, that the clause was inoperative under that law and that, accordingly, no injunction was to be granted. This put in issue how the governing law of the arbitration clause was to be assessed. At first instance the judge held that English law applied. This finding upheld the arbitration clause and permitted the grant of the injunction.

The legal background

As arbitration (and jurisdiction) clauses are expressly excluded from the scope of the Rome I Regulation (and its predecessor, the Rome Convention), the conflicts of law rules to be applied by courts in the EU to the question derive from national law i.e. in England, the common law.

In the situation (as was the case here) where an arbitration clause is included within a contract and only the latter contains a governing law provision, not being the law of the seat, English cases have traditionally adopted the view that the law chosen to govern the main contract also governs the, legally distinct, or separable, arbitration clause. Against this, however, some more recent authorities (*XL Insurance v Owens Corning* [2000] 2 Lloyd's Rep, C-v-D [2007] EWCA Civ 1282) had applied the law of the seat (i.e. England) to resolve the question.

The governing law of the arbitration clause will determine such matters such as its construction and scope.

Court of Appeal decision

The leading judgment of the Court of Appeal was handed down by Moore-Bick LJ (with whom Hallett LJ agreed). In it, he restated the law on the point as follows (paragraphs 25-32 of his judgment).

As the arbitration agreement was separable its proper law may not be that of the substantive contract. To find out the former, the court will look at (i) whether the parties have made an express choice to govern it. Alternatively, where there is none, it will look to see if the parties have (ii) made an implied choice or, (iii) in the absence of such, apply the law with which the clause has its closest and most real connection.

Here the parties had not made an express choice of law to govern the arbitration clause, so points (ii) and (iii) fell to be considered. As to (ii), Moore-Bick LJ stated that, in the absence of any indications to the contrary, an express choice of law governing the main contract would be a strong indication in respect of the parties 'intention in relation to the arbitration clause. A search for the proper law would therefore likely (as dicta in the earlier cases indicated) lead to that law applying unless other factors led to a different conclusion.

In this case, however, the parties choice under the main contract could not be taken to be sufficient evidence of an implied choice of Brazilian law to govern the arbitration clause because there was a serious risk that such a choice would undermine the agreement. Accordingly, the law with which the clause had its closest and most real connection was to apply. As the clause's purpose was dispute resolution, its closest connection was with the law of the supervisory seat i.e. England.

Comment & practical implications

On one view, the Court of Appeal's ruling is a robust one. It appears to promote the effectiveness of an arbitration clause by relying on the law of the seat as an alternative in the situation where applying the law of the main contract would impede the operation of the clause. This is arguably consistent with a trend apparent in *XL Insurance and C-v-D*.

This is encouraging for parties that have included an arbitration clause in a main contract as it suggests that the court will apply, in the absence of an express choice, the law which best gives effect to the clause.

Nevertheless, a question that the case has drawn attention to is whether parties should consider making the type of express choice that was absent in this case. In our view, the issue is not an altogether straightforward one; the pro-arbitration stance of the Court of Appeal (seemingly allowing for a "second bite at the cherry") needing to be weighted against the greater certainty, in terms of narrowing any scope for factual arguments, of expressing a choice from the start.

The latter position has already been advocated by some as a response to the case and the renewed focus on the issue may well lead parties to take more comfort in expressing a choice rather than placing reliance on the court's approach in the absence of choice. Accordingly, we would recommend, generally, that parties take such a step. This raises the question of how should you go about doing so?

Drafting tips

(1) What wording could be used?

Simply insert a new provision at the end of your arbitration clause.

"This clause [number] shall be governed by [*insert law governing main contract*]"

The choice is specified in favour of the law governing the main contract. Generally speaking, commercial parties intend that one law is to govern their relationship and their lawyers will have drafted the arbitration clause in that context so, unless there is some overriding reason not to, this should be kept consistent. It will, of course, always be necessary to ensure that the clause is properly drafted and works, in terms of being valid and of sufficient scope, under that chosen law.

(2) When is this action necessary?

Where England is chosen as the seat of arbitration and the main contract is governed by a foreign law, this is the scenario that was in play in *Sulamerica* and so is the principal scenario in which the change is directed at.

Where England is chosen as the seat of arbitration and the main contract is governed by English law then the issues in play in *Sulamerica* would not arise for obvious reasons. English law would govern the clause and so no wording is needed.

Finally, in circumstances where the seat of arbitration is not in England and the governing law of the main contract is different from the law of the seat (e.g. seat in France with an English law contract or a German law contract) it will be a question to put to local lawyers advising on the consequences of the choice of seat as to whether, in the light of the seat's conflicts of law rules, the use of such wording could be similarly beneficial.

Click here for a copy of the judgment.

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