THE IMPORTANCE OF THE APPLICABLE LAW ON THE ARBITRAL TRIBUNALS' JURISDICTION

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1. Introduction

International arbitration, although a very successful alternative dispute resolution (ADR) method, presents additional complications compared to domestic arbitration. One of them is that, given that several countries and nationalities can be involved in the dispute, the determination of the applicable law can become more complex. Regarding the substantive applicable law, arbitrators should apply the law agreed by the parties, but absent any such agreement they are normally granted broad discretion.[2] This means that questions of applicable substantive law do not often create problems with the enforcement of arbitral awards.[3] However, enforcement problems arise more frequently when choice of law issues relate to the arbitration agreement and the determination of who are parties to it.

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Despite efforts to promote uniformity among arbitration laws, there is still considerable divergence on how courts in different jurisdictions identify which law should govern an arbitration agreement. Moreover, the range of possible approaches is even more varied when it comes to situations in which non-signatories could be bound by an arbitration agreement. Consequently, although sometimes the possible applicable laws could coincide, in many occasions they will lead to different results. This is clearly illustrated, for example, by the fact that not all jurisdictions recognize the group of companies doctrine,[4] a theory on non-signatories that is frequently raised in arbitration. This brief contribution analyzes a recent example of the importance that the law applicable to these matters can have in the enforcement of arbitral awards and offers some guidance on how to better analyze these problems to conform to the parties' expectations.

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[2] *See, e.g.*, ICDR International Arbitration Rules, art. 31, version effective 1 June 2014.

[3] *See* Linda Silberman & Franco Ferrari, *Getting to the Law Applicable to the Merits in International Arbitration and the Consequences of Getting it Wrong, in* CONFLICT OF LAWS IN INTERNATIONAL ARBITRATION 257 (Franco Ferrari & Stefan Kröll eds., 2010).

[4] *See, e.g.*, Peterson Farms Inc. v. C&M Farming Ltd. [2003] EWHC 2298 (Comm).

2. Law of the contract or law of the seat?

Consistent with party autonomy being a cornerstone of arbitration, it is logical that the analysis of what law governs an arbitration clause starts with the parties' agreement. Consequently, it is commonly accepted that if the parties have chosen a specific law to govern their arbitration agreement, that law should apply. This approach is enshrined in the New York Convention and the UNCITRAL Model Law in connection with the validity of the arbitration agreement.[5] Absent parties' agreement, the New York Convention and the UNCITRAL Model Law establish that the law of the seat of the arbitration applies.[6] As parties rarely make a specific selection of the law applicable to their arbitration agreement, it could initially seem that the law of the seat would almost always apply. However, an additional issue complicates the analysis: the possibility that the parties could have implicitly agreed on the law applicable to the arbitration agreement.

Thus, many jurisdictions recognize that the inclusion of a choice of law clause in a contract with an arbitration agreement could also be indicative of the parties' intention to have the entire contract, including the arbitration agreement, governed by the same law. Although this might seem to contradict the principle of separability of the arbitration agreement, the principle is not absolute, as its correct interpretation is that the arbitration agreement is separable, but not entirely separated from the main contract for all purposes. In other words, the legal fiction of separability should not prevail over the parties' expectations and agreements (even if implicit) on the law applicable to the arbitration agreement. Unfortunately, this framework has created uncertainty in several cases as to whether the law of the arbitration agreement or the law of the main contract governs the arbitration clause.

The latest example of this uncertainty arises from two parallel court proceedings in England and France.[7] The underlying dispute relates to a franchise agreements between a Kuwaiti and a Lebanese company. The contract contained 1) a governing law clause providing that the laws of England governed the contract, 2) an arbitration clause with Paris as the seat of arbitration, and 3) a couple of no oral modification clauses (an entire agreement clause and clause requiring

[5] *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 Jun. 1958, 330 U.N.T.S. 38, art. V(1)(a) [hereinafter "New York Convention"]; UNCITRAL Model Law on International Commercial Arbitration, Art. 36(1)(a)(i) [hereinafter "UNCITRAL Model Law"].
[6] *See* New York Convention, art. V(1)(a); UNCITRAL Model Law, Art. 36(1)(a)(i).
[7] However, note that the English decision has been appealed to the U.K. Supreme Court.

agreement in writing to waive any terms or conditions). Due to a corporate restructuring, the Kuwaiti company became a subsidiary of another Kuwaiti holding company. Although the new holding company paid some invoices arising from the contract, it never formally signed the contract or any side agreement. When a dispute arose, the Lebanese company initiated arbitration proceedings against the non-signatory holding company, but not the subsidiary. A majority of the arbitral tribunal applied French law and found that the holding company was bound by the arbitration agreement.

Enforcement proceedings followed in England, while annulment was sought in France. In the English proceedings, the England and Wales Court of Appeal found that English law governed the question as to whether the holding company had become a party to the arbitration agreement.[8] The court relied on the fact that the choice of law clause applied to the "Agreement", which had been defined in the contract as including "all the terms of agreement[.]"[9] The court then concluded that the holding company was not bound by the arbitration agreement under English law and therefore it denied enforcement of the award. Nonetheless, in the Paris Court of Appeals the outcome was the opposite, as the court determined that French law, being the law of the seat of arbitration, should apply; and under French law the holding company had become a party to the arbitration agreement, which resulted in the award being upheld.[10]

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3. An analysis based on the parties' actual expectations

Although the uncertainty surrounding which law should govern an arbitration agreement is unlikely to disappear any time soon, a better understanding of the parties' expectations would contribute to mitigate this problem. It is true that sometimes parties intend their entire agreement, including any arbitration provision, to be governed by the same law, and in particular the one selected in a choice of law clause. This can be the case especially in situations with unsophisticated parties, who might overlook the legal relevance of the arbitral seat or of the separability principle.

[8] *See* Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait) [2020] EWCA Civ 6.
[9] *Id.*, at ¶ 62.
[10] *See* CA Paris, 1e ch., 23 Jun. 2020, 17/22943.

For example, the lack of any selection of an arbitral seat in the arbitration clause could be indicative of this lack of sophistication.

However, jumping to complex ex post analyses in search of an implicit agreement from the parties on the law applicable to the arbitration agreement might end up deviating from the parties' actual intent. Thus, although we might be tempted to believe that parties carefully think about all contractual clauses, in reality many of these clauses are not carefully studied. Considerations about what type of dispute resolution clause to include can often be minimal and relegated to last-minute decisions, which is consistent with the idea that most parties expect that their transactions will not generate disputes. As a result, the possibility that the parties did not reach any agreement can be precisely the one that most closely matches the parties' approach during the contractual negotiation, which also appears better aligned with a plain reading of the New York Convention and the UNCITRAL Model Law.

In addition, there are good reasons to believe that parties would in many occasions expect the law of the seat to apply. This is because, except in scenarios where unsophisticated parties simply view the arbitral seat as a mutually convenient venue for an in-person hearing, to the extent that parties give any thought at all to which law should govern the arbitration agreement, they will probably express so by choosing an arbitration-friendly seat.[11] Moreover, although rare in practice, sophisticated parties could easily draft agreements specifying which law should govern the arbitration agreement. This would not even require changing the arbitration clause itself, but could be achieved by specifically establishing that the choice of law clause applies to all the clauses in the contract, including the arbitration agreement.

Furthermore, there is little support in terms of both the parties' intention and the legal framework to advocate for the general application of a validation principle.[12] Pursuant to this supposed validation principle, in order to give effect to the parties' intention to arbitrate, an arbitration agreement should be deemed valid as long as it is valid under any of the possible applicable laws. However, this approach disregards the idea that parties intend to be bound by agreements only to the extent that they are valid under the applicable law. Otherwise, the logical conclusion would be that parties waive any potential invalidity argument simply by signing the contract. Following this

[11] *See, e.g.*, Jeff Waincymer, PROCEDURE AND EVIDENCE IN INTERNATIONAL ARBITRATION 500 (2012).
[12] *See* GARY BORN, INTERNATIONAL COMMERCIAL ARBITRATION 495 (2nd ed. 2014).

approach, if it should be inferred that by including a clause in a contract the parties intended it to be valid at all cost, why limit the analysis to the possible applicable laws? Why not extend it to include soft law instruments like the UNIDROIT Principles, or *lex mercatoria*, or a theoretical set of rules the parties might have thought of in their heads? In practice, this would exclude the possibility of any contract invalidity, therefore contradicting laws from multiple jurisdictions on this matter.

However, this does not mean that a validation principle could not apply in some cases. Although the number of cases where the parties contractually agree to this validation principle will be scarce to none, parties could be bound by it if the applicable arbitration law specifically provides for it. For instance, the validation principle will apply to arbitration agreements governed by Swiss or Spanish law, as both of these laws establish that an international arbitration agreement is valid if it conforms to the law chosen by the parties, the law of the main contract, or Swiss or Spanish law respectively.[13]

Finally, it is worth mentioning that the case discussed in the previous section actually presented a simplified version of the applicable law issues faced in other situations involving non-signatories. Thus, in this case all the parties, including the holding company that argued that it should not be bound by the arbitration clause, agreed that the matter should be decided under the law of the arbitration agreement (be it English or French law). If the parties had not agreed on this point, applying the law of the arbitration agreement would have required the existence of some connecting factors between the holding company and the arbitration agreement.[14] Otherwise, the signatories could theoretically agree on an arbitration clause governed by a law with expansive theories on non-signatories and use it to bind a company with no connection to that law and that arbitration agreement, which is clearly an undesired outcome.[15]

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[13] *See* Loi fédérale sur le droit international privé [LDIP] [Law on private international law] 18 Dec. 1987, RO 1776, art. 178(2) (Switz.); Arbitration Law, art. 9(6) (B.O.E. 2003, 60) (Spain).
[14] *See* Rafael Carlos del Rosal Carmona, *The Law Applicable to Extension of the Arbitration Agreement: Protecting Non-Signatories while Providing Flexibility*, TRANSNAT'L DISP. MGMT, Jun. 2016.
[15] For some decisions considering this issue, *see* Bundesgerichtshof [BGH] [Federal court of Justice] 8 May 2014, III ZR 371/12 ¶ 87; *Jasmin Solar Pty Ltd v Trina Solar Australia Pty Ltd* [2015] FCA 1453, affirmed by *Trina Solar (US), Inc v Jasmin Solar Pty Ltd* [2017] FCAFC 6 ¶ 130.

4. Conclusion

Establishing which law applies to an arbitration agreement might not be possible without a case-by-case analysis, but due to the importance of party autonomy in arbitration, the guiding principle should be the parties' agreement and intention. As much as we, as lawyers, like to think of the importance of legal provisions, parties may frequently pay little attention to their arbitration agreement. They may sometimes expect the law of the seat to apply, with that expectation being the reason why they selected an arbitration-friendly seat. Sometimes they may not understand the legal significance of the seat and of the separability principle and would expect the law of the main contract to apply. Other times parties might have simply reached no agreement at all.

The correct approach to determine whether there was an implicit agreement or not should be to focus on the parties' circumstances and their expectations during the negotiating process. Ex post findings of implicit agreements based on minor details of the contract's wording whose implications the parties never considered does not contribute to achieve this goal. Neither does assuming that parties do not care about the potential invalidity of the arbitration agreement as long as it is valid under some law. Finally, this idea of protecting the parties' expectations should also include non-signatories to the arbitration agreement, who should not be surprised by the application of an unexpected law to which they had no connection. Consequently, for the law of the arbitration agreement to be applied to a non-signatory, the non-signatory should agree with that approach or, absent agreement, there should be some factors connecting him to the arbitration agreement.

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