

What Law is Applicable to Arbitration Agreements: Who Is to Decide and How? Or Yet Again About the Things That Truly Matter...

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The title of this article as it stands was selected for a reason. In the international arbitration sphere, this is one of those questions that are likely to be asked and need to be analyzed and answered in a large number of legal proceedings. Like many other questions, it deals with the international private law and, in particular, its conflict of laws rules since an answer to this question usually requires its evaluation from the perspective of several laws and orders.

The seat of arbitration to be selected by the parties often does not coincide with the jurisdiction of incorporation of the parties, with the differences deeply rooted in the legal culture. Arbitration agreements (including arbitration clauses in contracts) usually contain provisions on the law applicable to the merits of the dispute (*lex causae*), but not to the arbitration agreement itself. There used to be a debate in the theory of international arbitration, which concerned the question of determination of the law applicable to the arbitration agreement and, later on, to the arbitration procedure¹. Doctrinal battles did not result in the adoption of any common concept. It was, however, not that necessary at that time because the most popular arbitration jurisdictions at the time (England and France) were quite loyal to it.

The world, however, has changed dramatically since that time and so has the world of international arbitration as a reflection of economic globalization and changes in Europe, Asia, and USA. Nowadays, the geography of the largest and most active arbitration centers covers not only Paris, London and Stockholm, but also Singapore, Iraq, UAE and Hong-Kong. Arbitration centers in Eastern Europe and the CIS are also under active development and successfully compete with their western counterparts. There is an increasing number of disputes brought before international arbitration courts with the participation of somewhat unusual jurisdictions. What is, however, the most important is that, nowadays, despite a significant effect of unified regulation of the international arbitration, national law applicable to the arbitration differs in the degree of loyalty to the arbitration, level of flexibility, and percentage of optional and mandatory rules². Amid severe competition among international arbitration institutions, all of these issues made this somewhat forgotten problem relevant again and thus - the topic of this article.

¹ In principle, this debate was reflected in the history of international arbitration as polemics between English and French law scholars where the English law scholars advocated for the application of the national rules of the arbitration seat and the French scholars made the international arbitration subject to the so-called transnational law. The latter is, in particular, widely proclaimed in a number of publications of the 1980s, namely General Principles of Law in International Commercial Arbitration by Arthur von Meher (1988) or The Lex Mercatoria in International Commercial Arbitration by Ole Lando (1985), etc.

² E.g., in accordance with Article 142 of the Polish Law on Bankruptcy and Reorganization (2003), once bankruptcy proceedings are initiated, any arbitration agreement signed by a bankrupt entity shall cease to be effective and any pending arbitration shall be terminated. This gives rise to a question: may arbitration proceedings continue if a bankrupt entity is a Polish company and if a contract provides for the application of Polish law as a governing law but if the arbitration takes place in London? To what extent can the parties (including the Polish party) anticipate this problem when they agree upon an arbitration agreement?

Arbitration Agreement: Gateway to Heaven?

An arbitration agreement actually legalizes private justice and its hybrid nature (combination of procedural and contractual elements) no longer gives rise to irreconcilable disputes³. The arbitration agreement itself was dubbed both a cornerstone of arbitration and a gateway to the arbitration, but the international arbitration practice continues to suffer from a *primitivist approach*, which is used by the parties from time to time when they agree upon the conditions of dispute adjudication. The reasonableness and adequacy of understanding by the parties of the dispute adjudication procedure and proceedings, the parties' belief in wisdom and prudence of the arbitrators may give place to the disappointment in arbitration as such and to the sheer "guerilla tactics"⁴ as well as distrust in and aggression towards the arbitrators.

The problem is that an arbitration agreement itself contains certain conflicts of laws that need at least to be understood. Even at first sight, the following law enforcement problems can be discerned in determining the law applicable to: (1) the parties' capacity to conclude the arbitration agreement; (2) the arbitral procedure (*lex loci arbitri*), (3) the arbitrator's contract (*receptum arbitri*), (4) legal relations between the parties and the administering institution; and (5) the substance of the dispute.

A question arises then: to what extent does an arbitration agreement externally (in its written form) reflect an internal consent of the parties and to what extent should arbitrators understand internal conflicts within the arbitration agreement for its correct application in practice? How can one evaluate whether the arbitration agreement was correctly applied and interpreted by the arbitrators? There is no unambiguous answer. However, I believe that there are certain starting points, which, if used, would enable to identify internal potential conflicts within the arbitration agreement and prevent the transformation of the arbitration agreement from the gateway to Heaven to the "gateway to nowhere." And this would be a best-case scenario.

Unity of Substance and Form

First of all, it is not about compliance with a written form of the arbitration agreement, which is, however, also very important, but about a more global evaluation of whether there was an understanding between the parties with respect to dispute settlement through arbitration. The reverse of this understanding is a conscious rejection of the jurisdiction of a competent state court.

In my opinion, this is the main point which should be evaluated first and for most when a dispute arises as to the validity of the arbitration agreement by both the arbitrators and a competent state court if the parties referred their dispute to such court. As a sad departure from this topic, we should note that such approach is not being practiced by Ukrainian courts, which fact is proved by the practice of reversal of arbitral awards rendered by the ICAC at the UCCI⁵.

It becomes necessary to evaluate the form of will expression only after establishing the substance of such will expression by the parties. It is important to take into consideration that, in accordance with the developed principles of international private law (connecting factors), the material validity and formal validity of the agreement are subjected to different conflict of laws rules⁶. This may lead to a situation where the issue of the existence of an agreement to arbitrate and the form of arbitration must be governed by different laws. As regards the practice of Ukrainian courts, I am rather doubtful whether they differentiate between requirements as to the formal validity of an arbitration agreement (as a written

³ See Julian D.M. Lew, Loukas A. Mistelis, Stefan M. Kröll in *The Comparative International Commercial Arbitration* (Kluwer Law International 2003), par. 5-23: "In spite of their apparent diametrically opposed views, the jurisdictional and contractual theories can be reconciled. Arbitration requires and depends upon elements from both the jurisdictional and the contractual viewpoints; it contains elements of both private and public law; it has procedural and contractual features. It is not surprising that a compromise theory, claiming arbitration to have a mixed or hybrid character should have been developed."

⁴ Well-known "guerilla tactics" – opposition to arbitration, which was widely discussed at a number of international conferences in 2010 in Vienna, Stockholm, and Moscow.

⁵ E.g., Ruling of October 13, 2010 of the Supreme Court of Ukraine in a case of Arcelormittal Ambalaj Celigi Sanayi ve Ticaret Anonim Sirketi versus Argo Industrial and Commercial Company, LLC, which was brought to appeal the award of the ICAC at the UCCI. This case was discussed in the seventh issue of an arbitration newsletter of Vasil Kisil & Partners Law Firm (October 2010).

⁶ See Article 8 (Material validity) and Article 9 (Formal validity) of the Convention on the Law Applicable to Contractual Obligations dated June 19, 1980.

instrument in its broadest meaning) and the substantive validity of the agreement between the parties (providing for the arbitration of disputes). I am also doubtful whether they assess the so-called legal capacity of the parties to enter into arbitration agreements, or the proper representation of a party in the process of coordinating and signing an arbitration agreement, or the personal law of a party (the law of the place of incorporation, or the law of nationality, or the law of the place of location or residence, or the law of the principal place of business (the center of vital interests)).

To add to that, the arbitrability of a dispute or its part can be challenged, and this will also require the determination of the law applicable to the issue of arbitrability.

The arbitrability of a dispute, i.e. the ability of a dispute to be submitted to an arbitral tribunal (i.e. to a body of private justice rather than a state court), is a factor of paramount importance both at the stage when the dispute is accepted for consideration and, ultimately, at the final stage when the respective award is enforced.

If the dispute is non-arbitrable, the related arbitration agreement is also invalid, and the tribunal has no jurisdiction to decide the dispute, even if the parties want this. At this point, the autonomy of the parties' will comes into collision with public interest and public order considerations.

The approaches to the arbitrability of disputes applied in national jurisdictions and those based on certain general principles differ rather considerably. For example, Article 177 of the Swiss Federal Statute on International Private Law⁷ and Article 1(1) of the Swedish Arbitration Act⁸ govern the question of arbitrability directly without reference to any conflict of laws rules, provided that the seat of arbitration is, accordingly, within their jurisdiction. Therefore, the location of the seat of arbitration in these jurisdictions serves as the connecting factor for the arbitrators (and the parties) wishing to determine the arbitrability of a dispute. However, this approach will not work in the context of recognition and enforcement proceedings, and a state court of the country of enforcement will determine the arbitrability of the dispute in accordance with its own law⁹.

Therefore, already at this stage it is clear that more than one law can apply to an arbitration agreement, depending on the matter or the aspect to be determined.

Differences in Approaches to Evaluation of Arbitration Agreements: Arbitral Tribunals vs. State Courts

The generally accepted principle of *Kompetenz-Kompetenz*¹⁰ authorizes arbitral tribunals to determine the law applicable to an arbitration agreement whenever they need to determine their own jurisdiction over a dispute. Such a need usually arises when the jurisdiction of such tribunal is challenged by one of the parties to the dispute. Meanwhile, the arbitral tribunal has no *lex fori*, i.e. it is under no legal obligation to have resort to the conflict of laws rules applicable at the seat of arbitration to determine the law applicable to the arbitration agreement. Arbitral tribunals are under an obligation to apply the arbitration law of the seat of arbitration, but such laws (with only a few exceptions) do not contain any specific conflict rules governing the determination of the law applicable to an arbitration agreement by arbitral tribunals. Such exceptions include, for example, Sweden where the Arbitration Act directly governs matters relating to the determination of the law applicable to an arbitration agreement¹¹. In other cases, the conflict rules are concerned with the determination of the applicable law by state courts in setting aside and enforcement proceedings¹².

⁷ Article 177(1) of the Swiss Federal Statute on International Private Law of December 18, 1987 provides that "any dispute involving an economic interest may be the subject matter of an arbitration".

⁸ Article 1(1) of the Swedish Arbitration Act (SFS 1 1999:116) provides that "disputes concerning matters in respect of which the parties may reach a settlement may, by agreement, be referred to one or several arbitrators for resolution".

⁹ Article V(2)(a) of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards; Article 36(1)(b)(i) of the UNCITRAL Model Law on International Commercial Arbitration.

¹⁰ Article 16 of the UNCITRAL Model Law on International Commercial Arbitration; Article 16 of the Law of Ukraine "On International Commercial Arbitration".

¹¹ Section 48 of the Arbitration Act provides 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. The first paragraph shall not apply to the issue of whether a party was authorised to enter into an arbitration agreement or was duly represented".

¹² Articles 34 and 36 of the UNCITRAL Model Law on International Commercial Arbitration.

Therefore, arbitral tribunals independently identify the connecting factors when determining the law applicable to an arbitration agreement and are guided in the process, in particular, by the conflict rules in force at the seat of arbitration, international conventions, and the established practice.

The situation is somewhat different when the law applicable to an arbitration agreement is to be determined by state courts. First, unlike arbitral tribunals, state courts have a *lex fori* and they must apply the conflict of laws rules of that *lex fori*. This often triggers the so-called “forum shopping” effect (a search for the most favorable forum), as different national laws are applied to the same arbitration agreement in different jurisdictions. To avoid or reduce the risk of these forum shopping effects, state courts are also under an obligation to apply conflict of law rules contained in international uniform law instruments, such as the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the 1961 European Convention on International Commercial Arbitration. Both of these Conventions contain conflict of law rules governing the determination of the law applicable to the substantive validity and the formal validity of an arbitration agreement and providing for the direct choice of law.

Agreement to Submit Existing Dispute to Arbitration

According to Article 7 (1) of the UNCITRAL Model Law on International Commercial Arbitration, Article 7 of the Law of Ukraine “On International Commercial Arbitration” and other equivalent provisions of arbitration laws, an arbitration agreement for future disputes may be in the form of a separate agreement or in the form of an arbitration clause in a contract. Meanwhile, an arbitration agreement may also be entered into in respect of an existing dispute already pending before a state court. Its major distinction is that it is not part of another agreement, but is a freestanding agreement between the parties providing, in particular, for the specific aspects of the application of conflict of laws rules. First of all, the question arises in this context whether the law applicable to the main contract between the parties (under which the dispute has arisen) can also apply to such arbitration agreements. The law applicable to the main contract does not automatically extend to the related arbitration agreement. Typically, arbitration agreements on submission of pending disputes to arbitration must contain provisions regarding the choice of applicable law. Otherwise, the general principles governing the determination of applicable law, in particular the choice of law, must apply.

Pro-arbitration Approach to Arbitration Agreements

The application of the “*in favorem validitatis*” principle of interpretation is part of the pro-arbitration approach. In particular, it is applied during the process of determining the law applicable to an arbitration agreement when there are several national laws involved.

As a result of the arbitration-friendly climate currently observed in most jurisdictions, when interpreting the will of the parties arbitrators now show a strong tendency to respect the common intention of the parties as expressed in their agreement to arbitrate. To a certain extent, arbitrators even feel some sort of obligation to help the parties realize their wish.

Meanwhile, the use of such “pro-arbitration” approach requires ascertainment of the fact that the arbitration clause has been agreed in good faith and executed in a manner that upholds its validity. The point is that the *in favorem* is the interpretation principle under which the validity of an arbitration agreement is determined from the point of view of the agreement substance – dispute submission to arbitration. Besides, when determining the law applicable to arbitration agreements, arbitrators have to keep in mind that such law has to support the arbitration agreement validity. Such approach is reflected in Article 178 (2) of the Switzerland’s Federal Code on Private International Law, stating as follows: “As to substance, the arbitration agreement shall be valid if it complies with the requirements of the law chosen by the parties or the law governing the object of the dispute and, in particular, the law applicable to the principal contract, or with Swiss law¹³”.

Acknowledging and appealing to the *in favorem validitatis* principle, the Swiss lawmakers also pointed out that as to the form, the arbitration agreement shall be valid if it is made in writing, by telegram, telex, telecopier, or any other means of communication that establishes the terms of the agreement by a text¹⁴. I.e. the absence of a written arbitration agreement will prevent its implementation whatever liberal or arbitration-friendly is the way the arbitration agreement is determined in its substance.

The idea of alternative application of various rules of law to the substantive validity of an arbitration agreement is also expressed in the Resolution Arbitration Between States, State Enterprises, or State Entities, and Foreign Enterprises adopted by the Institute of International Law in 1989¹⁵, in which Article 4

¹³ https://www.sccam.org/sa/download/IPRG_russian.pdf

¹⁴ Article 178 (1) of the Switzerland’s Federal Code on Private International Law

¹⁵ http://www.idi-iiil.org/idiE/resolutionsE/1989_comp_01_en.PDF;

states that, where the validity of the agreement to arbitrate is challenged, the tribunal shall resolve the issue by applying one or more of the following: the law chosen by the parties, the law indicated by the system of private international law stipulated by the parties, general principles of public or private international law, general principles of international arbitration, or the law that would be applied by the courts of the territory in which the tribunal has its seat. In making this selection, the tribunal shall be guided in every case by the principle in *favorem validitatis*¹⁶.

Law Applicable To Substantive Validity of Arbitration Agreement

This matter does not cause any global arguments or controversies when determining the applicable law in practice. It has been recognized that the agreement to submit the dispute to arbitration is closely connected with the law of the place of arbitration as the place of the agreement implementation. Therefore, the choice of the place of arbitration by the parties (or arbitrators) is also an indirect choice of law applicable not only to the arbitration proceedings, but also to the arbitration agreement substantive validity, arbitrability of the disputes and the arbitration agreement formal validity.

Meanwhile, there is another issue to be resolved here: does the choice of law under the main contract also cover the arbitration agreement contained in such main contract? In most cases, in absence of parties' agreement, arbitrators tend to limit the choice of law applicable to the arbitration agreement either to the law of the place of arbitration or the law applicable to the main contract. As mentioned above, a slightly more moderate approach is determined regarding only arbitration agreements executed in respect of already existing disputes, since such arbitration agreements are considered as a fully individual agreement.

However, the above view disregards the concept of arbitration agreement separability from the main contract which does not allow claiming that the choice of law under the main contract automatically extends to the arbitration agreement. In this connection, the matter of the place of arbitration becomes the principal criterion in determining the law applicable to the arbitration agreement material substance.

Yet, the place of arbitration is not always agreed by the parties, and the arbitration institution or arbitrators may need some time before making the decision for the parties, which gives rise to a question: how to determine in this case the law applicable to the arbitration agreement when such issue of determining applicable law arises in a state court.

Article VI (c) of the European Convention on International Commercial Arbitration stipulates that failing any indication as to the law to which the parties have subjected the agreement, and where at the time when the question is raised in court the country in which the award is to be made cannot be determined, under the competent law by virtue of the rules of conflict of the court seized of the dispute. The courts may also refuse recognition of the arbitration agreement if under the law of their country the dispute is not capable of settlement by arbitration.

The law applicable to the substance of the arbitration agreement between the parties governs all matters of substantive validity of such agreement, i.e. the validity and acceptance of the offer to submit the dispute to arbitration, determination of the moment when the agreement was concluded, as well as any errors or frauds committed while concluding the agreement, performance and termination of the arbitration agreement, and other matters. Moreover, such law also governs the scope of arbitration agreement and its extension to any third parties.

Law Applicable to Formal Validity of Arbitration Agreement

While evaluating the formal validity of the arbitration agreement, arbitrators refer to the formal requirements stipulated in *lex loci arbitri*. It is widely known that the arbitrators are not bound by the provisions of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but they realize the practical need to ensure that the understanding of the formal requirements as to the arbitration agreement validity is in tune with the UN Convention. Such an understanding arises from the unwritten obligation of the arbitrator to make an award which will be enforced. However, when the law of the place of arbitration provides a more liberal approach to the formal criteria of the arbitration clause, nothing will prevent the arbitrators from accepting such an approach, even if there is a certain risk related to enforcement of the award in the country applying stricter requirements to the formal criteria compliance.

As far as the state courts go the situation is somewhat different. The provisions of Article II (2) of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards may be applied while evaluating the formal compliance of the arbitration award as a maximum and minimum

¹⁶ Institut de Droit International, Session of Santiago de Compostela 1989, Arbitration Between States, State Enterprises, or State Entities, and Foreign Enterprises; Article 4.

standard, depending on the strictness or liberality of the law of the place of arbitration and the place of award enforcement. A similar mechanism is common to courts regarding the place of arbitration, as well as to the country signatory to the Convention regarding the place of award enforcement.

Conclusions

This study has revealed that today it is widely recognized that particularly the law of the place of arbitration governs the following matters, before the arbitration proceedings take place and the arbitral award is rendered: (1) the substantive validity of the arbitration agreement, if the parties did not agree otherwise; (2) formal validity of the arbitration agreement, if it is to be determined by the arbitrators; (3) arbitrability of the subject matter of the dispute; (4) rules of arbitration procedure.

Based on the above, it should be mentioned that in terms of theory, today there is more consensus than confusion with respect to the law applicable to the arbitration agreement, and the international arbitration practice witnesses a certain commonality of approaches, which makes international arbitration procedures quite predictable. Nonetheless, it is questionable whether such conclusion may be made in respect of the practices of state courts in the place where the award is enforced.

This places even a bigger emphasis on the importance of adequate and sensible choice of the place of arbitration by the parties who, unfortunately, quite often are not aware of the meaning of that short sentence contained in their arbitration agreement: "The place of arbitration is ...".