Choosing the Law of an Arbitration Agreement

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Choosing the law of an arbitration agreement – is it the same as choosing the seat?

The importance of choosing the law governing an arbitration agreement regardless of the choice of the seat.

In an article by Baker & McKenzie (Geneva), stipulated that parties to a contract may not be aware that an arbitration agreement is separable and distinct from the main contract between the parties. However, an arbitration agreement can be governed by a law that is different to the governing law of the main contract, and that parties can choose that law in advance?

In any contract with an Arbitration clause, the parties may need to agree on up to three applicable laws:

1. The substantive law of the contract (law applied to determine the merits of the dispute);

2. Law of the seat of the arbitration (the law which affects procedural matters such as appointment of Arbitrators, application to set aside an award); and

3. Law of the arbitration agreement (which governs the formation, interpretation and enforcement of the arbitration agreement) and which often parties do not pay much attention to spending time on agreeing upon.

The Hong Kong International Arbitration Centre (HKIAC) and the London Court of International Arbitration (LCIA) have given consideration to this issue and both have released model clause updates including giving consideration the HKIAC released an updated model clause which convey detailed wording and encouraging parties to take into account in their agreement a law governing the arbitration agreement in their contract.

The revised set of Arbitration Rules of the LCIA (which comes into effect on 1 October 2014) includes a new provision which expressly states the law governing the arbitration agreement is the law of the seat, unless the parties have agreed otherwise (Article 16.4).

Choosing the law of the arbitration agreement does it matter?

The law of the arbitration agreement governs the formation, validity, interpretation and enforcement of the arbitration agreement itself. That law can vary between jurisdictions. There may even be dramatic differences between common law jurisdictions such as England, Australia and India and civil law jurisdictions such as Germany, France and China.

For example, a frequently debated outcome of these disputes mostly arises in multi-party or multi-contract arbitrations, which are becoming increasingly common in large commercial disputes in view of the expanding globalisation of International Commercial Trades.

Such disputes often involve subsidiaries and other related entities which are not party to the contract and may not have consented and/or may not be bound by the arbitration clause.

In common law jurisdictions generally, Courts and Tribunals adopt a narrower view of consent than civil law jurisdictions, and therefore will only allow non-signatories to be considered.
"parties" to an arbitration agreement in limited circumstances. Even within the common law systems, there can be considerable departure from similar cases.

Nevertheless, parties that are aware of these differences and are able to choose an appropriate law for their arbitration clause will better place themselves at a considerable advantage when a dispute arises.

**Disadvantages of not specifying a Law for Arbitration?**

The court or the tribunal will choose the law governing the arbitration agreement which will be subject to much divergence between jurisdictions. Some jurisdictions apply the law of the seat of the arbitration; others apply the substantive law of the contract. The English courts look to the express or implied choice of the parties or otherwise the law with the "closest and most real connection" to the dispute.

Hence, choosing not to specify the law governing an arbitration agreement may lead to considerable delay and increase in cost of resolving an arbitrable dispute. Specifying the law of the arbitration agreement either expressly (as in the HKIAC model clause) or through the operation of the arbitral rules (the approach adopted by the LCIA) may aptly remove that uncertainty and regardless of the arbitral rules being used, parties should make sure the arbitration agreement expressly reflects their will of choice.

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