Determining the law of an arbitration agreement: the *Sulamérica* test in practice

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A recent decision of the English Commercial Court has clarified the legal test for determining the governing law of an arbitration agreement.

It is well established that an arbitration agreement is severable from the substantive contract in which it is recorded and that the two agreements may be governed by different laws. Despite this, contracts often include an express choice of law governing the substantive contract, while remaining silent as to the law governing the arbitration agreement. Parties commonly (but wrongly) assume that the law of the arbitration agreement is always the same as that governing the substantive contract.

In the 2012 *Sulamérica* decision, the English Court of Appeal formulated a three-stage test to determine the law of an arbitration agreement: (i) is there an express choice of law governing the arbitration agreement; (ii) if not, can a choice be implied; and (iii) in the absence of a choice, with which law does the arbitration agreement have the "closest and most real connection".

The recent decision of the Commercial Court in *Arsanovia Ltd & Ors v Cruz City 1 Mauritius Holdings* concerned the application of the *Sulamérica* test in circumstances where the parties had expressly chosen Indian law to govern the substantive contract and London as the seat of arbitration. Interestingly, both parties sought to rely upon the decision in *Sulamérica* in support of their conflicting positions as to the law of the arbitration agreement.

The case gave rise to debate concerning the relative significance of a governing law clause compared to a choice of seat when determining the law of an arbitration agreement. The court in *Arsanovia* was satisfied on the facts of the case that the parties had evinced an intention that Indian law was to apply to the arbitration agreement, the effect of which was that the arbitral tribunal was found not to have had jurisdiction to issue one of the two challenged awards. Although not decisive, the court was satisfied that the choice of law governing the substantive contract was a "strong pointer" toward the law of the arbitration agreement which could not be displaced alone by the choice of a seat in a foreign jurisdiction.

**The decision in *Arsanovia***

*Arsanovia* concerned a challenge under s. 67 of the Arbitration Act 1996 to the substantive jurisdiction of an arbitral tribunal which had issued awards against the claimants. The disputes between the parties arose under substantive contracts concerning the development of slum areas in Mumbai, both of which were expressly governed by Indian
law and contained arbitration agreements which were silent as to their governing law but which provided (among other things) for arbitration seated in London.

Following an unsuccessful challenge to its jurisdiction, the tribunal issued three awards. Two of those awards were challenged in the Commercial Court before Smith J on the basis that the law of the arbitration agreements was Indian law, and that in accordance with applicable provisions of Indian law the tribunal lacked jurisdiction.

The Sulamérica decision dictated that the starting point is whether the parties made express provision for the law of the arbitration agreement. Neither party argued that an express choice had been made, however Smith J indicated that he may have been receptive to a case that the express choice of Indian law in the substantive contract governing "This Agreement" should apply to all clauses of the contract, including the arbitration agreement.

The parties instead focused their argument upon the implied choice of law. In support of their position, the claimants relied upon the observation of Moore-Bick LJ in Sulamérica that the choice of governing law provided "a strong indication of the parties’ intention in relation to the agreement to arbitrate". On this basis, the claimants contended that by choosing Indian law to govern the substantive contracts the parties had impliedly also chosen Indian law as the law of the arbitration agreement. In contrast, Cruz City argued that the choice of London as the seat of arbitration implied instead a choice of English law as the law of the arbitration agreement.

Smith J rejected Cruz City’s argument that the choice of an English seat is tantamount to an implied choice of English law as that applicable to the arbitration agreement. Smith J cited Sulamérica as authority that the location of the seat is not of itself an implied choice of the law of the arbitration agreement.

Smith J determined that, although the choice of London as the seat of the arbitration was a factor to be considered, it was not by itself enough to displace the inference to be drawn from the express choice of Indian law to govern the substantive contract, which Moore-Bick LJ referred to in Sulamérica as "a strong pointer" that the parties intended the same law to apply to the arbitration agreement.

Smith J was further persuaded that the parties intended Indian law to govern the arbitration agreement by an express reference in the arbitration clause to the exclusion of certain provisions of the Indian Arbitration Act, from which Smith J accepted a natural inference was to be drawn that Indian law would otherwise apply.

Smith J therefore held that the parties had evinced an intention that Indian law would apply to the arbitration agreement, with the effect that the tribunal was held not to have jurisdiction in relation to one of the challenged awards. Notably, Smith J went on to say that, had he been required to determine with which system of law the arbitration agreement had the closest and most real connection (the third stage of the Sulamérica test), he would have concluded, having regard to the choice of London as the seat of the arbitration, that English law applied. However, in this case it was not necessary for the court to consider the third stage of the Sulamérica test.

Drafting dispute resolution clauses: the need for certainty

Arsanova highlights the importance of giving careful thought to the drafting of dispute resolution clauses, particularly arbitration agreements.

Parties should consider making express provision for the law of the arbitration agreement. Arsanova confirms that the law governing the arbitration agreement will not always be implied from an express choice of governing law nor an express choice of seat. The omission of an express choice of law to govern the arbitration agreement may lead to uncertainty and protracted jurisdictional challenges, placing parties at risk of incurring significant expense and delay, and of an award being set aside.

For more information about drafting dispute resolution clauses, please contact:
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1 Sulamérica Cia Nacional De Seguros SA & Ors v Enesa Engenharia SA & Ors [2012] EWCA Civ 638.
2 [2012] EWHC 3702 (Comm). The first instance decision in this case was reported on in the Q1 2012 *International Arbitration Newsletter*