GEDİK & ERAKSOY

How to Determine Which Law Governs the Arbitration Agreement?

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Introduction

The arbitration agreement constitutes the main source for the resolution of a dispute via arbitration. Drafting the arbitration agreement with care allows parties to resolve the disputes in an efficient and successful manner, and prevents future uncertainties and extra costs. One of the most important issues in drafting an arbitration agreement is definitely the choice of applicable law. International arbitration may involve different systems of law, governing different parts of the arbitration process, such as the law of the seat, the law governing the substantive contract, and the law governing the arbitration agreement. In practice, it is observed that while parties select the former two, an express choice of law regarding the arbitration agreement is often omitted. However, the issue of law governing the arbitration agreement needs to be resolved if a claim of invalidity against the arbitration agreement is raised. In this letter, we aim to provide you with a succinct overview of how the law governing the arbitration agreement should be determined.

Doctrine of separability

In a nutshell, the doctrine of separability allows an arbitration agreement to be considered independently from the substantive contract between the parties. It is not unheard that the parties claim the invalidity of an agreement which also contains an arbitration agreement in it. The doctrine of separability mandates that the arbitration agreement should be treated as an autonomous agreement. Therefore, the invalidity of the contract should not affect the invalidity of the arbitration agreement. Otherwise, the private dispute settlement process through arbitration would be undermined.

The doctrine of separability is also recognized under Turkish law. According to Article 4(4) of the Turkish International Arbitration Law No. 4686 (**TIAL**), objections against the arbitration agreement cannot be made on the grounds that the substantive contract is invalid. The Court of Cassations has accepted this approach in various decisions. For example, in its decision numbered E.2011/11-742, K. 2012/82 and dated 22 February 2012, the Court ruled that "*The arbitration agreement is an independent, separate agreement from the substantive contract. The separability of the arbitration agreement is also applicable for arbitration clauses which are placed within the substantive contract. Therefore, the validity of the arbitration clause does not depend on the validity of the substantive agreement.*"

The issue of law governing the arbitration agreement

Since the arbitration agreement is a separate, independent agreement, the law applicable to the arbitration agreement needs to be evaluated independently as well. If the parties have made a choice of law regarding the arbitration agreement, this law will govern the arbitration agreement. However, in international arbitration, agreements do not generally contain a specific choice of law clause regarding the arbitration agreement. Choices of law are made with regards to the law of the seat and the law governing the contract. Parties may assume that the applicable law clause applies to the arbitration agreement as well. However, the scope of this choice of law is limited to the substantive issues of the dispute. In other words, the selected law is the law governing the contract. Under the doctrine of separability, it will not be applied to disputes arising in relation to the arbitration agreement itself. In such disputes, e.g. an objection to the validity of the arbitration agreement, the court or the

arbitral tribunal must determine the law governing the arbitration agreement. The tribunals and the courts generally adopt the following approaches in this respect:

- **The law governing the contract**

  If the parties have made an express choice of law to be applied to the contract, it is not unreasonable to assume that it was also the will of the parties to choose this law as the law governing the arbitration agreement. This view is accepted in various arbitral decisions. For example, in the very recent judgment of the English Supreme Court regarding a dispute between Enka and Chubb, it was held that, the law of the arbitration agreement should be the same as the law of the contract, unless there is a good reason to depart from this principle. The two exceptions identified by the Supreme Court are: (i) contracts where applying the principle would mean that there is a significant risk that the arbitration agreement would be ineffective; and (ii) any law of the arbitration seat which indicates that the arbitration will also be treated as governed by that country's law. A detailed analysis of this landmark decision can be found here.

  Some argue that this approach is in contradiction with the doctrine of separability because it may not be the will of the parties to have the same system of law apply to the substantive contract and the arbitration agreement.

- **The law of the seat**

  There are instances where a court or an arbitral tribunal accepts the law governing the arbitration agreement as the law of the seat. This view is grounded on the doctrine of separability, stating that the arbitration agreement and the substantive contract are autonomous agreements with different qualities.

  The London Court of International Arbitration Rules accepts the law of the seat as the law governing the arbitration agreement, stating in Article 16(4) that "*the law applicable to the Arbitration Agreement and the arbitration shall be the law applicable at the seat of the arbitration, unless and to the extent that the parties have agreed in writing on the application of other laws or rules of law and such agreement is not prohibited by the law applicable at the arbitral seat.*"

  This approach was taken by different tribunals as well. For instance, in the *FirstLink Investments v GT Payment* decision[1], Singapore Supreme Court ruled that an arbitration agreement has a closer and more real connection with the place where the parties have chosen to arbitrate rather than with the place of the law of the main contract and decided that the arbitration agreement should be governed by the law of the seat.

  The tribunals may resort to this approach not only when they consider the law of the seat is the most relevant law to the arbitration agreement but also when applying the law of the contract may result in the invalidity of the arbitration agreement. In such cases, it is possible for courts and arbitral tribunals to decide in favour of the law of the seat to uphold the validity of the arbitration agreement. For example, in the famous *Sulamérica* decision[2], the presumption that the parties' choice of Brazilian law to govern the main agreement would extend to the arbitration agreement was rebutted on the basis that under Brazilian law the arbitration agreement was at risk of being ineffective. It was ultimately decided that the English law, the law of the seat, should govern the arbitration clause.

[1] FirstLink Investments Corp Ltd v GT Payment Pte Ltd and others, Singapore High Court, 19 June 2014, Case No: [2014] SGHCR 12
[2] Sulamérica CIA Nacional de Seguros SA & ors v Enesa Engenharia SA & ors [2012] EWCA Civ 638.

➢ Different approaches

There are also some other approaches with regards to the law governing the arbitration agreement. For example, the Swiss Federal Statute of Private International Law provides under Section 178(2) that "*As regards its substance, the arbitration agreement shall be valid if it conforms either to the law chosen by the parties, or to the law governing the subject-matter of the dispute, in particular the law governing the main contract, or if it conforms to Swiss law.*" This approach prioritizes upholding the validity of the arbitration agreement in different circumstances.

French courts have accepted a different approach, where the arbitration agreement is not subject to different national laws but the common intentions of the parties. This approach considers the autonomy of the arbitration agreement as being independent not only from the substantive contract, but also from national laws. The Court de Cassation's *Dalico* decision in 1993 states that, the existence and validity of the arbitration agreement shall be determined on the basis of the common intentions of the parties, subject to the mandatory rules of French law and international public policy.

The law governing the arbitration agreement under Turkish law

The TIAL applies when the dispute includes a foreign element and the place of arbitration is chosen as Turkey, or in cases where the TIAL is chosen as the law of the seat by the relevant parties, the sole arbitrator, or the arbitral tribunal. Under Article 4 of the TIAL, the validity of the arbitration agreement is subject to the law expressly chosen by the parties, and if no choice of law exists, to the Turkish law. Therefore, when drafting the arbitration agreements, the parties should bear in mind that the choice of the seat as Turkey also means that the validity of the arbitration agreement will be subject to the Turkish law and thus they must ensure that the validity requirements of the Turkish law are fulfilled.

Conclusion

As summarized above, the issue of law governing the arbitration agreement still remains unsolved and is subject to various discussions. Therefore, it will be prudent for the parties to add a section in their arbitration agreement determining the law governing the arbitration agreement to prevent any uncertainty in future disputes.

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