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**The Presumption of Validity**

A novel approach to determining the law which governs the arbitration  
agreement in the absence of party choice

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## **Abstract**

*Courts and tribunals have struggled with how to determine what law governs the arbitration agreement in the absence of party choice. The arbitration agreement, as a separable agreement, is not necessarily governed by the law of the substantive contract. The issue is complicated by the fact that arbitration agreements refer disputes to a particular seat of arbitration. Courts and tribunals have either applied a presumption that the agreement is governed by the law of the seat or the law of the substantive contract. This paper argues that there is a stronger case for applying a presumption of validity. The policy behind the New York Convention and the governing principle of international arbitration, the doctrine of separability, both support a view that the parties should be taken to have selected a choice of law which would give effect to their arbitration agreement. This approach would also be more in line with the intention of parties who enter agreements to arbitrate and would bring certainty to an area of law which is incoherent and in a state of flux.*

### **Keywords**

*Choice of Law – Arbitration agreements- Arbitral clauses- Absence of Party Choice – Sulamerica – Firstlink – C v D – The New York Convention – The Doctrine of Separability – Premium Nafta Products – The Law of the Seat – The Law of the Substantive Contract.*

*Word Count: 14,825*

***Dedication:*** *To my family, in the hopes that one day this kind of analysis will put food in your stomachs.*

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## *I Introduction*

Agreement between the parties is the core of arbitration. If there is no agreement to arbitrate, then there will be no arbitration.<sup>1</sup> An arbitration agreement (AA) is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship.<sup>2</sup> The agreement will in many cases be a clause in a substantive contract rather than being a physically distinct document.<sup>3</sup> In other cases, the agreement may be signed as a free-standing document at the time of the execution of the main contract, after the execution of the main contract, or after a dispute has arisen about the main contract.<sup>4</sup> An AA, whether embedded as a clause in a substantive contract or as a freestanding agreement, is a separable agreement.<sup>5</sup> Accordingly, the arbitration clause is capable of having a different choice of law than the main agreement;<sup>6</sup> the express choice of law for the substantive contract does not necessarily extend to the AA.<sup>7</sup>

The widely accepted approach to determining the choice of law for the AA is as follows:<sup>8</sup> Firstly, the court or tribunal will determine whether there has been an express choice of law. If no express choice is found, the court will decide whether the parties have by implication selected a law to govern their AA. The divergence of authority on the second limb that this paper addresses is whether there should be a presumption that the parties intended to select the law of the main contract to govern their AA, or whether the law of the chosen seat of arbitration was intended to govern the AA. If a court or tribunal does not find an implied choice, then it will examine which law the arbitral clause has the closest connection to, which is the law of the seat.

Deciding what law governs the AA in the absence of party choice is complex considering that three systems of law may bear on international arbitration:<sup>9</sup>

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<sup>1</sup> Lawrence Collins and Others *Dicey, Morris and Collins on The Conflict of Law* (14<sup>th</sup> ed, Sweet & Maxwell, London, 2006) vol 2 at 717.

<sup>2</sup> At 715.

<sup>3</sup> At 715.

<sup>4</sup> At 715.

<sup>5</sup> At 715.

<sup>6</sup> Louise Wilhelmsen *International Commercial Arbitration and the Brussels I Regulation* (Edward Elgar Publishing, Cheltenham, 2018) ch 4 at 81.

<sup>7</sup> Robert Merkin *Arbitration Law* (LLP Professional Publishing, London, 2004) at 193.

<sup>8</sup> At 190; and Collins, above n 1, at 712.

<sup>9</sup> *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd* [1993] 1 All ER 664 at 682.

- i) The law of the substantive contract.
- ii) The law of the AA.
- iii) The law of the seat of arbitration, which governs the relationship between the arbitrator and parties in the conduct of arbitration (Curial law).

To a reader unfamiliar with international arbitration such a division may seem needlessly complicated. Selecting different types of law to govern different aspects of the parties legal relationship reflects the flexibility of arbitration and its responsiveness to party autonomy and choice. In a domestic context parties will often be content to allow the domestic law to govern all aspects of their relationship, being on equal footing in a neutral legal order. In the international context parties may have competing interests and require the striking of a fair balance because of their origins in legal orders worlds apart.

Parties may decide that they want particular procedural rules to govern potential disputes, reflected in their choice of curial law.<sup>10</sup> This may differ from the law they choose for their substantive contract, which will be informed by the nature of said contract and the law which best balances the parties reasonable expectations and desires for their commercial relationship outside of the context of a dispute.<sup>11</sup> Lastly, the choice of law for the AA will be informed by parties' intentions regarding the scope, validity and termination of the agreement; when and what kind of disputes will and will not be submitted to arbitration.

Courts and tribunals have struggled with the question of how the choice of seat of arbitration and the substantive contract's law bears on the implication of party choice for the AA.<sup>12</sup> The broader debate is well captured when comparing the conflicting judgments of *Sulameria*<sup>13</sup> and *Firstlink*,<sup>14</sup> which disagree on whether the parties should be presumed to have impliedly chosen the law of the seat or the law of the contract to govern the AA. The conflict of approach between the courts in these two centres of arbitration is significant. Between 2012 and 2016 the London Court of Arbitration heard 1503 disputes, and the Singapore International Arbitration Center

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<sup>10</sup> Merkin, above n 7, at 191.

<sup>11</sup> At 195.

<sup>12</sup> This will be discussed comprehensively in sections II(D) and IV of this paper.

<sup>13</sup> *Sulamerica CIA Nacional De Seguros SA & Ors v Enesa Engenharia SA & Ors* [2012] EWCA Civ 638.

<sup>14</sup> *FirstLink Investments Corp Ltd v GT Payment Pte Ltd and others* [2014] SGHCR 12.

heard 1330 disputes.<sup>15</sup> These two seats heard over 11% of the disputes submitted to the key arbitration centres over this time period.<sup>16</sup> A conflict of approach on such a significant issue creates unacceptable uncertainty in the field. The Supreme Court of the United Kingdom has identified the uncertainty but has yet to decide the point.<sup>17</sup> As will be discussed in sections II(D) and IV of this paper, there has been no clear answer in civil or common law jurisdictions to the question of what law governs the AA in the absence of express party choice.

#### A *Why Does it Matter What Law Governs the AA?*

In *BCY v BCZ* the two parties disputed the law which governed the AA in the absence of party choice.<sup>18</sup> The plaintiff argued that the clause was governed by Singapore law, and the defendant argued that it was governed by New York law.<sup>19</sup> The Tribunal noted that there was no material difference between the two laws in respect of the formation of the AA.<sup>20</sup> The only difference between the legal systems was that New York law allowed claims for promissory estoppel and unjust enrichment to be brought.<sup>21</sup> The Judge noted that it really did not matter which law governed the AA, and only expressed a view on the issue because of the divergence between authorities and academics on the matter.<sup>22</sup>

Despite the difference between the competing laws in *BCY v BCZ* being non-material, often the governing law of the AA will be of paramount importance. The law governing the AA will bear on whether the agreement is valid, ineffective or incapable of being performed.<sup>23</sup> If the AA has any of these features the dispute may not be capable of submission to arbitration. The

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<sup>15</sup> Dr. Markus Altenkirch and Dr. Jan Frohloff “International Arbitration Statistics 2016 – Busy Times for Arbitral Institutions” (26 June, 2017) Global Arbitration News <https://globalarbitrationnews.com/international-arbitration-statistics-2016-busy-times-for-arbitral-institutions/>

<sup>16</sup> The key centers include; The International Chamber of Commerce; The German Institution of Arbitration; The Stockholm Chamber of Commerce; The Vienna International Arbitration Center; The Swiss Chamber’s Arbitration Institution; The London Court of International Arbitration; The International Center for Dispute Resolution; The Singapore International Arbitration Center; The China International Economic and Trade Arbitration Commission; The Hong Kong International Arbitration Center; The International Center for Settlement of Investment Disputes. <https://globalarbitrationnews.com/international-arbitration-statistics-2016-busy-times-for-arbitral-institutions/>

<sup>17</sup> *AES Ust-Kamengorsk Hydropower Plant LLP v Ust-Kamengorsk Hydropower Plant JSC* [2013] UKSC 35, [2013] Bus. L.R. 1357 at [6].

<sup>18</sup> *BCY v BCZ* [2016] SGHC 249 at [38].

<sup>19</sup> At [38].

<sup>20</sup> At [38].

<sup>21</sup> At [39].

<sup>22</sup> At [39].

<sup>23</sup> Merkin, above n 7, at 191.



law of the AA will also determine its scope; what disputes may or may not be submitted to arbitration.<sup>24</sup>

The validity of the agreement of particular practical significance because there is the potential for billion-dollar awards to be declared unenforceable on the grounds that the AA is invalid under the law the parties chose to subject it to.<sup>25</sup> There may be specific doctrines that do not exist in some legal systems but do in others, such as equitable estoppel in New York Law which allows third parties to sue on the AA.<sup>26</sup> Finally, the scope of the clause will be governed by the chosen law of the AA, which can be important when determining what disputes the parties intended to submit to arbitration.<sup>27</sup> For example, under art 36(1)(iii) of the UNCITRAL Model Law, if the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, the part of the award that relates to said dispute may not be recognised or enforced.<sup>28</sup>

Whether the agreement is void may attract different answers in different jurisdictions. For example, in the United States an AA may be ineffective if it was not freely negotiated between the parties, such as a standard term on a cruise line ticket.<sup>29</sup> However, the ability of the other party to freely negotiate the clause will not necessarily be a material fact in other jurisdictions, having no bearing on the validity of the AA. An Australian Court decided that one of the parties not signing the AA did not invalidate the clause;<sup>30</sup> A Swiss Court found that one of the parties not signing the agreement did invalidate the agreement.<sup>31</sup> The choice of law for the AA can be material when deciding whether it is effective in submitting a dispute to arbitration.

Because the choice of law for the AA is closely linked to the validity, enforceability and scope of said agreement, the questions of why and when courts should recognise the validity of an

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<sup>24</sup> At 191.

<sup>25</sup> Convention on the Recognition and Enforcement of Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959), art V(1)(a).

<sup>26</sup> *BCY v BCZ*, above n 18, at [39].

<sup>27</sup> Gary B. Born *INTERNATIONAL COMMERCIAL ARBITRATION* (2nd ed, Kluwer Law International, Netherlands, 2014) at 489.

<sup>28</sup> *UNCITRAL Model Law on International Commercial Arbitration* GA Res 61/33 (2006).

<sup>29</sup> *The Bremen v. Zapata Off-Shore Co* 407 U.S. 1 (1972).

<sup>30</sup> *Altain Khuder LLC v. IMC Mining Inc and IMC Mining Solutions Pty Ltd* [2011] VSCA 248.

<sup>31</sup> *Camera di esecuzione e fallimenti del Tribunale d'appello, Repubblica e Cantone Ticino*, Switzerland, 22 February 2010, 14.2009.104.

AA cannot be considered in isolation from the question of the choice of law. Accordingly, arguments in favour of recognizing the validity of arbitral clauses must be considered when deciding what law governs the AA.

### *B This Paper's Structure and Argument*

This paper will first discuss the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (The New York Convention) and the underlying policy discovered in the travaux préparatoires. Despite this key instrument dealing with the validity and choice of law of arbitration clauses, the author will detail the unsettled state of the law across civil and common law jurisdictions. The doctrine of separability, which is both the author of and possible solution to the choice of law problem, will be the conceptual basis on which notable decisions made in international arbitration jurisprudence are analysed. The paper will then compare the approach of said arbitral agreements to choice of law under Rome I, and implication of terms under the common law and the UNIDROIT Principles. Finally, the author will offer his opinion on what approach would best resolve the confused state of law.

This paper will argue that in the absence of express party choice the AA should be presumptively governed by the choice of law that would allow the dispute to be submitted to arbitration. The author suggests this presumption should be called the presumption of validity. Where there is competition between the law of the seat and law of the substantive contract, and either would allow the dispute to be submitted to arbitration, the court or tribunal should not find a party choice and instead identify the law that the agreement has the closest connection to; this approach will be conducive of the clause's validity and any subsequent award's recognition because it aligns the choice of law test with the art V(1)(A) of the New York Convention, which will be discussed more fully in section II(A) of this paper. If there is clear evidence that the parties did impliedly select a particular law, then the presumption should succumb to the facts of the case, and the evidenced law should be applied.

A presumption of validity is more aligned with the reasonable expectations of the parties, the doctrine of separability, and approaches taken in contract interpretation and implication of terms. The merits of this approach will be discussed more fully in section VII once the substantiating reasons are canvassed in detail in the body of this paper.

## II *Choice of Law in International Arbitration*

### A *The New York Convention*

Article V(1)(a) of the New York Convention explains the effect of invalidity of the AA on the recognition and enforcement of the relevant award.<sup>32</sup> If the AA is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made, then the award may not be recognised or enforced.<sup>33</sup> The country where the award is made is the place of the seat of arbitration.<sup>34</sup>

Article II of the New York Convention requires contracting states to recognise AAs.<sup>35</sup> The Article is directed to national courts and arbitrators are not required to apply it.<sup>36</sup> The purpose of the Article is to recognise AAs as valid so as to facilitate the enforcement of arbitration internationally.<sup>37</sup> The circumstances in which a national court could deem the AA null, void or incapable of performance are thought to be limited to defences such as fraud, lack of consent or unconscionability.<sup>38</sup> The limited circumstances in which a court can find an arbitral clause to be invalid are narrow because of the pro-enforcement bias of the convention.<sup>39</sup>

#### 1 *Travaux préparatoires*

The travaux préparatoires of the New York Convention reveal a number interesting insights on the question of when and why validity of AAs should be recognised; and how courts should approach choice of law when applying article V(1)(a). The summary records of the United Nations Conference on International Commercial Arbitration saw a number of state

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<sup>32</sup> Convention on the Recognition and Enforcement of Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959), art V(1)(a).

<sup>33</sup> Art V(1)(a).

<sup>34</sup> *Dallah Real Estate and Tourism Holding Company v. Ministry of Religious Affairs* [2008] EWHC 1901, upheld by *Dallah Real Estate and Tourism Holding Company v. Ministry of Religious Affairs* [2010] UKSC 46.

<sup>35</sup> Convention on the Recognition and Enforcement of Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959), art 2.

<sup>36</sup> Wilhelmssen, above n 6, at 85.

<sup>37</sup> At 85.

<sup>38</sup> At 97.

<sup>39</sup> At 97.

representatives grapple with the issues dealt with by this paper, including the validity, scope and choice of law for the arbitral clause.

In the second meeting of the conference the Italian representative argued that the question of the validity of the AA should be dealt with alongside the Convention on the recognition and enforcement of awards because the two questions are so closely linked.<sup>40</sup> Before the New York Convention the question of validity was addressed by the 1923 Geneva Protocol on Arbitration Clauses. The Protocol said that Contracting States should recognise the validity of an AA.<sup>41</sup> While some states thought the question of validity of the AA and recognition and enforcement of the award were distinct and the former outside of the scope of the discussion,<sup>42</sup> the Conference voted in favour of its own competence to table the issue.

Sweden and Poland both proposed provisions similar to the 1923 Geneva Protocol to be included in the convention, which would require contracting states to recognise the validity of the AA.<sup>43</sup> Poland said that the amendment would have the advantage of making international transactions more secure by preventing parties from evading arbitrations to which they had agreed, promoting commercial certainty in the field.<sup>44</sup> Turkey pointed out in the ninth meeting that such a provision would encourage commercial parties to enter into AAs, remedying a serious omission in the current draft form of the convention.<sup>45</sup>

The reference to the “law of the country in which the award was made” now contained in Article V(1)(a) was not included in the draft convention until very late in the travaux préparatoires, in meeting 23.<sup>46</sup> On the 6 June 1958 the draft text read “the AA is not valid under the law applicable to it; or”. On 9 June 1958 the USSR suggested that “the law applicable”

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<sup>40</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.2 (1958).

<sup>41</sup> Protocol on Arbitration Clauses 157 LNTS 27 (opened for signature 24 September 1923, entry into force 28 July 1924).

<sup>42</sup> Representatives from Belgium, Guatemala, El Salvador and the Netherlands all raised objections. In the seventh meeting India made a forceful rebuttal, saying that objections based on scope were without substance because the question of validity and the recognition and enforcement of the award were inextricably linked.

<sup>43</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.7 (23 May 1958).

<sup>44</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.9 (26 May 1958).

<sup>45</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.9 (26 May 1958).

<sup>46</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.23 (9 June 1958).

should be defined; and therefore proposed that the Article be rephrased to read “not valid under the national law to which the parties have subjected their agreement or, failing any indication thereon, under the law of the country where the award was made.”<sup>47</sup> Norway thought it would be simpler to delete any reference to the applicable law, instead proposing it should read: “the AA is not valid.”<sup>48</sup> Norway’s proposal was rejected, and the USSR’s proposal was adopted.<sup>49</sup>

Despite a great deal of debate being had over whether the question of whether states should have to recognise the validity of the AA, little was said of the inclusion of the sub article reading “under the law of the country where the award was made.” Speculatively one might guess that it was included to ameliorate representatives concerns that any question of validity needed to be connected to the award to justify it being an issue addressed by the convention.<sup>50</sup>

The reference to the law of the country in which the award was made may have also been influenced by the responses to Israel’s proposal that the validity of the AA could be determined in reference to the law of the country in which the award was to be enforced.<sup>51</sup> Israel argued that there needed to be a rule which determined which law should govern the validity because simply including the words “invalid under the law applicable to the AA” was far too obscure and vague to be workable.<sup>52</sup> France thought that the question of what law is applicable to the AA is a question to be resolved by the courts and outside of the competence of the convention.<sup>53</sup> El Salvador thought that the question of what jurisdiction should decide the validity was essential to the convention.<sup>54</sup>

France said that allowing the country in which the award was sought to be enforced to determine the validity of the clause would cause serious problems and result in their refusal to

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<sup>47</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.23 (9 June 1958).

<sup>48</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.23 (9 June 1958).

<sup>49</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.23 (9 June 1958).

<sup>50</sup> A point made by Germany, Turkey and Israel in meeting 9.

<sup>51</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.11 (27 May 1958).

<sup>52</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.11 (27 May 1958).

<sup>53</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.13 (28 May 1958).

<sup>54</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.13 (28 May 1958).

accede to the convention.<sup>55</sup> El Salvador made a forceful complaint that it was inappropriate to allow the enforcing state to look into the substance of the matter.<sup>56</sup> The validity of the arbitration clause should be determined not by the enforcing state, but instead the State under the law of which that clause had been drawn up.<sup>57</sup>

One might then speculate that the inclusion of “under the law of the country where the award was made” was designed to ensure that if the award was challenged in the enforcing state, it would be determined according to the law of the state where the award was made; striking a balance between the states who thought the validity of the agreement was too linked to the original aims of the convention to exclude and the states who thought allowing the enforcing state to determine validity would create serious problems. Significantly, directing the courts to apply the law of the seat in the post award stage will ensure the agreement will be valid, as the award would not have been granted if the law of the seat had invalidated the agreement to arbitrate.

#### *B UNCITRAL Model Law*

UNCITRAL approaches the issue in a similar fashion to the New York Convention. Article 36 provides grounds for refusing the recognition or enforcement of the award.<sup>58</sup> Article 36(1)(a)(iv) suggests that an award may not be recognised or enforced if the composition of the arbitral tribunal or arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.<sup>59</sup>

#### *C Significance of Finding the Law of the Seat as the Governing Law of the AA*

Two observations result from the analysis of the travaux préparatoires and the New York Convention. First, a majority of state representatives noted that the question of the AA’s

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<sup>55</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.11 (27 May 1958).

<sup>56</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.13 (28 May 1958).

<sup>57</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.13 (28 May 1958).

<sup>58</sup> *UNCITRAL Model Law on International Commercial Arbitration* GA Res 61/33 (2006), art 36.

<sup>59</sup> Art 36(1)(a)(iv).

validity was essential to the recognition and enforcement of awards. The proposed requirement that contracting states should recognise the validity of the agreement reflects a desire for a presumption that the agreement should be valid. Second, the travaux préparatoires show that representatives were conscious of the fact that the question of the choice of law for the AA was essential to the mandate of the conference. Representatives noted the unacceptable uncertainty that would be created in arbitration if the question of validity and the choice of law that determines the agreement's validity was not dealt with adequately; the "law applicable to the agreement" with no further reference to how such a question would be resolved being too vague to achieve the aims of the convention.

The significance of finding the law of the seat as being the governing law of the AA is that, in practical terms, such a finding would in most circumstances result in the AA being valid. The award would not have been made if an application of the law of the seat had resulted in the AA being invalid. A preference for the law of the country in which the award was made at the point of enforcement is in effect a preference for a system of law which would find the arbitration clause to be valid. The reference to the law of the seat also suggests that the seat should apply its law when there has been no party choice, which will ensure the award will be effective at the enforcement stage. This is an important point to be kept in mind when canvassing this paper.

#### *D The Confused State of the Law*

There has been no clear answer to the question of what law governs the AA in the absence of party choice. The French representative's comment in the travaux préparatoires of the New York Convention about the question of the law applicable to the AA being best resolved by the courts appears to have been highly optimistic.<sup>60</sup>

Traditionally in English law the courts may take the law of the substantive contract to have been reasonably intended to govern the arbitral clause in the absence of party choice.<sup>61</sup> This position has been revised following the decision by the English High Court, who held that the

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<sup>60</sup> United Nations Economic and Social Council *New York Conference 1958: Session Records* E/CONF.26/SR.13 (28 May 1958).

<sup>61</sup> *Cia Maritima Zorroza SA v Sesostris SAE* [1984] 1 Lloyd's Rep. 652; and *Union of India v McDonnell Douglas Corporation* [1993] 2 Lloyd's Rep. 48.

law of the seat may apply notwithstanding an express choice of law in the main contract;<sup>62</sup> this conclusion should be noted particularly because the substantive contract's choice of law would have resulted in the arbitration clause being invalid, suggesting the Court was in part influenced by a presumption of validity. The High Court of Australia applied Article V(1)(a) of the New York Convention and decided that the applicable law was that of the seat rather than the law of the substantive contract.<sup>63</sup>

The Court in *C v D*<sup>64</sup> held that where there is direct competition between the law of the seat and the law of the substantive contract, the arbitral agreement is governed by the system of law that it has the closest connection to.<sup>65</sup> Accordingly, there have been at least three different approaches in English law to the question of choice of law. Interestingly, Robert Merkin has noted that in principle English courts might disregard an express choice of law for the arbitral clause if that system of law does not recognise the validity of AAs.<sup>66</sup>

The confusion extends beyond the commonwealth and similarly plagues the civil law jurisdictions. Germany is a Model Law country.<sup>67</sup> The Karlsruhe Court of Appeal indicated that in the absence of party choice, the law of the seat of arbitration will apply;<sup>68</sup> in part influenced by the preparatory works for art 16 of the Model Law which would apply the choice of law rules in art 34 at the pre-award stage.<sup>69</sup> However, the Hamburg Court of Appeal found that unless the parties had chosen a specific law to govern their AA, the law of the substantive contract would apply.<sup>70</sup>

The Supreme Court of Austria, when applying Article V(1)(a), declared that in the absence of party choice the law applicable to the AA is the law of the country in which the award is made.<sup>71</sup> The Swedish Court of Appeal went even further, applying the law of the country where the

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<sup>62</sup> *XL Insurance Ltd. v Owens Corning* [2000] 2 Lloyds Rep. 500.

<sup>63</sup> *Altain Khuder LLC*, above n 30.

<sup>64</sup> *C v D* [2007] EWCA Civ 1282.

<sup>65</sup> *Wilhelmsen*, above n 6, at 124.

<sup>66</sup> *Merkin*, above n 7, at 194.

<sup>67</sup> *Wilhelmsen*, above n 6, at 120.

<sup>68</sup> At 120.

<sup>69</sup> At 120.

<sup>70</sup> *Buyer (Poland) v Seller (Poland)*, *Hanseatisches Oberlandesgericht*, case no.: 11 SCH 06/01, Jan. 2003, in *Y.B. Com. Arb.*, Vol. XXX, p. 516.

<sup>71</sup> *K v. F AG, Oberster Gerichtshof*, Austria, 23 October 2007, XXXIII *Y.B. Com. Arb.* 354 (2008).



award was made without even considering whether the parties had made an express or implied choice of law for their AA.<sup>72</sup>

The French courts have taken a novel approach to deciding the choice of law for the AA; under French law the AA is independent from national laws in addition to being separate from the main agreement.<sup>73</sup> The existence and effectiveness is judged by reference to mandatory rules of French law and international public policy, in accordance with the common intention of the parties, with no need to refer to national laws.<sup>74</sup> The French approach reflects a clear preference for an extreme doctrine of separability, because the arbitral clause is not only separate from the main agreement but also a national system of law.<sup>75</sup> The French Supreme Court found that an arbitration clause was valid on the basis on the principle of the validity of arbitration clauses.<sup>76</sup>

It is clear that there is a diversity of approaches to determining choice of law of an AA. The author proposes a return to fundamental principles of arbitration to see whether a superior approach may be devised.

### *III The Doctrine of Separability*

The doctrine of separability treats an agreement to arbitrate as distinct from the main contract in which it may be embedded.<sup>77</sup> This doctrine allows the arbitration clause to survive the main contract, so disputes about the contract may be submitted to arbitration, despite the main contract not being legally operative at the time the dispute clause is exercised.<sup>78</sup> The doctrine is internationally recognised as a governing principle of arbitration, and should be given according weight;<sup>79</sup> “*it is part of the very alphabet of arbitration law.*”<sup>80</sup> As mentioned, a

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<sup>72</sup> *Planavergne S.A., Fontanes v. Kalle Bergander i Stockholm AB*, Svea Court of Appeal, Sweden, 7 September 2001, T 4645-99.

<sup>73</sup> Wilhelmsen, above n 6, at 126.

<sup>74</sup> At 126.

<sup>75</sup> At 126.

<sup>76</sup> *M. Zanzi v J. de Coninck et autres, Cour de Cassation*, The French Supreme Court, France, Jan. 1999, *Revue de l'Arbitrage* 260 (1999).

<sup>77</sup> Collins, above n 1, at 716.

<sup>78</sup> At 717.

<sup>79</sup> Wilhelmsen, above n 6, at 81.

<sup>80</sup> *Lesotho Highlands Development Authority v Impregilo SpA* [2005] UKHL 43, [2006] 1 A.C 221 at [21].

consequence of the doctrine is that the express choice of law for the substantive contract does not necessarily extend to the AA.<sup>81</sup>

A contract may not be capable of enforcement for a variety of reasons. It may have been cancelled, terminated, repudiated, frustrated, illegal, not in compliance with legal formalities or initially invalid due to a lack of consensus ad idem.<sup>82</sup> If the AA were part of the main contract, it would be similarly incapable of enforcement.<sup>83</sup> Therefore, disputes about these very situations would not be capable of submission to arbitration unless the arbitration clause survives the demise of the main contract.<sup>84</sup>

The question this section will address is whether the court simply deploys a legal fiction when applying the doctrine of separability: is the arbitration clause only to be treated as a separate agreement for the specific purpose of allowing a category of disputes to be submitted to arbitration? Or in reality have the parties entered into two separate contracts which may survive each other? Many of the reasons given in support of the presumption that the parties intended to choose the law of the substantive contract are premised on the view that the AA and the main contract form components of one distinct relationship, whereas the judgments in support of the seat of arbitration are premised on the view that the agreements are distinct and create two different relationships.<sup>85</sup>

Even if separability does not create two distinct agreements, the doctrine could be undermined by a presumption in favour of the substantive contract. For example, if a contract is void under a system of law, and the AA is governed by that law, it will also be void. This would result in disputes about the invalidity of the contract being incapable of submission to arbitration, which could defeat the purpose of even a weak doctrine of separability. The Court in *Sulamerica* argued that the doctrine of separability only insulated the arbitration clause from the main agreement's invalidity, but not for other purposes, suggesting that it should not operate to influence the inferred choice of law.<sup>86</sup> However, this fails to appreciate that the doctrine could not operate without influencing the choice of law of the arbitration clause, because having the

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<sup>81</sup> Merkin, above n 7, at 193.

<sup>82</sup> At 191.

<sup>83</sup> At 191.

<sup>84</sup> At 191.

<sup>85</sup> This will be discussed more fully in section IV.

<sup>86</sup> *Sulamerica*, above n 13, at [18].

same choice of law for both agreements could result in the arbitration clause not surviving the main contract's demise.

## A *Genesis of the Doctrine*

The separability doctrine began as a matter of contractual construction.<sup>87</sup> Courts would construe the wording of an arbitration clause to determine which disputes the parties intended to be submitted to arbitration.<sup>88</sup> If the clause could be so construed, then it would remain effective despite the termination or ineffectiveness of the substantive contract.<sup>89</sup> *Heyman v Darwin*<sup>90</sup> is frequently cited as a foundational case in the doctrine's acknowledgement and acceptance in the common law. In *Heyman* an arbitration clause survived a repudiatory breach because the parties intended the scope of the arbitration clause to include disputes about repudiatory breaches.<sup>91</sup> The doctrine accordingly has its origins in contractual interpretation and construction.

### 1 *Close Reading of Heyman*

Viscount Simon L.C. said that a party who denies they entered into the main agreement would necessarily be denying they agreed to arbitrate.<sup>92</sup> The reason why the disputes about the repudiation of the contract were capable of being submitted to arbitration is that the contract, and therefore the AA, was binding at the outset;<sup>93</sup> the parties are taken to have intended that the clause would remain binding despite being relieved of all other obligations under the contract, to give effect to their intention that disputes about repudiatory breaches would be submitted to arbitration.<sup>94</sup> The parties may also intend that the arbitration clause would be operative when the contract ends, such as in the event of frustration, despite all other obligations being discharged in the event.<sup>95</sup>

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<sup>87</sup> *Premium Nafta Products Limited and Ors v Fili Shipping Company Ltd and Ors* [2007] UKHL 40 at [11].

<sup>88</sup> At [11].

<sup>89</sup> At [11].

<sup>90</sup> *Heyman v Darwin* [1942] A.C. 357.

<sup>91</sup> *Heyman*, above n 90.

<sup>92</sup> At 366.

<sup>93</sup> At 366.

<sup>94</sup> At 366.

<sup>95</sup> At 367.

Lord Wright, on the other hand, argued that the AA was procedural, ancillary and collateral to the main agreement. While this could be read as “collateral to the purpose of the main contract, he also later referred to the clause as a “collateral agreement”.<sup>96</sup> This suggests that Lord Wright considered the AA to be a collateral contract, i.e. a promise to arbitrate is supported by consideration in the form of entry into the substantive contract. Such an analysis would create a second contract.

Lord Porter said that he saw no reason why the parties would not in some circumstances want disputes about the non-existence of the contract to be submitted to arbitration, although he thought clear language would be needed to effect this result.<sup>97</sup> He explicitly said that such an agreement would have to be collateral to the main agreement, but saw no reason why this would conflict with principle.<sup>98</sup>

## 2 *Analysis*

The majority ruling in *Heyman* supports the view that the AA is not a separate contract. The clause does not survive the initial ineffectiveness of the main contract because it is not distinct – it lives and falls with the substantive contract. The clause will be treated like every other term of the agreement, and be invalid.

The majority, who did not think that disputes about the initial invalidity of the contract could be submitted to arbitration, never made reference to the agreement as a collateral or separate. The minority judges, who did think that questions of initial ineffectiveness or invalidity could be submitted to arbitration, described the agreement as collateral to the main agreement.

Conceptually, both analytical methods makes sense. If the arbitration clause were a term of the contract, and not separate, it would still be capable of submitting disputes about frustration or repudiatory breaches to arbitration if the parties intended that it would remain binding in those circumstances. However, if the contract is allegedly initially void and the AA is part of the

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<sup>96</sup> At 378.

<sup>97</sup> At 392.

<sup>98</sup> At 392.

contract then both will be void. This reflects the logical principle that nothing may result from nothing.<sup>99</sup>

However, if the agreement is collateral there is no reason why the initial invalidity of the contract should necessarily invalidate the AA. They are separate contracts that require individual assessments of their validity. Any judgment which allows the clause to survive the main contracts validity must at a minimum conceptualise it as a collateral contract; subsequent judgments went further than this collateral contract analysis.

## *B Modern Decisions*

### *1 Harbour Assurance*

*The Harbour Assurance* case held that arbitration clauses survive the initial invalidity of the main contract. Both the Queen's Bench Division (Commercial Court) and Court of Appeal made valuable insights regarding the nature of the doctrine of separability. In the Commercial Court Steyn J engaged in a detailed discussion of the doctrine which could shed light on the distinctiveness of the agreements.

Steyn J said that there has been a remarkable shift in the approach of English Courts to AAs, reflecting the recession of judicial scrutiny regarding arbitration and broadening the scope of disputes the courts will allow the parties to submit to their chosen tribunal.<sup>100</sup> The fates of the AA and substantive contract are only linked if they are conceptualised as a single contract.<sup>101</sup> However, Lord Steyn said that the current law is that the arbitration clause is in the same position as an AA contained in a separate document but executed at the same time as the main contract.<sup>102</sup>

Lord Steyn contrasted three types of free-standing AAs:<sup>103</sup> one concluded after the dispute has arisen, one concluded after the contract but before the dispute has arisen, and one executed at the same time as the main contract.<sup>104</sup> All three would not suffer the defects of the main

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<sup>99</sup> *Harbour Assurance Co. Ltd v Kansa General International Insurance* [1992] 1 Lloyd's L.Rep 81 at 85.

<sup>100</sup> At 88.

<sup>101</sup> At 92.

<sup>102</sup> At 86.

<sup>103</sup> At 86.

<sup>104</sup> At 86.

contract's validity, and there is no distinction between the treatments of all three freestanding agreements.<sup>105</sup> Because there is no distinction between the three forms of freestanding AAs, and no distinction between a freestanding agreement executed the same time as the substantive contract and an embedded agreement;<sup>106</sup> it logically follows that Steyn J thinks all AAs should be treated as if they were free-standing. Steyn J argued that not allowing the doctrine to preserve the AA would seriously undermine the usefulness of international arbitration.<sup>107</sup>

The Court of Appeal upheld Steyn J's view that the arbitration clause would survive initial invalidity.<sup>108</sup> Hoffman LJ held that the presumed intention of the parties was to have 'one-stop adjudication' by referring all disputes to arbitration.<sup>109</sup> However, the Court held that there would be some circumstances where the initial invalidity of the contract necessarily meant that there was no agreement to arbitrate.<sup>110</sup> For example, a lack of contractual capacity could result in both agreement being void.

The *Harbour Assurance* case established that a dispute about in non-existence or invalidity of the main contract is capable of being submitted to arbitration.<sup>111</sup> However, the arbitration clause would not be protected when the contract fails to form for a reason that also impacts the AA.<sup>112</sup> For example, a lack of intention to be legally bound could result in both agreements failing to form.<sup>113</sup> The significance of the case is that it went far further than the minority in *Heyman* and explicitly said that the agreements are to be treated as freestanding even if one is embedded in the other, rather than conceptualising the clause as a collateral agreement.

## 2 *Premium Nafta Products Limited and Ors*

This House of Lords decision is considered the leading authority on the doctrine of separability in common law jurisdictions. The case involved the construction of an arbitration clause to measure its scope and determine which disputes may be submitted to arbitration.<sup>114</sup> Lord

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<sup>105</sup> At 87.

<sup>106</sup> At 86.

<sup>107</sup> At 87.

<sup>108</sup> *Harbour Assurance Co. Ltd. v. Kansa General International Insurance Co. Ltd* [1993] 3 WLR 42.

<sup>109</sup> At 62.

<sup>110</sup> At 62.

<sup>111</sup> At 72.

<sup>112</sup> At 62.

<sup>113</sup> *Galliard Homes Ltd v J Jarvis & Sons Plc* (1999) 71 Construction LR 219.

<sup>114</sup> *Premium Nafta Products*, above 87, at [5].

Hoffman said that the scope of an AA is dependent on the parties' respective intentions as expressed in their AA.<sup>115</sup> The words the parties choose will be read against the commercial background and the purpose of the agreement.<sup>116</sup>

Lord Hoffman explained the purpose of an arbitration clause will generally be as follows: The parties entered into a business relationship agreed to refer disputes that may occur in the course of this relationship to arbitration.<sup>117</sup> They want the disputes decided by a tribunal they have chosen, for the purpose of neutrality, privacy, expertise, the efficiency of the procedural law and for quick resolution of disputes.<sup>118</sup> Lord Hoffman explained that it would be surprising if the parties chose some disputes to be submitted to arbitration, but not others.<sup>119</sup> A strange distinction would be created if a dispute about repudiation could be submitted to arbitration, but not a dispute about misrepresentation.<sup>120</sup>

The principle of separability means that an attack on the main contract will not invalidate the arbitration clause.<sup>121</sup> A party will have to show that the AA itself is invalid.<sup>122</sup> However, Lord Hoffman repeated his comments regarding situations where an attack on the main agreement could also be put to the arbitration clause;<sup>123</sup> in that circumstance you do not have to attack the validity of the main contract to argue your case.

Lord Hoffman also ended the linguistic approach to construction that had at times unduly restricted the types of disputes capable of submission to arbitration.<sup>124</sup> For example, if the clause said "all disputes arising under the contract shall be submitted to arbitration" rather than "arising out of the contract", previous courts held that the parties did not intend disputes about the validity of the contract to be arbitrated.<sup>125</sup> Lord Hoffman thought such an approach did commercial law no credit, especially because draftsmen considered the terms to be

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<sup>115</sup> At [5].

<sup>116</sup> At [5].

<sup>117</sup> At [6].

<sup>118</sup> At [6].

<sup>119</sup> At [28].

<sup>120</sup> At [28].

<sup>121</sup> At [35].

<sup>122</sup> At [35].

<sup>123</sup> At [17].

<sup>124</sup> At [11].

<sup>125</sup> At [11].

interchangeable.<sup>126</sup> Instead, there should be an assumption that rational businessmen are likely to have intended any dispute arising out of their relationship they entered, or purported to enter, by the same tribunal.<sup>127</sup> This assumption can be displaced by clear language that excludes certain types of disputes.<sup>128</sup>

The reasoning deployed in this case is of particular significance when deciding what law the parties' intended to govern the AA. The author's contention is that the parties' intention that the disputes should be arbitrated supports an implied choice of law that would allow the arbitral clause to be enforceable and/or valid. This will be discussed in more detail in section VII.

### *C Distinct Agreements?*

Common law jurisprudence supports the view that the agreements are separate contracts. The minority in *Heyman* said an AA would survive the initial invalidity of the main contract, and referred to the clause as a collateral agreement. The majority, who did not think that the clause survived initial invalidity, did not use any language that suggested the AA is distinctive from other terms of the contract. The subsequent cases that adopted the minority view in *Heyman* continued to use language and methods of argumentation premised on a view that the main contract and AA are separate.

In addition to the common law, common sense dictates that the doctrine separability reflects the parties' intention to enter into two distinct agreements. The doctrine cannot functionally work unless one is to treat the AA and the main contract as two distinct contracts that are executed contemporaneously. It is not enough to say that the court will treat the AA as binding notwithstanding the main contract's defects; one should not be quick to allow the courts to deny the logical principle that nothing may result from nothing without scrutiny.<sup>129</sup> The only way the agreement could survive the main contract without conceptual incoherence would be to say the parties entered into two separate contracts. The French courts go so far as to say that the arbitral clause is separate from any national system of law in addition to the main agreement.<sup>130</sup> The parties intended to make two distinct agreements to give effect to their

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<sup>126</sup> At [12].

<sup>127</sup> At [13].

<sup>128</sup> At [13].

<sup>129</sup> *Harbour Assurance*, above n 98, at 85.

<sup>130</sup> *Wilhelmsen*, above n 6, at 126.



intention that they would have all disputes arising out of their relationship determining by a single neutral tribunal.<sup>131</sup>

The doctrine of separability is underpinned by a strong presumption that the parties intended that the arbitral clause should remain valid despite the invalidity of the main agreement.<sup>132</sup> It cannot be reasonably argued that the doctrine of separability is simply a policy direction to national courts to recognise AAs; the case law refers the doctrine to what would have been reasonably intended by the parties. The national courts are already under an obligation to recognise the validity of AAs under Article II of the New York Convention.<sup>133</sup> Additionally, the doctrine of separability has been recognised for jurisdiction agreements which do not fall within the scope of the New York Convention;<sup>134</sup> accordingly, the doctrine originates from the reasonable expectations of the parties.<sup>135</sup>

#### *IV Conflicting Case Law*

##### *A Sulamerica and Firstlink*

The conflict over the what law should presumptively govern the AA in the absence of party choice is stark when comparing the decisions of the High Court of Singapore and the English Court of Appeal (Civil Division). Because the two judgments sit at opposite ends of the debate over which presumption should be applied in the absence of party choice, it is useful to detail the reasoning offered by each and the subsequent jurisprudence to examine whether either presumption has a justified basis. Firstly, a description of what each court held and why will be provided. Secondly, the summary of reasons provided by the courts for preferring their chosen presumption will be detailed. Lastly, this paper will discuss which approach is more conceptually coherent and consistent with principle.

##### *1 Sulamerica*

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<sup>131</sup> *Sulamerica*, above n 13, at [9].

<sup>132</sup> *Harbour Assurance Co*, above n 119, at 62.

<sup>133</sup> *Wilhelmsen*, above n 6, at 85.

<sup>134</sup> Adrian Briggs *Agreements on Jurisdiction and Choice of Law* (Oxford University Press Inc, New York, 2008) at 81.

<sup>135</sup> At 81.

*Sulamerica* involved a dispute about an insurance policy which had an arbitration clause naming London as the seat of arbitration, but also an express choice of Brazilian law to govern the substantive contract.<sup>136</sup> The arbitration clause did not have an express choice of law.<sup>137</sup>

The insured attempted to restrain the insurers from bringing the dispute to arbitration, on the grounds that under Brazilian law the arbitration clause could only be invoked with their consent.<sup>138</sup> Under English law the insurers would be able to invoke the clause without additional consent.<sup>139</sup> The choice of law of the AA was material in deciding whether the dispute could be submitted to arbitration.

The Court of Appeal advocated for a three-stage inquiry for determining the law governing the AA.<sup>140</sup> The choice of law is to be determined in accordance with the established common law rules of any contract;<sup>141</sup> first, whether there had been an express choice of law; second, whether the parties' choice of law can be implied; and third, which system of law the agreement has the closest and most real connection. Because the Court did not find an implied choice, they decided the case on the basis that the AA had the closest connection to and was governed by the law of the seat.<sup>142</sup>

*Sulamerica* stands for the proposition that in the absence of an express choice of law, there is a rebuttable presumption that the parties intended the AA to be governed by the law of the substantive contract.<sup>143</sup> There were a number of reasons explained in *Sulamerica* which justified the presumption; commercial practice indicates that only in exceptional circumstances will the parties select a choice of law for their AA which differs from that of the substantive contract.<sup>144</sup> Additionally, the parties are likely to have intended the totality of their contractual relationship to be governed by one system of law.<sup>145</sup>

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<sup>136</sup> *Sulamerica*, above n 13, at [8].

<sup>137</sup> At [3].

<sup>138</sup> At [6].

<sup>139</sup> At [7].

<sup>140</sup> At [9].

<sup>141</sup> At [9].

<sup>142</sup> At [32].

<sup>143</sup> At [26].

<sup>144</sup> At [15].

<sup>145</sup> At [15].

On the facts of *Sulamerica*, there were two factors that rebutted the presumption.<sup>146</sup> Firstly, the AA's effectiveness would be compromised by such a choice of law;<sup>147</sup> Under Brazilian law the clause could only be invoked with additional consent from the insured, whereas under English law the clause would be effective notwithstanding the lack of additional consent.<sup>148</sup> Secondly, the fact that the parties had chosen England as the seat of arbitration pointed away from an implied choice of Brazilian law.<sup>149</sup> The Court decided that these factors suggested the parties had not impliedly chosen the governing law.<sup>150</sup> Because the Court would prefer the law of the substantive contract when in competition with the law of the seat, it was the ineffectiveness of the arbitral clause under Brazilian law which was determinative in rebutting the presumption.<sup>151</sup>

The Court then went on to consider what system of law the agreement had the closest and most real connection.<sup>152</sup> The Court held that the agreement to resolve disputes by arbitration in London had a closer connection to the law of the place where the arbitration will be held, and was accordingly governed by English law.<sup>153</sup>

## 2 *Firstlink*

The Court in *Firstlink* said it cannot be assumed that the parties intended the same law to govern their relationship under the substantive contract, and their relationship in the resolution of dispute.<sup>154</sup> The natural inference would be that the parties should be taken to have intended a different system of law to govern the two distinct relationships.<sup>155</sup> In the case of a relationship between two parties in a dispute, the desire for neutrality is overwhelming so it is natural that they would prefer the law of the seat, which would have been selected for the purpose of neutrality.<sup>156</sup> The Court referred to *C v D*, where it was noted that it would be rare for the proper

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<sup>146</sup> At [29]-[30].

<sup>147</sup> At [30].

<sup>148</sup> At [30].

<sup>149</sup> At [29].

<sup>150</sup> At [31].

<sup>151</sup> At [26].

<sup>152</sup> At [32].

<sup>153</sup> At [32].

<sup>154</sup> *Firstlink*, above n 14, at [13].

<sup>155</sup> At [13].

<sup>156</sup> At [13].

law of the AA to be different from the seat because of the closeness of connection between the two.<sup>157</sup>

The Court found guidance from the House of Lords decision of *Premium Nafta Products*.<sup>158</sup> The decision held that the construction of an AA should start from the assumption that parties to a contract who have entered into an AA intend that any dispute arising out of their relationship should be decided in accordance with the dispute resolution procedure chosen by the parties.<sup>159</sup>

The Court also made a full discussion of the importance of the seat of arbitration under the New York Convention, referring to art V(1)(a) which would refer the choice of law to the place where the award is made in the absence of party choice.<sup>160</sup> The Court argued that most rational businesspeople must intend any subsequent award to be binding and enforceable.<sup>161</sup> The parties' intention will primarily be focused on the law of the seat, because they will have an intention that the law of that seat recognise and enforce the AA.<sup>162</sup>

Parties choosing the procedural rules provided by the *lex arbitri* would not desire inconsistency or incoherency between those rules and the law governing the procedural and substantive effect of their AA.<sup>163</sup> They should be presumed to have picked the same law for both processes.

The Court concluded that, all other facts being equal, where there is direct competition between the law of the seat and the law of the substantive contract, the parties should be presumed to have selected the law of the seat to govern their AA.<sup>164</sup>

## *B Cases that Preferred the Law of the Substantive Contract*

### *1 Arsanovia Ltd and Ors v Cruz City 1 Mauritius Holdings*<sup>165</sup>

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<sup>157</sup> At [14].

<sup>158</sup> At [13].

<sup>159</sup> At [13].

<sup>160</sup> At [14].

<sup>161</sup> At [14].

<sup>162</sup> At [13].

<sup>163</sup> At [15].

<sup>164</sup> At [16].

<sup>165</sup> [2013] 2 All ER (Comm).

In this case, the main agreement was governed by Indian law, but chose London as the seat of arbitration.<sup>166</sup> The arbitration clause also expressly excluded specific provisions of the Indian Arbitration Act from applying to the agreement.<sup>167</sup> The Court said that the fact that the parties thought it necessary to exclude specific provisions of Indian law suggested that the parties assumed those provisions would otherwise apply, thereby implying a choice of Indian law.<sup>168</sup> The case provides an example of a situation where a presumption is unnecessary to apply or should be rebutted because there is a sound basis for inferring a choice of law on the facts alone.

The Court said that there was a good case for there being an express choice, because the parties said “this agreement” should have been governed by and construed in accordance with the laws of India, they might have been thought to have meant that all clauses in the agreement, including the AA.<sup>169</sup> This is the linguistic argument subsequently relied on by *BCY v BCZ*.<sup>170</sup> The Court distinguished *Sulamerica* on the grounds that in that case the choice of law provision referred to “this policy” which suggested a choice of law for the substantive obligations only.<sup>171</sup> The judge concluded that the parties evinced an intention that the AA is to be governed by Indian law, and it did not matter whether the choice is characterised as express or implied.<sup>172</sup>

### 1 *BCY v BCZ*

The Court considered both *Sulamerica* and *Firstlink*, but preferred the presumption that the law of the AA is likely to be the same as the express chosen law of the substantive contract.<sup>173</sup> The Court argued the presumption is supported by the weight of authority and is preferable as a matter of principle.<sup>174</sup>

The weight of authority the Court referred to were both cases where the law of the seat and the choice of law for the AA were the same.<sup>175</sup> One of the cases did not refer to either *Sulamerica*

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<sup>166</sup> At [4].

<sup>167</sup> At [22].

<sup>168</sup> At [22].

<sup>169</sup> At [22].

<sup>170</sup> *BCY v BCZ*, above n 18, at [59].

<sup>171</sup> *Arsanovia*, above n 164, at [22].

<sup>172</sup> At [23].

<sup>173</sup> *BCY v BCZ*, above n 18, at [49].

<sup>174</sup> At [50].

<sup>175</sup> At [51].

or *Firstlink*,<sup>176</sup> and the second only briefly to *Sulamerica*.<sup>177</sup> The Court also referred to Gary Born’s remark that the parties rarely distinguish between the main and AA in their choice of law provision as academic support for *Sulamerica*.<sup>178</sup>

The Court re-emphasised the point made by *Arsanovia*, that when a substantive contract has a choice of law clause covering “this agreement”, the natural inference is that the parties intended the clause to every clause in the agreement, including the arbitration clause.<sup>179</sup> To say that the words “this agreement” should be construed to mean “this agreement, save for the arbitration clause” would be inconsistent with the ordinary meaning of agreement.<sup>180</sup>

*BCY v BZC* also made an assessment of *Firstlink*’s argument in respect of the parties’ desire for neutrality. The desire for neutral forum and law of procedure did not necessarily indicate a desire for the substantive law to govern the formation of that agreement.<sup>181</sup> The law of the substantive contract could have also been picked for the purposes of neutrality, and on the facts of the case the two parties had no connection to the chosen law of their substantive contract.<sup>182</sup>

The Court said that the presumption that the substantive law governed the AA would be displaced if the agreement would be ineffective under said law.<sup>183</sup> The parties would not be taken to have negated their ability to refer disputes to arbitration by choosing a law which render the clause ineffective.<sup>184</sup> The Court referred to the facts of *Sulamerica* as being precisely that situation.<sup>185</sup>

## *C Cases that Preferred the Law of the Seat*

### *1 C v D*

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<sup>176</sup> At [52].

<sup>177</sup> At [53].

<sup>178</sup> At [59].

<sup>179</sup> At [59].

<sup>180</sup> At [59].

<sup>181</sup> At [63].

<sup>182</sup> At [63].

<sup>183</sup> At [74].

<sup>184</sup> At [74].

<sup>185</sup> At [74].

*C v D* involved an insurance dispute stemming from a policy with a New York choice of law but an arbitration clause naming London as the seat.<sup>186</sup>

However, the value of this judgment is eroded slightly by the framing of the issue:<sup>187</sup>

*“The question then arises whether, if there is no express law of the AA, the law with which that agreement has its closest and most real connection is the law of the underlying contract or the law of the seat of arbitration.”*

This framing is unfortunate because of the lack of reference to the possibility of finding an implied choice of law. Once an express intention is not found, the court should examine the agreement and the surrounding circumstances and see whether a choice of law can be inferred from the circumstances. However, *C v D* should be seen as a case of there being no implied choice where there is competition between the law of the substantive contract and the law of the seat, because either could apply.<sup>188</sup> The Judge cited a House of Lords decision which held that the presence of an arbitration clause was relevant to inferred intention, but would be displaced by evidence that the contract has a closer connection to another legal system.<sup>189</sup> The Court therefore decided there was no party choice, and decided the case on the basis on what law the AA had the closest connection; the law of the seat.<sup>190</sup>

#### *D Rationale for the Presumptions Provided by Arbitral Jurisprudence*

It is worth attempting to boil down the reasons provided by the jurisprudence for preferring one presumption over the other. Once the reasons are reviewed, it will be clear that many judgments suffer from conceptual incoherency.

##### *1 For the substantive contract*

###### *(a) Linguistic arguments*

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<sup>186</sup> *C v D*, above n 64, at [15].

<sup>187</sup> At [24].

<sup>188</sup> *Wilhelmsen*, above n 6, at 124.

<sup>189</sup> At [25].

<sup>190</sup> At [34].

When a substantive contract has a choice of law clause covering “this agreement”, the natural inference is that the parties intended the choice of law to apply to every clause in the agreement, including the arbitration clause.<sup>191</sup> To say that the words “this agreement” should be construed to mean “this agreement, save for the arbitration clause” would be inconsistent with the ordinary meaning of agreement.

(b) *Parties intentions*

The parties should be taken to have intended the totality of their relationship to be governed by the same law.<sup>192</sup> Intuitively, it makes sense that parties may have been unaware that the arbitration is separable, and assumed that their choice of law applied to all clauses in their contract. In this circumstance, the inference is that they intended that law to govern their entire agreement, including any legally separable agreements therein. The desire for neutral forum and law of procedure did not necessarily indicate a desire for the law of the seat to govern the formation of that agreement.<sup>193</sup> The law of the substantive contract could have also been picked for the purposes of neutrality.<sup>194</sup>

(c) *Commercial practice*

It will be exceptional for parties to not choose the same system of law to govern the three aspects of arbitration.<sup>195</sup> Parties rarely distinguish between the main and AA in their choice of law provisions.<sup>196</sup> Commercial practice reflects what would have been reasonably intended by the parties by reference to what commercial parties generally intend.

(d) *Factors which may rebut the presumption*

Overall, clear evidence that the parties intended some other system of law will displace the presumption. However, there have been specific factors pointed out by the courts:

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<sup>191</sup> *Arsanovia*, above n 183, at [22].

<sup>192</sup> *Sulamerica*, above n 13, at [15].

<sup>193</sup> *BCY v BCZ*, above n 18, at [63].

<sup>194</sup> At [63].

<sup>195</sup> *Sulamerica*, above n 13, at [15].

<sup>196</sup> At [15].



If the law of the main agreement would render the AA ineffective, as was the case in *Sulamerica*, the presumption that the arbitral clause is governed by the law of the substantive contract will be rebutted.<sup>197</sup> Excluding legislative provisions from a system of law that is inconsistent with the law of the substantive contract will also usually rebut the presumption.<sup>198</sup>

*For example: if the law of the contract is English but the AA excludes two provisions of the New Zealand Arbitration Act 1996, there is a strong inference that the parties thought New Zealand law would otherwise apply.*

## 2 *For the law of the Seat*

The main reasons provided for preferring the seat of arbitration are as follows;

### (a) *The parties' intentions*

While the parties intended the law of the substantive contract to govern their business relationship, the relationship in the context of a dispute is different.<sup>199</sup> Because of the difference, it is difficult to argue that the parties intended one system of law to govern the totality of their relationship, including the relationship that is necessarily different and distinct while in dispute.

In the context of a dispute, the desire for neutrality between the parties will be overwhelming.<sup>200</sup> Given that the law of the seat is usually picked for the purpose of neutrality, it naturally follows they would intend that the law of the seat would neutrally govern their AA.

The seat of arbitration is of such importance in respect of obtaining an award that in the context of a dispute, that the parties are likely to have impliedly chosen that system of law.<sup>201</sup> Ordinary businesspersons would not pick a seat that would not enforce their agreement, so would not

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<sup>197</sup> *Sulamerica*, above n 13, at [30].

<sup>198</sup> *Arsanovia*, above n 183, at [22].

<sup>199</sup> *Firstlink*, above n 14, at [13].

<sup>200</sup> At [13].

<sup>201</sup> At [14].

pick a system contrary to the law of the seat to govern their AA because of the unacceptable risk that their chosen dispute resolution mechanism would be ineffective.<sup>202</sup>

Parties choosing the procedural rules provided by the *lex arbitri* would not desire inconsistency or incoherency between those rules and the law governing the procedural and substantive effect of their AA.<sup>203</sup> They should be presumed to have picked the same law for both processes.

## *E Analysis*

### *1 Analysis of the presumption in favour of the law of the substantive contract*

#### *(a) Failure to correctly approach the doctrine of separability*

The notion that commercial parties should be taken to have both their AA and their substantive contract to be governed by the same legal system is at odds with the widely accepted doctrine of separability. The Court in *Sulamerica* did not consider the relevancy of the doctrine in determining the impliedly chosen law.<sup>204</sup> The Court dismissed it in their analysis, saying that separability merely reflects the presumed intention that the AA would remain effective in circumstances that would render the substantive contract ineffective.<sup>205</sup> Lord Justice Moore-Bick said that the doctrine was not designed to insulate the agreement from the main contract for all purposes, including the main contract's choice of law.<sup>206</sup> However, if applying substantive contract's law to the arbitral clause resulted in the invalidity of both, the doctrine of separability would be undermined. In that situation, the doctrine of separability would be highly relevant to the implication of a choice of law and would need to insulate the agreement from the substantive contract's choice of law or otherwise provide no assistance toward the arbitral clauses survival of the main agreement.

The underlying foundation of separability, that the parties intended their arbitral clause to remain valid despite the main agreement's invalidity, cannot co-exist with an intention to choose a governing law which would invalidate the arbitral agreement. The parties intended

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<sup>202</sup> At [14].

<sup>203</sup> At [15].

<sup>204</sup> *Sulamerica*, above n 13, at [26].

<sup>205</sup> At [26].

<sup>206</sup> At [26].

their AA to be effective and any consequential award to be recognised and enforced. The doctrine of separability is accordingly highly relevant when choosing the law of the AA.

*BZY v BCY* had an extensive discussion of the doctrine of separability. The Court said that the doctrine is often used to justify treating the arbitration clause as an agreement distinct to the main contract.<sup>207</sup> The Court claimed the doctrine of separability is supposed to give effect to the parties' reasonable expectation that the clause will remain effective despite the main contract being alleged or found to be invalid, but not giving effect to an intention that the parties entered into two independent agreements.<sup>208</sup> As argued in section III, the arbitral clause cannot be preserved unless it is a distinct agreement, and the Court's analysis is inconsistent with the doctrine of separability.

The cases which relegate the significance of the doctrine of separability often contradict themselves conceptually. Every judgment treats the AA as separate from the main contract for the purpose of determining what law it has the closest connection to. One hand the courts say that the AA is only insulated for the narrow purpose of surviving the main contract's invalidity; but are also implicitly treating it separately for the purpose of determining which law the agreement has the closest connection to. The courts also conceptualise the arbitration clause as capable of having its own choice of law. Why the doctrine of separability would not be relevant to the choice of that law is unclear. It does seem that the courts in fact treat the arbitration clause as a distinct agreement except when deciding whether the AA should be insulated from the choice of law clause in the substantive contract.

The failure to approach separability correctly spills over onto two other arguments put forward in favour of the substantive contract. Firstly, the Court in *Sulamerica* said the parties are likely to have intended the totality of their contractual relationship to be governed by one system of law.<sup>209</sup> If the Court is using the words "totality of their relationship" to mean the every contractual relationship entered into by the parties, the inference is plainly wrong. There is no basis for saying the parties intend that every contract they execute to be coloured by the concurrent or past contractual relationships. If they mean the totality of their contractual relationship present in the main contract, then the AA as a separate and completely distinct

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<sup>207</sup> *BCY v BCZ*, above n 18, at [60].

<sup>208</sup> At [60].

<sup>209</sup> At [15].

agreement is a separate relationship which does not form part of the substantive contractual relationship.

Secondly, the Court in *Sulamerica* said that a free-standing agreement to arbitrate is unlikely to contain a sufficient basis for finding an implied choice of law;<sup>210</sup> it would be necessary to identify the system of law that has the closest and most real connection to the agreement, the law of the seat being of overwhelming significance.<sup>211</sup> The Court noted that an AA which is embedded requires a presumption that it is governed by the law of the contract. However, this statement fails to appreciate that a correct application of the doctrine of separability means there is no legal distinction between a free-standing agreement to arbitrate and an arbitration clause.<sup>212</sup> Perhaps if the doctrine had been correctly applied the court would have descended to stage three without dealing with the issues surrounding inferred intention and identified the law with which the AA has the closest connection.

One thing to note is the significance of the lack of effectiveness of the arbitration clause under Brazilian law being determinative in the Court's refusal to find an implied choice of law.<sup>213</sup> The Court in *BCY v BCZ* also said that the presumption that the substantive law governed the AA would be displaced if the agreement would be ineffective under said law.<sup>214</sup> It seems counterintuitive to prefer the law of the substantive contract only to rebut the presumption on the basis that the application of said law would result in the AA being unenforceable, and then applying the closest connection test to achieve the desired enforceability. Why not just take the parties to have presumptively selected a choice of law that would validate or make effective that agreement rather than a presumption that the agreement is governed by the law of the substantive contract?

*(b) Commercial practice*

Firstly, the preference for the law of the substantive contract has been largely predicated on the view that it is exceptional for parties to choose different law for their substantive contract and

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<sup>210</sup> At [26].

<sup>211</sup> At [26].

<sup>212</sup> *Harbour Assurance*, above n 98, at 87.

<sup>213</sup> At [30].

<sup>214</sup> *BCY v BCZ*, above n 18, at [74].

their AA.<sup>215</sup> The author is of the view that unless an empirical study is taken on the frequency at which parties do in fact select different law, judicial speculation of commercial trends obscures more valuable considerations to be accounted for when selecting an approach to choice of law.

A more relevant commercial trend is the tendency for international commercial parties to enter into AAs. One could say that nearly all parties entering into such agreements intend for them to be enforceable and effective, otherwise there would be little sense in agreeing to arbitrate. The commercial trend of parties agreeing to arbitrate supports a view that parties' should be taken to presumptively chosen a law which would validate their agreement.

(c) *Linguistic arguments*

The linguistic argument made in *Arsanovia* and repeated in *BCY v BCZ* also suffers when a correct approach to separability is taken.<sup>216</sup> To borrow the linguistic argument from *Arsanovia*: it would be inconsistent with the ordinary meaning of "this agreement" to construe the words to mean "this agreement, including any other separate agreements entered into at the time of this agreement's execution."

(d) *The parties intentions*

The notion that commercial parties should be taken to have intended the entirety of their relationship to be governed by the same legal system is at odds with the widely accepted doctrine of separability. The Court in *Sulamerica* did not consider the relevancy of the doctrine in determining the impliedly chosen law, saying that it did not bear on the question of the relative weight to be given to the law of the seat or the law of the contract.<sup>217</sup> However, the doctrine reflects the presumed intention that the arbitral agreement survives the invalidity of the main agreement. If applying substantive contract's law to the arbitral clause resulted in the invalidity of both, the doctrine of separability would be significantly undermined; the underlying foundation of separability, that the parties intended their arbitral clause to remain valid despite the main agreement's invalidity, cannot co-exist with an intention to choose a governing law which would invalidate the arbitral agreement. One could more powerfully

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<sup>215</sup> *Sulamerica*, above n 13, at [15].

<sup>216</sup> *Arsanovia*, above n 164, at [22]; and *BCY v BCZ*, above n 18, at [59].

<sup>217</sup> *Sulamerica*, above n 13, at [18].

speculate that the parties intended their AA to be effective and any consequential award to be recognised and enforced.

## 2 *Analysis of the presumption that the parties chose the law of the seat*

### *(a) Correct Approach to Separability*

The Court in *Sulamerica* said that a free-standing agreement to arbitrate is unlikely to contain a sufficient basis for finding an implied choice of law;<sup>218</sup> *C v D* did not find a choice of law where there competition between the law of the substantive contract and the law of the seat, because either could apply.<sup>219</sup> Instead, the Court identified the system of law with which the AA had the closest connection to. Longmore LJ cited *Harbour Assurance* in support of the proposition that the arbitration clause is a separate agreement.<sup>220</sup> This is significant because of the potent version of separability applied in *Harbour Assurance*, which equated an arbitration clause to a freestanding agreement. The reference suggests that *C v D* applied the doctrine correctly and decided that competition between the seat and the substantive contract resulted in no finding of an inferred intention, instead deciding what law the agreement had the closest connection to. This is how the Court in *Sulamerica* argued a free-standing agreement should be treated.<sup>221</sup>

The author proposes a presumption that the parties chose a law which would validate the agreement. However, *C v D*'s analysis is useful when both the law of the seat and the law of the substantive agreement would validate the agreement. In that instance, the Court should simply find no inferred choice and identify the law that the agreement has the closest connection to, which is the law of the seat.

### *(b) Parties intentions*

The estimations of the parties' intentions choosing a choice of law are reminiscent of the parties' intentions which underlie the doctrine of separability.

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<sup>218</sup> At [26].

<sup>219</sup> *Wilhelmsen*, above n 6, at 124.

<sup>220</sup> *C v D*, above n 71, at [24].

<sup>221</sup> *Sulamerica*, above n 13, at [26].

The Court in *Firstlink* argued that rationale businessmen would not risk their award or agreement being unenforceable under the law of the seat.<sup>222</sup> Under the Model Law the award will be unenforceable if the AA is invalid under the law the parties subjected it to, or failing any indication, the law of the seat,<sup>223</sup> as would art (V)(1)(a) of the New York Convention.<sup>224</sup> This is in compliance with the presumption that the parties intended the arbitral clause to survive the main contract's ineffectiveness so they might arbitrate disputes about the contract. A desire to arbitrate disputes naturally suggests an intention that the outcomes of those arbitrations will be binding; otherwise there would be no reason to arbitrate, which would frustrate the former intention.

The Court in *Firstlink* also appreciated that the parties did not necessarily intend the same law to govern their relationship under the substantive contract, and their relationship in the resolution of dispute.<sup>225</sup> The natural inference would be that the parties should be taken to have intended a different system of law to govern the two distinct relationships.<sup>226</sup> In the case of a relationship between two parties in a dispute, the desire for neutrality is overwhelming so it is natural that they would prefer the law of the seat, which would have been selected for the purpose of neutrality.<sup>227</sup> The Court shows sensitivity to the existence of two distinct contractual relationships, possibly because of their appreciation of the fact that there are two distinct contracts.<sup>228</sup> This conclusion is bolstered by the Court's citation of *Premium Nafta Products*, the leading case on the doctrine of separability in the commonwealth.<sup>229</sup>

#### *F Comparative Approach*

Now that the reasons for preferring one presumption over the other have been analysed, it is useful to compare the approaches to other areas of law which grapple with similar legal issues. The Rome I regulation deals with choice of law issues for contracts that are not AAs The common law and UNIDROIT Principles deal with when it will be appropriate for a court or

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<sup>222</sup> *Firstlink*, above n 14, at [14].

<sup>223</sup> *UNCITRAL Model Law on International Commercial Arbitration* GA Res 61/33 (2006), art 36(1)(iii).

<sup>224</sup> Convention on the Recognition and Enforcement of Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959), art V(1)(a).

<sup>225</sup> *Firstlink*, above n 14, at [13].

<sup>226</sup> At [13].

<sup>227</sup> At [13].

<sup>228</sup> At [13].

<sup>229</sup> At [13].

tribunal to imply a term into a contract. All aforementioned areas will provide a useful point of comparison to examine whether the approach taken by the arbitral jurisprudence is consistent with principle, or whether the authors suggested presumption of validity provides a better conceptual basis for inferred choice of law.

## V *Rome I*

The Rome Convention 1980 established uniform rules for choice of law for contract between EU member states.<sup>230</sup> The UK implemented the Convention in the Contracts (Applicable Law) Act 1990.<sup>231</sup> The Convention was replaced by the Rome I Regulation which came into force in 2009. The Convention and Regulation differ in some respects but have the same overall structure, policy aims.<sup>232</sup> The two articles relevant to this paper remain substantively the same so the case law from the Convention is still relevant.<sup>233</sup>

Given that embedded AAs are stand-alone contracts, it would pay to compare the choice of law approach in international arbitration to how choice of law is assessed under the Rome I Regulation. However, Rome I does not apply to AAs.<sup>234</sup> To argue for their inclusion EU member states pointed out that AAs were not different enough from other contracts to justify their exclusion, and if not included the EU would not have uniformity on the issue.<sup>235</sup> The UK delegation were strong advocates for the AA's inclusion, reasoning that the agreements did not differ from other contractual agreements. However, it was ultimately decided that there was no pressing need to extend the scope of the convention and that the "closest connection" test would be difficult to apply to an AA,<sup>236</sup> the latter point is demonstrably untrue. Despite the exclusion of AAs it will be useful to see how Rome I could give guidance to the development of choice of law for arbitration.

AAs are treated as distinct contracts under the Rome I Regulation with no reference to separability. It would not have been necessary to exclude AAs if they were not distinct

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<sup>230</sup> Zhen Tang "Law Applicable in the Absence of Party Choice" (2008) 71 MLR 785 at 785.

<sup>231</sup> At 785.

<sup>232</sup> At 787.

<sup>233</sup> At 787.

<sup>234</sup> Regulation 593/2008 on the Law Applicable to Contractual Obligations [2008] OJ L12/1, art 1(2)(e).

<sup>235</sup> Bursu Yuksul "The Relevance of the Rome I Regulation to International Commercial Arbitration in the European Union" (2011) 7 JPIL 149 at 151.

<sup>236</sup> At 152.



agreements. Significantly, one of the justifications for not including AAs in the scope of Rome I was that the existence of the New York Convention.<sup>237</sup> It perhaps follows that art V(1)(a)'s direction to apply the law of the seat was considered sufficient to cover choice of law issues in the context of AAs.

#### A *Party Choice under Rome I*

Under art 3 of Rome I, a contract is governed by the law chosen by the parties. This choice can be expressed or clearly demonstrated from the terms of the contract and the circumstances of the case. If an inquiry under art 3 does not result in finding party choice, the Court may infer that a contract is governed by the law of the country with which it is most closely connected in accordance with art 4.

Express choice is usually a straightforward inquiry. The main issue will usually be whether the parties reached consensus ad idem on a choice of law, approached with the same analysis as if it were any other contractual term. In the context of AAs there will also be a requirement of unequivocal acceptance before an express choice will be found.

The more complex inquiry is whether a choice can be clearly demonstrated from the terms of the contract or the circumstances of the case. There is little explicit articulation of the threshold of "clear demonstration".<sup>238</sup> In *American Motorists Insurance Co v Cellstar Corporation*<sup>239</sup> the Court drew the comparison between art 3(1) and the test governing the implication of an implied term at common law, on the grounds that the choice must have been intended or was so obvious that it went without saying.<sup>240</sup> The mere fact that it would be reasonable to infer a choice of law would not be sufficient.<sup>241</sup>

#### B *Comparison to Choice of Law in International Arbitration*

Article 3 of Rome I has the same obvious starting point as the approach taken to choice of law in arbitration: The AA is governed by the parties' express choice of law. The interesting point

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<sup>237</sup> Wilhelmssen, above n 6, at 83.

<sup>238</sup> Johnathan Hill "Choice of Law in Contract under the Rome Convention: The Role of the UK Courts" (2004) 53 ICLQ 325 at 328.

<sup>239</sup> [2003] ILPr 370.

<sup>240</sup> At [44].

<sup>241</sup> At [44].

of comparison is the factors courts consider when deciding whether the parties have by implication chosen the law to govern their AA.

When applying art 3, the Courts will usually decide that the parties have chosen the law of the seat if they select a particular seat of arbitration. In *Egon Oldendorff v Libera Corporation*<sup>242</sup> Clark J said that the parties had chosen English law by including England as the seat of arbitration. The Judge said that the introduction of the Rome Convention did not bring about a significant change to the common law authorities which indicate that, in the absence of exceptional circumstances, the court should presume that, if the parties' contract included an English jurisdiction clause or AA, the parties intended English law to govern their contract.<sup>243</sup>

In *Marubeni Hong Kong and South China Ltd v Mongolian Government*,<sup>244</sup> the weight to be given to the seat of arbitration was demonstrably potent. Over a series of drafts a choice of law provision was deleted but an English arbitration clause was retained. The fact of the arbitration clause would have led the Court to decide that the entire contract was governed by English law.

When applying art 3, courts will usually take an arbitration clause specifying the seat of arbitration as a strong prima facie inference that the parties impliedly chose the law of the seat to govern their substantive contract.<sup>245</sup> This is at odds with the approach from *Sulamerica* which does not consider the chosen seat as being the prima facie indication of the parties implied intention in respect of the law governing the AA. The chosen seat must be heavily weighted considering the high threshold for finding an implied choice under art 3, the choice needing to be "so obvious it goes without saying" that the entire contract was intended to be governed by the law of the seat.<sup>246</sup>

One would think that in the context of an AA, rather than a substantive contract, it would be even less controversial to say the law of the seat were prima facie intended considering the agreement is about arbitration. The likely reason it would be less controversial is because an AA is most closely connected to the seat of arbitration's system of law.<sup>247</sup> As the Court in

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<sup>242</sup> [1996] 1 Lloyd's Rep 380.

<sup>243</sup> *The Komminos S* [1991] 1 Lloyd's Rep 370.

<sup>244</sup> [2002] 2 All ER (Comm) 873.

<sup>245</sup> Johnathan Hill, above n 238, at 329.

<sup>246</sup> *American Motorists Insurance*, above n 239, at [44].

<sup>247</sup> *Sulamerica*, above n 13, at [26].

*Sulamerica* pointed out, the inquiries under stages two and three will overlap because the connection may play a part in finding an implied choice.<sup>248</sup>

The significance of this insight is that the presence of an arbitral clause and the chosen seat will be taken to be a choice so obvious it goes without saying in the context of contracts falling within the scope of Rome I. This is a strange contrast considering that the context of arbitration the choice of the seat is not powerful enough to displace the presumption that the AA is governed by the law of the substantive contract, let alone be treated as a choice of law for the AA which is so obvious it goes without saying. This analysis casts doubt on whether the law of the substantive contract should be applied as a presumptive choice, particularly in light of the comparative strength of the law of the seat in the context of Rome I. Arguably the law of the seat should be of even greater significance in the context of AAs, and be more likely to overwhelm other factors such as the law of the substantive contract.

## *VI Implication of Terms under the Common Law and the UNIDROIT Principles*

The Tribunal in *Arsanovia* said that question about the law applicable to AAs are determined in reference to English common law conflict of law rules;<sup>249</sup> the approach is analogous to implication of terms in the common law.<sup>250</sup> The Court in *American Motorists Insurance Co* said inferring a choice of law for a contract is approached in the same way as implication of terms in the common law, the choice needing to be “so obvious it goes without saying”.<sup>251</sup>

The purpose of this section’s comparative exercise is to demonstrate that a presumption that the AA is governed by the law of the substantive contract cannot be said to be “so obvious it goes without saying”, and does not reach the threshold for implying a term under the common law or the UNIDROIT Principles. Instead, there is a more powerful argument that the parties intended the arbitration clause to be valid and enforceable; the presumption of validity is more in compliance with the principles of UNIDROIT and the common law approach to implication of terms.

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<sup>248</sup> At [25].

<sup>249</sup> *Arsanovia*, above n 164, at [8].

<sup>250</sup> *American Motorists Insurance Co*, above n 239, at [44].

<sup>251</sup> At [44].

## A *Interpretation*

Lord Hoffman's starting point for the construction and interpretation of contracts is set out in the canonical *ICS* case.<sup>252</sup> Interpretation is the ascertainment of meaning that the document would convey to a reasonable person with knowledge of all background information which would have reasonably been available to the parties in the situation they were in at the time of the contract being made.<sup>253</sup> Prima facie it is appropriate to consider the choice of law of agreements executed at the same time as the AA when constructing the AA, as they form part of the background information which would have been available to the parties at the time of execution.

## B *Implication of Terms*

Implications of terms is an exercise in interpretation, albeit not an orthodox instance.<sup>254</sup> The agreements may be read alongside one another for the purpose of implying a term, which is an unorthodox example of interpretation. The implication of a term seems unintuitively labelled as an interpretive practice because it is not a process of interpreting any particular words, but instead the meaning of the document as a whole.<sup>255</sup>

In *Belize Telecom* requires the court to satisfy itself that the extra words are necessary to spell out the meaning of the contract.<sup>256</sup> There is only one test, the ostensibly competing officious bystander test and the business efficacy test are reflects of the fundamental question: what the instrument, read against the relevant background, would be reasonably understood to mean.<sup>257</sup> The power to imply a term should be used sparingly, and with the traditional threshold of necessity before the court will intervene.

In the context of an AA there is a question of what business efficiency would require for the agreement to be effective. Arguably the commercial purpose of the AA is to ensure disputes covered by the scope of the agreement will be submitted to arbitration. To give business efficiency to the contract the implied choice of law should be the law which ensures that

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<sup>252</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896.

<sup>253</sup> At 912-913.

<sup>254</sup> *Codelfa Construction Prop Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337.

<sup>255</sup> Lord Hoffmann, 'The Intolerable Wrestle with Words and Meaning' (1998) 56 SALJ 656 at 662.

<sup>256</sup> *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] BCC 43 at [21].

<sup>257</sup> At [21].

disputes can be submitted to arbitration; in other words the choice of law which would validate the agreement.

## *C UNIDROIT Principles*

The common law approach to interpretation of contracts is largely in accordance with the international standard for the law of contract. For the purposes of analysing the correct approach to implying a term the UNIDROIT Principles provide another useful point of comparison, albeit a similar comparison to the above common law analysis.

### *1 Interpretation*

Under chapter 4 of the UNIDROIT Principles a contract shall be interpreted according to the common intention of the parties.<sup>258</sup> If such an intention cannot be established, the contract will be interpreted according to the meaning that reasonable persons of the same kind as the parties would give it in the same circumstances.<sup>259</sup> The relevant circumstances include:<sup>260</sup>

- a) preliminary negotiations between the parties;
- b) practices which the parties have established between themselves;
- c) subsequent conduct of the parties;
- d) nature and purpose of the contract;
- e) the meaning commonly given to terms and expressions in the trade concerned.

Both the common law approach to interpretation and the UNIDROIT Principles support the view that the law of the substantive contract can be considered when inferring a choice of law.

### *2 Implication of terms*

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<sup>258</sup> UNIDROIT Principles of International Commercial Contracts 2016, art 4.1.

<sup>259</sup> Art 4.1.

<sup>260</sup> Art 4.3.

Where the parties to a contract have not agreed with respect to a term which is important for the determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.<sup>261</sup> In determining what an appropriate term is, regard shall be had, among other factors, to;<sup>262</sup>

- a) the intention of the parties;
- b) the nature and purpose of the contract;
- c) good faith and fair dealing;

In the comments attached to art 4.8 it is explained that regard is first had to the intention of the parties as inferred from the contract and circumstances surrounding said contract. If the intention cannot be ascertained, the term may be determined in accordance with the nature and purpose of the contract, and the principles of good faith and fair dealing.

#### *D Conclusions on Implication and Relevance to Choice of Law in Arbitration*

The purpose of the discussion of implication of terms is to argue that it cannot be said that it is so obvious it goes without saying that the parties chose the law of the substantive contract for their AA. The author does not deny that the law of the substantive contract may be considered as part of the factual matrix in which the AA exists. However, it is difficult to see how the arguments in favour of the law of the substantive contract could be taken as an argument for the choice of law of the AA being “so obvious it went without saying”.

Arguments made by both Lord Hoffman in *Prima Paint* and the Court in *Firstlink* relating to what parties to an AA should be taken to have intended cast far too much doubt on the *Sulamerica* approach to the parties presumptive intentions for it to be argued as a choice that is so obvious it goes without saying.<sup>263</sup> The strength of the choice of arbitral seat when inferring a governing law under Rome I also casts doubt on whether the presumptive choice of the substantive contract is justified. The argument that the parties should be taken to have intended their entire relationship to be governed by one system of law is self-asserting with no real basis

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<sup>261</sup> Art 4.8.

<sup>262</sup> Art 4.8.

<sup>263</sup> Discussed in sections III(B)(2) and IV(E)(2)(b) of this paper.

other than a prediction of commercial trends. The parties intention to submit their disputes to arbitration and have their arbitral clause be valid for that purpose provides a much stronger argument that it is so obvious it goes without saying that the parties' intended a choice of law that would validate the clause.

Hypothetically, if the law of the substantive contract would render the AA invalid, having a presumption that favoured that law would cut across the parties intention that the arbitral clause would remain valid notwithstanding the main contract's invalidity; a presumed intention so strong that the courts and tribunals take the parties to have entered into two distinct contracts. Why prefer the law of the substantive contract as the presumptive choice when this tension could be ameliorated by a presumption of validity?

Applying the UNIDROIT Principles, if the intention of the parties cannot be ascertained the term should be inferred with reference to the nature and purpose of the contract, good faith and fair dealing. The purpose of an AA is to refer disputes about the parties' substantive relationship to arbitration, which would support inferring a choice of law that validates the agreement. The nature of an AA is an agreement to submit disputes to arbitration, again supporting a view that the parties intended the agreement to be valid. Good faith and fair dealing would require a party comply with their obligation to submit to arbitration.

## *VII The Presumption of Validity*

### *A How Would the Presumption Work?*

Where there is no express choice of law for the AA, and competition between the law of the seat and the law of the substantive contract; a court or tribunal should apply a presumption that the parties' intended a choice of law which would allow their arbitral agreement to be valid, include the particular dispute in the scope of the agreement, or otherwise be effective. If both systems of law would validate the agreement or allow the dispute to be submitted, then in the absence of additional evidence of intention the court should decline to find a party choice and instead identify the law the AA has the closest connection to.

However, if there is evidence that the parties' intended a particular system of law to govern the AA then the presumption should be rebutted. For example, excluding legislative provisions from a system of law that is inconsistent with the presumed choice should usually rebut the

presumption. Another example of evidence of this nature is if the arbitration clause is drafted in a fashion that is unique to a particular system of law- if the type of drafting is only used in Germany, then there is a strong suggestion that the parties' impliedly chose German law to govern the AA.

## *B Why the Presumption Should be Applied*

### *1 The parties' intentions*

A presumption of validity is more consistent with the intentions of the parties. Lord Hoffman thought there should be an assumption that rational businesspeople are likely to have intended any dispute arising out of their relationship they entered, or purported to enter, by the same tribunal.<sup>264</sup> They want the disputes decided by a tribunal they have chosen, for the purpose of neutrality, privacy, expertise, the efficiency of the procedural law and for quick resolution of disputes;<sup>265</sup> if this intention is to be given effect, the commercial parties must have also intended their arbitral clause to be governed by a choice of law that ensures its validity. The doctrine of separability reflects the parties' intention that the arbitration clause remains valid so disputes about the main contract may be submitted to arbitration; this intention of validity is so potent that the courts will take them to have intended to enter into two distinct agreements.<sup>266</sup> Additionally, most rational businessman must commonly intend the awards to be binding and enforceable;<sup>267</sup> therefore most commercial parties must intend for their AA to have a choice of law which ensures it is valid.<sup>268</sup>

### *2 The doctrine of separability*

The foundational principle of arbitration, the doctrine of separability, could be compromised without a presumption that the parties intended a choice of law that would validate the agreement. If the law of the substantive contract would make the arbitral clause invalid, then applying that law would mean the arbitral clause would not survive the main agreements invalidity; this is the opposite result that the doctrine of separability seeks to create. The fact that the presumption in favour of the law of the substantive contract can be rebutted by evidence

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<sup>264</sup> *Premium Nafta Products*, above 87, at [6].

<sup>265</sup> At [6].

<sup>266</sup> *Harbour Assurance Co*, above n 98, at 87.

<sup>267</sup> *Firstlink*, above n 14, at [14].

<sup>268</sup> At [14].



that the arbitral award would be ineffective under said law, as was the case in *Sulamerica*, creates a redundant presumption when considering that the presumption of validity could achieve the same result with less complexity.

### 3 *The New York Convention*

Article II of the New York Convention directs Contracting States to recognise the validity of arbitral agreements, unless they are null and void. The circumstances in which a national court could deem the AA null, void or incapable of performance are thought to be limited to defences such as fraud, lack of consent or unconscionability.<sup>269</sup> The limited circumstances in which a court can find an arbitral clause to be invalid are narrow because of the pro-enforcement bias of the convention.<sup>270</sup>

Article V(1)(a) of the New York Convention represents a similar policy. While at first glance art V(1)(a) appears to represent a conflict of laws rule which favours the law of the seat, it in fact represents a rule in favour of validity. As previously discussed, at the enforcement stage the law of the seat represents a system of law that found the AA to be valid; the award could not have resulted from an arbitral clause that was found to be valid. These articles represent a widely accepted policy that courts should seek to recognise the validity of arbitral agreements except in limited circumstances.

The approach taken by art V(1)(a) New York Convention is also the author's rationale for not finding a presumptive choice if both the law of the substantive contract and the law of the seat would either validate or otherwise allow the agreement to be enforceable. A conflict between the law of the seat and substantive contract makes it difficult to argue either choice is so obvious it goes without saying if both would validate the agreement. The better way to ensure that the parties intention that the dispute will be arbitrated and the subsequent award recognised and enforced would be to apply the law of the seat at the third stage of the enquiry and achieve consistency with art V(1)(a) of the New York Convention.

### 4 *Enhancement of arbitration, certainty and justice*

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<sup>269</sup> Wilhelmssen, above n 6, at 97.

<sup>270</sup> At 97.

The presumption would prevent commercial parties from evading their obligations by arguing for a choice of law that would invalidate the AA, as it will be presumed they selected a choice of law that would allow their arbitral clause to be effective. If underlying considerations of validity had not played on the minds of the Judges in *Sulamerica* then under the law of the substantive contract the dispute would not have been submitted to arbitration, in clear contravention of the intention of the parties. Such a presumption prevents commercial parties from avoiding their obligations to arbitrate.

A presumption of validity would prevent parties from taking the benefits of a substantive contract and avoiding the agreed dispute resolution procedure.<sup>271</sup> To illustrate the danger, it is worth borrowing an example from the closely related area of law relating to jurisdiction agreements:<sup>272</sup> In *Samengo-Turner v J&H Marsh & McLennan*<sup>273</sup> insurance brokers entered into an agreement with an American company which provided them with financial incentives to induce them into staying in employment. The jurisdiction agreement provided for New York jurisdiction. The brokers resigned after taking the benefits of the substantive contract, and the American company brought a claim to the New York courts. However, the Court of Appeal ordered an anti-suit injunction preventing the claim from being pursued in New York because the law of the substantive contract invalidated the jurisdiction clause. If there had been a presumption of validity in operation there would not have been an ability to take the benefits and avoid the burdens of the contract.

### *C Conclusion*

Overall, where there is competition between the law of the seat and the law of the substantive contract in the absence of party choice, there should be a presumption that the parties' intended the system of law which would validate their AA. The proposed presumption of validity would bring certainty to an otherwise fraught area. Commercial parties should be able to rely on their agreement to arbitrate and be assured that when they enter into international transactions they will be able vindicate their rights; and have any subsequent award recognised and enforced. Such a presumption would promote and facilitate the use of arbitration as a dispute resolution

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<sup>271</sup> Adrian Briggs, above n 133, at 84.

<sup>272</sup> At 85.

<sup>273</sup> [2007] EWCA Civ 723, [2007] 2 All ER (Comm) 813.

mechanism, facilitating international trade and creating consistency between tribunals, courts, the parties' intentions and instruments of arbitration.

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