Arbitration - United Kingdom

Importance of establishing legal regime applicable to arbitration agreement

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Introduction

A matrix of legal regimes is often applicable to any international commercial arbitration. For example, the governing law of a contract can be different from the law governing the conduct of the arbitration. The parties' arbitration agreement – being a separate and independent agreement – can also conceivably be subject to an entirely different legal regime. In the latter situation, ascertaining precisely which law governs the parties' arbitration agreement is complicated by the fact that parties rarely specify, in the arbitration agreement itself, which legal regime will govern its terms.

In the recent case of *Arsanovia Ltd v Cruz City 1 Mauritius Holdings*, the High Court had to determine the proper law applicable to the parties' arbitration agreement. That determination had particular importance as it provided the reference point for determining whether a tribunal had substantive jurisdiction in two related, but not consolidated London Court of International Arbitration arbitrations.

While the seat of the arbitration was England, Indian law governed the underlying shareholders' agreement. The court decided that the arbitration agreement was also governed by Indian law. The court went on to decide that, as regards the first arbitration, a third party had not consented to arbitration and that, as a matter of Indian law, the dispute as a whole was not arbitrable – even as between the two parties that had definitively consented to arbitration.

However, the challenge against the award in the second arbitration was dismissed.

Facts

In 2008 Burley (along with certain other entities) signed up to a number of provisions in a shareholders' agreement, to which Arsanovia and Cruz City (along with a number of other entities) were already party. The agreement governed the terms of a joint venture for the development of certain slum areas in Mumbai, India.

In 2010 Arsanovia served termination and buy-out notices on Cruz City on account of delays in the clearance of the slums. Cruz City sought to exercise a put option of its own, triggering a buy-out on more favourable terms. These matters led to three arbitrations, two of which were the subject of challenge before the English High Court.

In the first arbitration, Cruz City sought damages and specific performance under the shareholders' agreement against Arsanovia and Burley.

In the second arbitration, Cruz City sought damages against Burley and Unitech (Burley's parent company) under a separate keepwell agreement. Under the keepwell agreement, Unitech effectively agreed to put Burley in funds to meet its payment obligations.

The same tribunal was constituted for both arbitrations. The arbitrations were heard together, although they were not formally consolidated.

Arsanovia, Burley and Unitech (the claimants) made an application under Section 67 of the Arbitration Act 1996, challenging both arbitral awards on the basis that the tribunal lacked substantive jurisdiction to determine the claims.

Proceedings

First award
The thrust of the claimants' application was as follows:

- The law applicable to the arbitration agreement within the shareholders' agreement was Indian law;
- Under Indian law (but also under English law), Burley did not agree to be bound by the arbitration agreement. Therefore, the tribunal had no jurisdiction to determine the claims between Cruz City and Burley; and
- Under Indian law, where an arbitration is brought against two parties (in this case Arsanovia and Burley), only one of which is party to an arbitration agreement, the arbitration cannot be maintained against either. Therefore, the tribunal did not have jurisdiction to determine the claims against either Arsanovia or Burley.

With respect to the first issue, the court carefully considered *C v D*.(1) In that case, the Court of Appeal decided that the law applicable to an arbitration agreement is that of the jurisdiction which has the closest and most real connection with the arbitration agreement. However, the court also considered the decision in *Sulamerica Cia Nacional de Seguros v Enesa Engenharia SA*,(2) in which the Court of Appeal decided that a court must first look to whether the parties have expressly or implicitly specified the law applicable to the arbitration agreement before ascertaining which jurisdiction has the closest and most real connection with the arbitration agreement. The court followed *Sulamerica*.

The court decided that the parties had implicitly chosen Indian law as the law applicable to the arbitration agreement. The court's reasons were as follows:

- The governing law of the shareholders' agreement, being Indian law, was a "strong pointer" to the parties' intention concerning the governing law of the arbitration agreement; and
- The arbitration agreement itself carved out Part I of the Indian Arbitration and Conciliation Act 1996. The court found that as the parties had expressly excluded specific statutory provisions of Indian law, the natural inference was that they understood that Indian law would otherwise apply.

With respect to the second issue, when Burley signed up to the shareholders' agreement, it had specifically agreed to be bound by some of its provisions, but not others. The list of provisions that it had signed up to did not include the arbitration clause. The claimants argued that as a result, Burley had not agreed to arbitration, as a matter of either Indian or English law. The court agreed, notwithstanding that it led to an interpretation of the shareholders' agreement whereby Cruz City would have to pursue claims against Arsanovia and Burley in different forums. As inconvenient as that may be, that was the arrangement that had been entered into.

Arguably, the most intriguing aspect of the court's decision concerned the third issue. Despite the fact that Cruz City and Arsanovia were unquestionably signatories to the arbitration agreement in the shareholders' agreement, the court heard evidence from an Indian legal expert to the effect that where a dispute involves a third party which has not agreed to arbitration, the dispute as a whole is not arbitrable. The court accepted that evidence. Consequently, the entirety of the first arbitration, even as between Cruz City and Arsanovia, was not arbitrable. The tribunal's award was of no effect.

Second award
With respect to the second award, the claimants argued that the arbitration agreement within the keepwell agreement was governed by Indian law. The court agreed, adopting the same reasoning as before. The court rejected, on the facts, an argument under Section 73 of the Arbitration Act 1996, that as the claimants had failed to raise this argument before the tribunal, they could not raise it before the High Court.

The claimants then argued that under Indian law, the claim under the keepwell agreement could not be brought until Burley's liability under the shareholders' agreement had first been adjudicated. As such an adjudication had not occurred, the arbitration was premature and the tribunal lacked jurisdiction. The court did not agree that Indian case law established a principle of this nature.

Finally, the claimants argued that Burley's liability required an analysis of the shareholders' agreement, which was not within the scope of the arbitration agreement under the keepwell agreement. This argument was also rejected. The tribunal had jurisdiction to determine whether Burley had a liability under the shareholders' agreement, in order to determine whether Unitech was liable under the keepwell agreement.

As the result, the tribunal refused the claimants' application challenging the second arbitral award.

Comment

The court's decision in *Arsanovia* reflects how the legal regime applicable to an arbitration agreement can have potentially significant implications for the resolution of disputes between contracting parties. In this context, it is no coincidence that the court reasoned its decision carefully on this point.

Importantly, a reference to the laws of a particular legal regime within an arbitration agreement may lead to a finding that the arbitration agreement is governed by the laws of that regime.

Having decided that the arbitration agreement was governed by Indian law, the court was bound to follow the applicable principles of that legal regime. In the present case, that led to a finding that two parties to an arbitration agreement could not arbitrate their dispute, because the dispute itself involved a third party that had not consented to arbitration.

The decision highlights the importance of ensuring that third parties which agree to be bound by certain terms of an agreement also agree to the dispute resolution clause within that agreement.

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Endnotes

(1) 2007.

(2) 2012.