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Applicable Law in Validity of Arbitration Clause: Judicial Practices of the US Courts on Charterparty Disputes

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Abstract

Incorporating the arbitration clause of charterparty into bills of lading (incorporation clause) is widely used in practice. When the rightful holder of bills of lading, usually the consignee, claims cargo damage to carrier, a valid arbitration clause rejects jurisdiction of domestic courts, or it will result in the jurisdiction of an arbitration tribunal. Determining governing law of examining arbitration clause, therefore, is the prerequisite of such cases. Choice of law turns out to be a controversial legal problem on account of either absence of uniformed legislation, or the complicated nature of relevant dispute. Generally, potential choices include governing law of charterparty, of bills of lading, or *lex fori*. In accordance with judicial practices in the United States, various courts prefer different governing law choices, but considering the interests balance between consignee and carrier, as well as party autonomy of commercial activities, the United States provides with the international society its inclination that governing law of bills of lading shall be applied.

Keywords: arbitration clause, bills of lading, applicable law, charterparty

1. Introduction

Bills of lading, being *prima facie* evidence of a carriage contract, may contain an arbitration clause which excludes jurisdiction of domestic courts and only allows jurisdiction from certain arbitration tribunal. Apart from specific dispute settlement clauses directly and originally provided on bills of lading, incorporation clause from other documents is used in commercial practice as well. For example, when the carrier shall rent a bareboat from the ship owner for transporting goods, they may reach a consensus that arbitration clause in their charterparty shall be incorporated into bills of lading. In this way, arbitration clause is referred to as part of charterparty conditions.

Suppose that cargo damage occurs during carriage, then the rightful holder of bills of lading, usually the consignee, claims against the carrier or even the ship owner for contractual liabilities. After the court filed this case, the first procedural issue is jurisdiction of the court, later comes the existence of breach of contract and then the division of liability. Whether there is a

valid arbitration clause of bill of ladings, is essential for examining the court's jurisdiction. If arbitration clause is void or even fails to exist in bills of lading, then domestic court is undoubtedly empowered to draw judgement.

How to examine the validity of an arbitration clause? Transnational carriage contains at least one foreign element, such as foreign contractual party, foreign destination of carriage. Therefore, the court shall solve the issue of whether substantial regulations of domestic law apply in this case. Suppose that the courts have chosen a correct or proper governing law, it will examine if the arbitration clause, being a part of the contract, actually exists and comes into force.

Whereas, some factors in reality make choice of law more complicated. By analyzing the difference between carriage and charterparty, it is not hard to conclude that the consignee could not easily allege claims as a contractual party. Meanwhile, the globally wide use of simply wording bills of lading also confuses the choice of law. Moreover, international conventions have not provided solution to this issue for now.

This article takes a brief view choice of law in such carriage disputes, from the perspective of the United States, given to its abundant law data sources and significance in international trade. To begin with, it introduces the background of choosing governing law and its potential legal problems, such as lack of uniformed notions. In the next section, it summarizes the admiralty law system of the United States, including current legislation and the courts' passive attitude on governing law of charterparty. The following section goes further to analyzes and compares potential choices of governing law of *lex fori* and bills of lading, from various American courts. At last, it comes to conclusion that under current American legislation and judicial practice, preference for the law governing bills of lading is more reasonable.

2. Obstacles to Determine Applicable Law

2.1 Absence of International Conventions

International society has been exploring a uniformed regulation on maritime field since the beginning of the twentieth century. For now, Hague-Visby Rules and Hamburg Rules are accepted by many major countries on maritime transactions. However, these international conventions fail to solve this problem in actual. Firstly, Hague Rules (1924) excludes application on charterparty in Article 5.1. Secondly, in Article 5 of Hague-Visby Rules (1968), the convention empowers contracting countries to govern with their domestic law, when carriage contract provides that the legislation of these countries giving effect to them could also govern the contract. But for now, the US has not approved Hague-Visby Rules, while not all carriage contracts are set in accordance with American law. Thirdly, Hamburg Rules and Rotterdam Rules are either not coming into force, or approved by the US.

2.2 Popularity of Simple Bills of Lading

Apart from the referral clause or charter conditions in the text of charterparty, bills of lading could prove the existence and validity of the arbitration clause as well. Whereas, in maritime practice, bills of lading are usually simply worded, which means they lack specific agreement of arbitration terms. Companies with the independence characteristic of arbitration clause from the main body, simple bills of lading are fronted with legal risks that the court may directly hold that the arbitration clause is null. In some cases, the court views that there is no valid arbitration clause in carriage, since contractual parties do not explicitly include arbitration clause from charterparty into bills of lading. For example, in *Cargill Inc. v. Golden Chariot MV* case, [1] the plaintiff only leaves general statements on the back of bill of lading, saying that "all terms and conditions... of the charterparty... are herewith incorporated" without identifying more detailed information and signatures of charterparty.

2.3 Consignee Being out of Charterparty

Bills of lading, as mentioned above, perform as surficial evidence of carriage contract, which directly relates the shipper and the carrier. Consignee, though not being the contractual party of carriage, enjoys benefits of such a contract as the interested third party, since the shipper and the carrier reach and perform this contract for the interest of consignee.

When the carrier shall rent a bareboat to fulfill its carriage duty, it reaches a charterparty with the owner of bare boat. Arbitration clause in charterparty will be referred to the aforementioned carriage contract by an independent referral clause or term in charter conditions. Apparently, the consignee fails to prove itself as direct or indirect party of charterparty. In this case, as the plaintiff, the consignee shall take burdens of proof to claim

that not only it enjoys right for cargo damage compensation (as the rightful holder of bills of lading, it is not a stressful issue), but also other procedural issues that under which governing law whether arbitration clause fails to exclude jurisdiction of the court, so that the court will carry on judgment itself.

3. Legal System in the United States

3.1 Legislation

Domestic legislation of the US mainly consists of United States Code Annotated (USCA), Carriage of Goods by Sea Act (COGSA).

Based on USCA, American courts enjoy jurisdiction over international maritime disputes and the power to apply American procedural law. But USCA does not provide the choice of law after noting the validity of written provisions. COGSA integrates the content of Hauge Rules (1924) but did not solve the problem as well.

Apart from legislation, The Second Edition of Restatement of Law: Conflicts of Law, serves as a convincing scholarship source in practice. Restatement, infers in its article 187, 188 and 218, that law governing arbitration could be chosen among a series of reasonable connecting countries. However, Restatement is not a legally binding source.

3.2 Caselaw of Denial on Charterparty Law

The American courts show different choices of governing law when they are required to examine the validity of arbitration clause. Some caselaw depict the tendency of choice: firstly, the courts reject to apply the law governing charterparty; secondly, the courts may choose the American law or the law governing bills of lading.

So far, no evidence shows courts choose the law governing charterparty. Take the judgment of *Steel Warehouse Co., Inc. v. Abalone Shipping Ltd. of Nicosai* case as an example.[2] The court rebuttals claim of the consignee who alleges that British law (governing law of charterparty) shall be applied and under British law, carrier fails to incorporate arbitration clause from charterparty. From the perspective of the court, the consignee in essence assumes that charterparty has been into bills of lading at first, then proves such a supposed incorporation is a failure. This analysis is not acceptable to American courts because it cannot answer the reason to "suppose arbitration clause has been into bills of lading". Without a doubt, it is unreasonable to assume incorporation is valid at the beginning, though it is widely used in British legal system. Normally speaking, whether charterparty has successfully incorporated into bills of lading is an independent issue from the validity or fulfillment of charterparty itself, let alone charterparty that largely keeps consignee away from involvement but asks for their obligation is questionable in justice.

4. Possible Choices for Governing Law

The courts, while rejecting applicable law of charterparty, tend to choose the American law, and the law of bills of lading.

4.1 Default Choice: Lex Fori

Many courts, considering provisions of USCA, are inclined to apply American law directly in viewing cases. In *Barna Conshipping, S.L. v. 8,000 Metric Tons* case, [3] the court examine the existence of arbitration clause on the basis of Title 9 of USCA, which empowers American court to decide on whether approve a compelling arbitration after a "limited inquiry". The court views that since the consignee and the carrier have a legally binding (carriage) contract from commercial activities, the only issue is whether arbitration clause of charterparty is specially referred to on the bill of lading. What shall be noted is that the court does not even consider choosing governing law to examine the validity of arbitration clause, and it only writes that "after finding the existence of arbitration agreement" will the court choose more arbitration-favorable federal policies. From the context of judgment, the court seems to apply American domestic law directly indeed. Another case, *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer* also suggests that the court views arbitration clause with American law COGSA and FAA (now part of USCA).[4] But this court takes arbitration clause altogether with forum selection clause, rather than turning them separately, thus it actually rejects the possibility to apply foreign law. In *Hawkspere Shipping Co., Ltd. v. Intamex* case,[5] the court directly rejects incorporation from simple bills of lading, regardless of necessity to choose the governing law.

Some cases emphasize the significance of general principles of federal maritime law, such as *Iota Shipholding Ltd. v. Starr Indemnity and Liability Company* case and *Son Shipping Co. v. De Fosse & Tanghe* case.[6] The court of the former

case, no difference from aforementioned courts who cited USCA, still interprets its standard of examination by American caselaw, which turns out to be the automatical application of domestic law.

Anyway, many courts take it for granted that applying American law is a natural and normal approach, either supported by USCA or COGSA. In their judgments, the focus of trials is to examine whether arbitration clause shall be accepted.

4.2 Governing Law of Bills of Lading

Consignee is usually unable to involve charterparty, and since most American courts believe that the choice of governing law belongs to a contractual issue of bills of lading, rather than charterparty, some courts tend to view the case on the base of bills of lading. In this way, they prefer to choose law governing bills of lading instead of forum law.

In *Michael v. S Thanasis* case,[7] the court considers the possibility of foreign law and American law. If the consignee knows or should have known charterparty, then terms of charterparty, rather than the law governing charterparty shall be incorporated. Even though this explanation seemingly emits the correct logical sequence that choice of law shall goes earlier than validity of arbitration (see Steel Warehouse Co., Inc. v. Abalone Shipping Ltd. of Nicosai case), it comes up with solution to governing law, namely the law applicable on bills of lading or carriage. At the absence of choice of law from charterparty in this certain case, the consignee may choose law of (1) the place with the most contractual contacts; (2) the flag of the ship; or (3) American law as forum law. However, foreign law is reckoned as an objective factum rather than legal bases, so the defendant shall raise foreign law itself in response.

Judgment of *Trans-Tec Asia v. M/V Harmony Container* case points out the need of choosing governing law before examining incorporation of arbitration clause.[8] The court reviews the caselaw of *Lauritzen v. Larsen* where the supreme court decides on the criteria of choice of law in tort.[9] No matter whether arbitration clause originally provided in charterparty has been into force, the court only needs to follow American conflict law to search for governing law. In this case, the court considers Malaysian law as the governing law of bills of lading and thus the law examining arbitration clause.

5. Conclusion

The applicable law is a practical problem lacking enough hard-law regulation. When studying for a possible and widely acceptable solution to governing law of validity of arbitration clause, analyzing diversified states' practices is a necessary step. This article attempts to review the United States' judicial preference on the choice of governing law under this circumstance, by comparing precedents from various courts. Before drawing conclusion of governing law of bills of lading being a more reasonable choice, what I shall acknowledge is that such a review has limit on the latest tendency, due to the size and timeliness of my acquired sources.

Judicial practice of the United State courts shows that, comparing lex fori or governing law of charterparty, governing law of bills of lading is more convincing and convenient. On the one hand, it helps to balance interests between the consignee and the carrier, while the former is highly likely unable to involve charterparty but has to take the risk of cargo damage. If the judicial system assigns the consignee with more power on maritime transportation disputes, the consignee will have more say when accusing the carrier. On the other hand, it does not infringe party autonomy in charterparty, because the essential of bills of lading is just transferring property rights from the consigner to the consignee, not to change rights or obligations on charterparty between the charterer (carrier) and the ship owner.[10] The carrier may still reserve entire rights to insist on their selection on dispute settlement by explicitly referring to it in bills of lading.

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