

# **Developments in the Interpretation of Arbitration Agreements by Local Courts**

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Arbitration is fast becoming the preferred route for dispute resolution, particularly in certain sectors, for instance; foreign direct investments, cross-border transactions and construction. But local courts still play a vital role in the arbitration process including, but not limited to, determining tactical challenges raised by the parties to nullify the arbitration agreement and/or rule on the recognition or setting aside of arbitral awards.

Over the last two decades the Dubai Courts have become increasingly arbitration friendly. However, in certain instances there are some obstacles from the Dubai Courts which are mainly due to the approach adopted by the Court when interpreting certain well settled principles of arbitration in connection with the

validity and effectiveness of arbitration agreements. These interpretations stand to influence the confidence parties place in arbitration being an effective alternative dispute resolution method in the Middle-East.

Having said that we, as legal practitioners, believe that it is an important part of our professional duty to highlight the positive developments that make Dubai more arbitration friendly. Therefore, we set out below an analysis of one of the recent judgments issued by the Dubai Court of Cassation that confirms the positive approach taken by the court to deal with arbitration agreements.

## **Background**

On 27 February 2010 a distributor (the “Distributor”) entered into a distribution agreement (the “Agreement”) with a foreign supplier (the “Supplier”) for the distribution of a specific range of sports products and goods (the “Goods”) in certain territories (the “Territories”), some countries on exclusive basis including UAE, KSA, Kuwait, Bahrain, Oman, Pakistan and Qatar and others on a non-exclusive basis, including Egypt, Syria and Jordan.

The Agreement contained, amongst other things, some standard provisions, including:

- minimum target to be satisfied and met by the Distributor;
- specific marketing obligations and sales risks to be borne by the Distributor throughout the term;
- the term of the Agreement was for five years with a room for renewal; and
- an arbitration clause which provides for arbitration in the Netherlands under the rules of the Netherlands Arbitration Institute (the “NAI”).

The Distributor filed a case against the Supplier claiming that:

- Under the Agreement the Distributor was appointed as an exclusive distributor in the Territories;
- The Distributor has fulfilled all its obligations under the Agreement including the minimum target requirements;
- The Distributor has incurred huge costs and expenses for developing, marketing and promoting the sale of the Goods in the Territories and in fact obtained an appreciation reward from the Supplier;
- However, in 2015 the Supplier has acquired some retailers in the Territories and, thereafter, served a notice dated 31 March 2015 to the Distributor not to renew, and to terminate, the Agreement effective from 31 December 2015;
- Because of such invalid termination, the Distributor has filed a civil case before Dubai Courts (the “Court”) against the Supplier to pay an amount of circa AED 183 Million as compensation to cover the damages and losses incurred by the Distributor (in addition to the legal fees and interest); and
- Relying on the arbitration agreement, the Supplier has timely raised a jurisdictional challenge before the Court.

## **Court’s Judgment**

### **Court of First Instance (Case No. 101/2017 Commercial - Full Bench)**

In March 2017, the Court of First Instance decided that the case is inadmissible because of the arbitration agreement (i.e. dismissal for lack of jurisdiction).

### **Court of Appeal (Case No. 714/2017 Commercial Appeal)**

In September 2017, the Court of Appeal rejected the Distributor’s appeal and upheld the Court of First Instance’s judgment.

### **Court of Cassation (Case No. 993/2017 Commercial Challenge)**

In November 2017, the Distributor filed a second appeal before the Court of Cassation based on three main

challenges, namely:

- **Misapplication/ misinterpretation of Article 226 of the UAE Commercial Transactions Law (the “CTL”):**

The Distributor argued that under Article 226 of the CTL (the “Article”) the court, where a contracts agency agreement is to be executed, should have jurisdiction to adjudicate disputes arising in relation thereto. This Article applies on all types of jurisdictions including functional jurisdiction such as the current case (where there is an arbitration agreement).

- **Invalidity of the jurisdictional challenge:**

The Distributor argued that the power of attorney (the “PoA”) given to the attorney representing the Supplier (the “Attorney”) does not include an express authority to arbitrate and/or to initiate arbitration proceedings and, therefore, the jurisdictional challenge shall be disregarded.

- **Invalidity of the arbitration agreement:**

The arbitration clause is adhesive because it refers to arbitration in Netherlands under the Rules of the NAI. In addition to other clauses in the Agreement, the Distributor argued that under the arbitration clause the Distributor was forced – by the Supplier – to irrevocably waive all its rights to recourse to UAE local courts.

The Distributor urged, further, that the person who signed the Agreement is the Chief Executive Officer of the Supplier and does not have sufficient authority to agree on arbitration.

The Court of Cassation rejected the second appeal (cassation). In its judgment, the Court of Cassation responded to the Distributor’s challenges as follows:

### **Interpretation of Article 226 of the CTL**

The Article provides that:

*“As an exception to the rules of jurisdiction set out in the UAE Civil Procedures Law, the court in its place a contracts agency agreement was executed shall have jurisdiction to adjudicate all disputes arising out of such agreement”*

This Article regulates the courts’ territorial (i.e. geographical) jurisdiction in case of contractual agency arrangements by determining the competent court to hear any dispute which may arise out thereof (i.e. disputes in relation to such agency agreements). As an exception to the rules contained in the UAE Civil Procedures Law, the court where the agreement is to be executed, shall have jurisdiction to hear the said dispute. This Article does not relate to the distribution of functional jurisdiction between the courts judiciary and arbitration judiciary (i.e. between the courts and arbitral tribunals). The latter is derived from the litigants’ agreement to arbitrate instead of the default recourse to competent courts.

The appealed judgment validly ruled that this Article applies only when the state courts have jurisdiction and, as such, it would allow the court – where the contract is to be executed – to adjudicate the case. However, such Article does not apply in case of arbitration because it does not deal with the distribution of functional jurisdiction between local courts and arbitral tribunals.

### **Invalidity of the jurisdictional challenge for lack of express authority**

It is well settled that considering the capacity and authority of the person who signed the arbitration agreement is something for the court to decide, in its sole discretion, based on valid grounds and supporting documents.

Whereas the appealed judgment considered the capacity of the person who signed the arbitration agreement and the validity of the PoA to the Attorney as it provides that *“..... the argument raised by the appellant (Distributor) on the invalidity of the arbitration clause is incorrect. The clause was signed by Mr. [...], the Chief Executive Officer, whose name appears on the commercial registry extract of the defendant company (Supplier) and, therefore has the authority to agree on arbitration.”*

Further, the appellant’s argument on the capacity of the Attorney to raise the jurisdictional challenges is

invalid. The act of raising a jurisdictional challenge by an attorney is within the scope of the PoA. In fact, this is one of the core actions entrusted to an attorney during the representation of his/her client and, therefore, the Attorney does not require any specific authorization to challenge the court's jurisdiction based on the arbitration agreement. An attorney can represent his/her clients in any case filed by or against them without the need of having a specific authorization or special consent from clients during the proceedings before courts.

Therefore, the person who signed the Agreement has valid capacity and authority to agree on arbitration and the PoA given to the Attorney is valid.

### **Invalidity of the arbitration agreement due to adhesion (by force to waive the rights to recourse to local courts)**

This is an invalid challenge because of the principle of *pacta sunt servanda* (This is a Latin term which means 'agreements must be kept'). In general, contracts are entered into on the basis of presentation and bargaining. Each of the contracting parties presents its terms and when such terms are accepted by the other party a binding contract is made.

The only exception is an adhesive contract, which terms are not subject to negotiation and bargaining. In such (adhesive) contract one of the contracting parties provides its terms and the other shall either accept them all or reject the contract (i.e. on take it or leave it basis). In this event, the legislator interferes to disclaim the affected party (the weakened party who is subject to an undue adhesion) from the application of the adhesive term. A good example of this would be Article 1028 of the UAE Civil Transactions Law which invalidates certain terms that may be included in an insurance contract.

The request by the Supplier to recourse to arbitration for resolving any disputes that may arise with the Distributor is not an adhesive term. This is because arbitration is a *radif* to judiciary (The term *radif* means, in Arabic, alternative/supplementary). The judgment tries to say that arbitration is another auxiliary, supplementary or parallel to the normal judiciary (referring to the state courts). However, there is no much clarity on the intended meaning of this term as far as the UAE courts' judgments on arbitration are concerned).

Further, there is no adhesion in agreeing to have the seat of arbitration outside the state. It just requires certain procedures for the enforcement or nullification of a foreign arbitral award in accordance with either the provisions of the Civil Procedures Law, New York Convention 1958 or any other bilateral or regional treaty subject to the principle of reciprocity.

Whereas courts are not necessarily required to respond to corrupted, invalid and baseless challenges, and whereas the Distributor's challenge – to invalidate the arbitration clause because of the alleged adhesion – is obviously corrupted, therefore the Court will disregard such challenge.

### **Views and Analysis**

We are of the view that the above judgement is of importance to the arbitration community. It shows a certain development in the way local courts currently deal with arbitral/ jurisdictional challenges, even before the issuance of the UAE Federal Law no. 6 of 2018 concerning arbitration (the "New Arbitration Law"). Judges have become more flexible while deciding on arbitration related challenges. We set out below our analysis of the Court of Cassation's reasoning.



### **Interpretation of the Article**

Although we do agree with the Court of Cassation's determination, however there might be a change if the argument was based on grounds of public policy. In other commercial agency disputes, a claimant (most probably the distributor/ agent) would argue that the contractual relationship is protected by the local laws as a matter of public policy. Under certain provisions, such as Article 6 of the Commercial Agencies Law no. 14 of 1988, as amended, the local courts have exclusive jurisdictions to hear all disputes in relation to a commercial agency and any other agreement to the contrary (such as arbitration) shall be disregarded. This challenge may result in invalidating an arbitration clause and, therefore, gives local courts jurisdiction on public policy grounds as the subject matter is not arbitrable however certain conditions need to be met including that the agency/ distribution agreement shall be registered, this is from one hand.

On the other hand, in this judgement the Dubai Court of Cassation has treated arbitration in a way that could be seen as similar to court's adjudication, to a certain extent. The court referred to two different jurisdictions, one for courts and another one for arbitration, which shows that courts look to arbitration as another way of dispute resolution and shares the jurisdiction (with judiciary).

This looks normal from an outside perspective however, in practice judges used to apply very restrictive approaches when it comes to arbitration. They were of the view that arbitration is an exceptional way of dispute resolution. This view resulted in a number of controversial conclusions by local courts including that:

1. Arbitration is an exception to the default position, i.e. recourse to courts, (please see the Dubai Court of Cassation's judgments issued on the following dates 24/5/1992 in Rights cassation no. 51/1992, on 29/1/1994 in Rights cassation no. 374/1993, on 16/3/1997 in Rights cassation no. 173/1996, on 16/1/2011 in Real Estate cassation no. 102/2010, on 15/5/2011 in Real Estate cassation no. 204/2010 and on 1/6/2011 in Commercial cassation no. 275/2010).
2. The arbitration agreement should be interpreted in a very narrow way and courts shall consider all things which may suggest/ result in the waiver of arbitration to the maximum extent possible. This is supported by a number of Dubai Court of Cassation's judgments including the judgment issued on 20/5/2012 in Real Estate cassation no. 244/2011, judgment issued on 18/3/2012 in Real Estate cassation no. 181/2011, judgment issued on 27/1/2007 in Commercial cassation no. 192/2007, judgment issued on 23/9/2007 in Civil cassation no. 133/2007, judgment issued on 2/11/2002 in Rights cassation no. 261/2002 and Judgement issued on 29/1/1994 in Rights cassation no. 274/1993.
3. The party signing the arbitration agreement shall have an authority to dispose of the right disputed and not only the authority to recourse to courts/ judiciary. The arbitration agreement assumes a waiver of recourse to state courts and represents a danger/ risk. This is in accordance with a number of Dubai Court of Cassation's judgments including the judgment issued on 29/5/2011 in Civil cassation no. 87/2011, judgment issued on 12/6/2004 in Rights cassation no. 577/2003, judgment issued on 16/1/2011 in Real Estate cassation no. 102/2010, and judgment issued on 12/6/2004 in Rights cassation no. 577/2003.
4. An arbitration agreement may be made by a specific authorization or special power of attorney, however an arbitration agreement may be waived without such specific authorization (Please see the Dubai Court of Cassation's judgment issued on 18/5/2002 in Rights cassation no. 144/2002).
5. An arbitral tribunal cannot refer constitutional challenges to the Supreme Court, only courts can. The arbitration agreement shall not be presumed and not impliedly agreed upon (Please see the Dubai Court of Cassation's judgment issued on 12/6/2004 in Rights cassation no. 577/2003).

However, other recent courts' judgments, including the subject matter of this article, show development in the above views. Further, the New Arbitration Law is expected to fix many practical issues and support the UAE to become more arbitration friendly. Under Articles 1 and 52 of the New Arbitration Law an arbitral award is treated as a court judgment.

### **The requirement of express authority to arbitrate:**

The Court of Cassation has accepted the lower courts' conclusion that the CEO of the limited liability company has the necessary powers and authorities to agree on arbitration. However, this is not the first sign of flexibility we have seen by local courts on the capacity and authority of managers to agree on arbitration.

For instance in 1994, the courts' approach was that:

- a manager may not sign an arbitration agreement without having a specific authorization with express authority to agree on arbitration; and
- the manager's role is limited to taking the management actions and other disposals that are in line with the companies objectives (these shall not include actions that are beyond or in conflict with the company's objectives such as agreeing on arbitration). This is in accordance with the Dubai Court of Cassation's judgment issued on 25/6/1994 in Cassation no. 32/1993.

Therefore, the default position was that unless the manager has an express and specific authorization he/she couldn't sign a valid arbitration agreement.

However, a few years later and in particular since 1999 that approach was changed. Courts confirmed that a manager of a limited liability company has the full power and authorities to manage the company including the authority to agree on arbitration. This is supported by a number of the Dubai Court of Cassation's judgments including the judgment issued on 2/3/2003 in Rights cassation no. 462/2002, judgment issued on 23/4/2000 in Rights cassation no. 537/1999, and judgment issued on 2/3/2003 in

Rights cassation no. 462/2002.

In 2005, another judgment confirmed that in general the manager might agree on arbitration unless otherwise the manager's authorities are expressly restricted in the company's articles of associations (Please see the Dubai Court of Cassation's judgment issued on 17/1/2005 in Commercial cassation no. 220/2004). Similar judgments were issued in 2010 and 2017 including the Dubai Court of Cassation's judgment issued on 26/2/2017 in Commercial cassation no. 767/2016. Further, another judgment – with the same conclusion – was issued in relation to partnerships including the Dubai Court of Cassation's judgment issued on 15/6/2011 in Commercial cassation no. 309 & 310/2010. This shows a significant development in the mindset of judges since 1994.

The above judgment is important because it confirms that an executive manager (such as a CEO) may have authority to agree on arbitration if his name appears on the company's commercial register. This represents another move in the right direction and may, hopefully, result in paving the way towards more flexibility on the required authority to agree on arbitration.

### **Arbitration/arbitral tribunals shall be treated as judiciary/ local courts**

The court stated that the agreement to arbitration is not adhesive and confirmed that arbitration is a *Radif* (as explained above) to courts/ judiciary. This represents a new change in the courts' approach and may have some positive implications, especially if arbitration is regarded as an equal and parallel way of dispute resolution. If arbitral tribunals are treated like local courts, this may change some of the settled principles including, by way of example, that a tribunal may refer a constitutional challenge to the Supreme Court. Note that in the past the Supreme Court has said that referrals can come only from local courts and an arbitral tribunal is not a court and therefore cannot refer a constitutional challenge to the said court.

We believe the Court of Cassation intended to treat arbitration as an alternative or parallel way to local courts/ litigation. Nevertheless, we hope to see more flexible approaches to local practice so they run in line with international arbitration practice including providing that arbitration is an alternative way of dispute resolution, similar to the courts in all effects, and not an exception. Taking into account that before the New Arbitration Law, arbitration was organized and provided for in the Civil Procedures Law, which regulates the work, practice and procedures before local courts.

In this context, according to Article (1) of the New Arbitration Law defines arbitration as “a way organized by law under which certain dispute(s) between two or more parties are finally resolved”. Furthermore, Article 52 of the New Arbitration Law provides that, following its ratification, an arbitral award shall have the same executive effect as if it was a judicial judgment.

### **Conclusion**

Undoubtedly, we see some positive changes in the way local courts deal with arbitration agreements. Not only is the legislator moving in the right direction, which is evidenced by the issuance of the New Arbitration Law, but it also shows that courts are steadily developing their pro arbitration approach. We hope that the local practice will soon be developed to match the international practice in order to enable Dubai to become a global hub for arbitration and become one of the world's preferred seats of arbitration.