The Proper law of the Arbitration Agreement – the Final Word from the Supreme Court

On Friday 9 October 2020, the UK Supreme Court gave judgment in *Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb*[1] ("Enka v Chubb"). It ended an unedifying episode of real doubt as to the approach under English law to identifying the proper law applicable to arbitration clauses. This issue arises because it is well established that an arbitration clause stands as a separate and independent agreement within the main contract where it is found (the "separability principle") and each agreement must be governed by a system of law.

Summary of case

The case involves a fire at power plant in Russia. Chubb was the insurer and paid out on the insurance claim, then pursued a subrogated claim against Enka, which was involved in the construction of the plant. The construction contract had no governing law clause but contained an arbitration clause specifying arbitration in London. Chubb said that there was an implied choice of Russian law in the construction contract and that as a result Russian law also applied to the interpretation of the arbitration clause; and since the arbitration clause must be interpreted narrowly under Russian law, the claim that Chubb brought (which involved some elements of tort) fell outside the arbitration clause and could proceed in the Russian Courts. Enka, on the other hand, said that English law applied to the arbitration clause because England was the seat of the arbitration, and since the arbitration clause must be interpreted expansively under English law, Chubb's claim had to proceed through arbitration and Enka sought an anti-suit injunction from the English Courts to compel Chubb to bring the Russian litigation to an end.

The High Court dismissed Enka's claim on the primary ground that the appropriate forum to determine to scope of the arbitration agreement was the Russian Court. On appeal, the Court of Appeal overturned the judge's decision. It held that, unless there has been an express choice of the law that is to govern the arbitration agreement, the general rule should be that the arbitration agreement is governed by the law of the seat, as a matter of implied choice; that there was no express choice of law in this case and that the arbitration agreement was therefore governed by English law; and that it was appropriate to grant an anti-suit injunction to restrain Chubb from pursuing the Russian claim. Chubb appealed to the Supreme Court.

Supreme Court judgment

The Supreme Court has dismissed that appeal. The Court split 3-2 but, essentially, only on the facts. All members were agreed on the legal principles that in relation to determining the proper law of an arbitration agreement contained in a host contract, the "host contract" approach should be preferred to the "seat" approach; and the Court of Appeal was wrong to find that there is a "*strong presumption*" that the parties have, by implication, chosen the law of the seat of the arbitration to govern the arbitration agreement.

The majority reasoning is the judgment of Leggatt and Hamblen JJSC, with whom Kerr JSC agreed. They said that if there had been an express or implied choice of law applicable to the main contract, that would, in the absence of any good reason to the contrary, also apply to the arbitration clause. Here, however, there was no express or implied choice of law in the main contract, and as a result the majority said that the governing law of the arbitration clause should be identified by looking at the

[1] [2020] UKSC 38

law which has the closest connection with that clause – and that is likely to be the law of the seat of arbitration. As a result, they said that English law applied. Consequently, they upheld the decision of the Court of Appeal, albeit on different grounds.

The minority view was set out by Burrows JSC – with whom Sales JSC agreed (and gave his own judgment). He said that he thought there was an implied choice of Russian law in the main contract, which meant that, in the absence of any good reason to the contrary, Russian law also applied to the arbitration clause. But he also criticised the majority for simply looking at whether there was an express or implied choice of law in the main contract and not taking the further step which was to look at what was the law most closely connected to the main contract. If one did that, then Russian law again applied because the power plant was in Russia, and again Russian law would apply to the arbitration clause. In practice, therefore, under his formulation the arbitration agreement would always be governed by the same law as the main contract and there would not be a need to look at the law that was most closely connected to the arbitration clause – apart from in the rare cases when the arbitration agreement was invalid under the law applicable to the main contract, which might lead a court to prefer the law applicable at the seat of the arbitration if the arbitration agreement was valid under that law (this is the "validation principle").

Comment

This is a long and detailed judgment and I do not propose to analyse it all. There are many sound aspects, the analysis of the validation principle, for example, with which there is nothing to quibble. However, there are two areas which do give cause for comment: the Supreme Court's treatment of the separability principle, and the international perspective.

Separability

The Supreme Court held that the "*separability principle does not require that an arbitration agreement should be treated as a separate agreement for the purpose of determining its governing law*."[2] The analysis that led to that conclusion started with the sound proposition that it is "*generally reasonable to assume that parties would intend or expect their contract to be governed by a single system of law*."[3] The majority also said that "*unless there is good reason to conclude otherwise, …* [that assumption] *applies to an arbitration clause, as it does to any other clause of a contract*."[4] Thus the Supreme Court held that the "*principle of separability is ... that it is to be so treated for the purpose of determining its validity or enforceability*" i.e. it has no wider scope than s7 of the Arbitration Act 1996 ("the Act").

I confess to finding that proposition difficult – indeed contrary to high authority. At common law, an arbitration agreement has a separate and independent existence from that of the host contract in which it is found. It was described in *Bremer Vulkan Schiffbau und Maschinenfabrik v South India Shipping Corp*[5] by Lord Diplock as "*a <u>self-contained</u> contract collateral or ancillary to*" (emphasis added) the shipbuilding contract in which it was to be found in that case. Lord Scarman[6] described it as "*a <u>separate</u> contract ancillary to the main contract*" (emphasis added).

[2] [41]
[3] [39]
[4] [40]
[5] *Bremer Vulkan Schiffbau und Maschinenfabrik v South India Shipping Corp* [1981] AC 909, [1981] 2 WLR 141
[6] *Bremer Vulkan Schiffbau und Maschinenfabrik v South India Shipping Corp* [1981] AC 909 at 998

Lord Diplock further said "*an arbitration clause is collateral to the main contract in which it is incorporated and it gives rise to collateral primary and secondary obligations of its own*".[7]

In the landmark decision in *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd*, in which Steyn J's reasoning was approved on appeal,[8] the doctrine was applied to an issue of illegality which would render void *ab initio* the host contract. On the appeal Ralph Gibson LJ held:

> "*An arbitration clause, in ordinary terms—that is to say, without special words to ensure survival—is usually, and has been held to be, a <u>self-contained contract</u> collateral to the containing contract. As with any other contract, it must be construed according to its terms in and with regard to the relevant factual situation. I see no reason to establish a principle of this nature which would require special words to be inserted in order to secure that which the parties would probably suppose was covered by the ordinary words*."[9] (emphasis added)

If that is correct, then the arguments that separability should always be limited to the statutory definition falls away. With that also goes the force of any argument that separability is only for specific purposes or only applies in the event that the host contract is, said to be, invalid, non-existent or ineffective.

The Supreme Court addressed these authorities[10] saying that they "*need to be seen in their context as ways of expressing the doctrine that the discharge by frustration (or for other reasons) of the substantive obligations created by the contract will not discharge the parties' agreement to arbitrate.*"[11] I, respectfully, disagree. It is, I suggest, quite clear from Lord Diplock in *Bremer Vulkan* that he was not confining himself to a limited, s7 style, doctrine of separability. He was emphasising the very real differences in the contracts: one substantive and one to arbitrate.[12]

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[7] *Paal Wilson & Co A/S v Partenreederei Hannah Blumenthal* [1983] 1 AC 854 at 917, [1982] 3 WLR 1149

[8] *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1993] QB 701, [1993] 3 WLR 42

[9] *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1993] QB 701 at 711. Cited with approval in Fiona Trust.

[10] [62] – [64]

[11] [62]

[12] In particular at p981/2 see the following: "*My Lords, in the instant case the shipbuilding agreement, apart from the arbitration clause, had ceased to be executory; the time for performance of the parties' primary obligations under it was past. The arbitration clause on the other hand would continue to remain executory so long as there were outstanding any disputes between the parties as to the existence or extent of their secondary obligations under the other clauses of the shipbuilding agreement. The collateral agreement contained in the arbitration clause does not fit readily into a classification of contracts that are synallagmatic on the one hand or unilateral or "if" contracts on the other. It is an agreement between the parties as to what each of them will do if and whenever there occurs an event of a particular kind.*

The event is one that either party can initiate by asserting against the other a claim under or concerning the shipbuilding agreement which they have not been able to settle by agreement. In that event, each is obliged to join with the other in referring the claim to arbitration and to abide by the arbitrator's award. The arbitration clause itself creates no obligation upon either party to do or refrain from doing anything unless and until the event occurs, and even then the mutual obligations that arise are in relation to the particular claim that constitutes the event. The primary obligations of both parties that arise then are contractual, whether express, or implied by statute or included by necessary implication in the arbitration clause. Breach of any of them would give rise to a general secondary obligation to pay compensation (damages), though this may well be nominal, but if the breach were such as to deprive the other party of substantially the whole benefit which it was the intention of the parties he should obtain from the mutual performance by both parties of their primary obligations in relation to the reference of the particular dispute to arbitration, i.e., what in an ordinary synallagmatic contract would be a repudiatory breach, I see no ground in principle why the party not in breach

This, as I see it, error on separability leads inexorably to the substantive conclusion in *Enka v Chubb*. The Supreme Court held that where a contract has both a governing law clause and an arbitration agreement "*it is natural to interpret such a governing law clause, in the absence of good reason to the contrary, as applying to the arbitration clause for the simple reason that the arbitration clause is part of the contract which the parties have agreed is to be governed by the specified system of law."*[13] That is only correct if you start from the proposition that the agreement to arbitrate is merely a clause in the host contract and not, for most or all purposes, a self-contained contract.

International Perspective

Under the Model Law, an action for setting aside an award may only be brought in respect of an award made within the territory of the state concerned. It must be brought before the designated court of that state and it may only be brought on the grounds set out in the Model Law. These grounds are taken from the New York Convention ("NYC") art V. There is a consistency: the NYC, in art V, sets out the grounds on which recognition and enforcement of an international award may be refused and art 34 (and 36) of the Model Law sets out the same grounds (albeit with slight differences of language) as the grounds on which such an award may be set aside. The consistent feature is that the venue for these challenges is the seat of the arbitration.

The NYC art V(1)(e) provides that an award can be set aside by "*a competent authority of the country in which, or under the law of which, that award was made*". The Model Law art 36(1)(a)(v) has, for all practical purposes, identical language.

The ability to set aside therefore generally rests in the courts where the award was made, i.e. the courts of the seat (there is a theoretical exception: if the parties chose a procedural law other than that of the location where the arbitration is held - but that will be a very rare case). The arbitration law of the jurisdiction where the seat is located, for example, the Act in England, will be the curial law of the arbitration. The curial law governs the relationship between the parties, the arbitral tribunal and the supervising courts. It will govern, for example, the constitution of the tribunal, its entitlement to rule on its own jurisdiction, and the grounds of challenge to the jurisdiction of the arbitral tribunal on the substantive award. All this amounts to at least a primary jurisdiction vested in the courts of the seat.[14] If, therefore, there were a London-seated arbitration, any attempt to set aside the award should be to the Courts of England.

The challenges permitted are often of a "*due process*" nature and include that the arbitration agreement is not valid "*under the law to which the parties have subjected it*";[15] "*the award … contains decisions on matters beyond the scope of the submission to arbitration*",[16] and "*the arbitral procedure was not in accordance with the agreement of the parties*".[17]

Take the situation of a London seat and Indian governing law. There is a challenge arising from the jurisdiction of the arbitral tribunal. The London seat dictates that English law is the curial law. The

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should not be entitled to elect to put an end to all primary obligations to proceed with the reference then remaining unperformed on his part and on the part of the party in default, and, in appropriate cases, to obtain an injunction to restrain the party in default from continuing with the reference to arbitration of that particular dispute."

[13] [43]

[14] *U & M Mining Zambia Ltd v Konkola Copper Mines Plc* [2013] EWHC 260 (Comm), [2013] 2 Lloyd's Rep 218

[15] Model Law art 34(2)(a)(i)

[16] Model Law art 34(2)(a)(iii)

[17] Model Law art 34(2)(a)(iv).

arbitral tribunal's power to rule on its own jurisdiction derived from the Act and the challenge is also on the grounds permitted under the Act. The English Court will consider these issues, therefore, from an English perspective. The governing law of the agreement to arbitrate will, however, determine the actual jurisdiction of the arbitral tribunal as the effect or construction of the agreement to arbitrate, which is a matter for the governing law of that agreement. The upshot of *Enka v Chubb* is that the English Court deciding this challenge will, almost invariably, now have to apply the law of India, in this example, to the arbitration agreement to determine the actual jurisdiction of the tribunal. That is, perhaps, surprising at best.

I consider the NYC and the Model Law must presuppose that the courts of the seat will, in the vast majority of cases, apply the law of the seat (i.e. as both the curial law and the governing law of the agreement to arbitrate) to all issues concerning, for example, questions of due process.

We are now, however, post-*Enka v Chubb* in the bizarre and anachronistic world where challenges on the award to be mandated to be in England, to have English law determine the ability of the arbitral tribunal to rule on its own jurisdiction and the grounds of that challenge also to be subject to English law, and yet have the principal issue of the actual jurisdiction of the tribunal to be under a law other than England's. Nobody would devise such a system.

The answer to this, the Supreme Court held, is that this is the law: provided by s4(5) of the 1996 Act. This provides:

> "*The choice of a law other than the law of England and Wales or Northern Ireland as the applicable law in respect of a matter provided for by a non-mandatory provision of this Part is equivalent to an agreement making provision about that matter.*
>
> *For this purpose an applicable law determined in accordance with the parties' agreement, or which is objectively determined in the absence of any express or implied choice, shall be treated as chosen by the parties*."

As the Supreme Court held: "*where a foreign law is applicable to an arbitration agreement …, that fact alone is enough to disapply any non-mandatory provision of the Act in so far as it would otherwise affect a matter governed by the law applicable to the arbitration agreement*."[18] Thus in the example above (Indian governing law and London seat), the arbitration agreement would be governed by Indian law (by reason of the Indian governing law) and any challenge etc would indeed be in the English Commercial Court but that various non-mandatory parts of the Act would fall away as there would be, in effect, a contrary agreement.

One such non-mandatory provision that would fall away is s7 of the Act.[19] This results in falling back on the Indian law on separability which might, therefore, result in a completely different analysis. As it happens the Indian law embodies the Model Law. The Indian provision provides that:

> *"Competence of arbitral tribunal to rule on its jurisdiction.—(1) The arbitral tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement, and for that purpose,— (a) an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of*

[18] [75]
[19] [92]

the contract; and (b) a decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause."[20]

I make no pretension of being an Indian law scholar but it is evidently in quite different terms to s7: the Indian Arbitration and Conciliation Act extends to any ruling on jurisdiction and for that purpose the arbitration agreement is independent; whereas the English Act it is clear that it is distinct only for the purpose of whether it is invalid etc. That may result in entirely circular reasoning – but that is for another day.

Conclusion

The Supreme Court justified its finding on the basis of principle: certainty, consistency, avoidance of complexities and uncertainties, avoidance of artificiality, and coherence.[21] I do not, however, see that the Court of Appeal had not achieved the same result. Nonetheless, the finality and certainty of the Supreme Court's ruling is to be welcomed. As is apparent, I have some difficulties with some of the reasoning but the essential fight over 'host contract' or 'seat' is over - and the hosts have it!

Peter Ashford (with thanks to my co-head of international arbitration, Ben Giaretta, and senior associate, Kate Felmingham, for their thoughts and comments on a draft of this bulletin. In the time-honoured way, all opinions and errors are mine alone).

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[20] The Arbitration and Conciliation Act, section 16, (1996).
[21] [53]